

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-89039; File No. SR-OCC-2020-803)

June 10, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Related to Changes to The Options Clearing Corporation's Non-Bank Repo Facility Program as Part of Its Overall Liquidity Plan

I. INTRODUCTION

On April 15, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) advance notice SR-OCC-2020-803 (“Advance Notice”) pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 (“Exchange Act”)³ concerning OCC’s overall program and requirements for executing one or more committed repurchase arrangements with non-bank, non-clearing institutional investors.⁴ The Advance Notice was published for public comment in the Federal Register on May 22, 2020,⁵ and the Commission has received no comments regarding the changes proposed in the Advance Notice. The Commission is hereby providing notice of no objection to

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78a et seq.

⁴ See Notice of Filing infra note 5, at 85 Fed. Reg. 31235.

⁵ Securities Exchange Act Release No. 88906 (May 19, 2020), 85 Fed. Reg. 31235 (May 22, 2020) (File No. SR-OCC-2020-803) (“Notice of Filing”).

the Advance Notice.

II. BACKGROUND⁶

Currently, OCC's liquidity plan provides it with access to a diverse set of funding sources to help it manage its daily settlement obligations, including in the event of a default of a Clearing Member. Those sources include (i) a syndicated credit facility,⁷ (ii) a master repurchase agreement with a bank counterparty ("Bank Repo Facility"),⁸ and (iii) Clearing Members' Cash Clearing Fund Requirement.⁹ In addition, as a fourth funding source, OCC's liquidity plan also includes a program for executing one or more committed repurchase arrangements with non-bank, non-clearing institutional investors (i.e., no counterparty may be a Clearing Member or affiliated bank). Those arrangements, taken together, constitute OCC's "Non-Bank Repo Facility."¹⁰

As noted, OCC relies on its funding sources, including the commitments under the Non-Bank Repo Facility, as potential sources of liquidity to manage the default of a

⁶ Capitalized terms used but not defined herein have the meanings specified in OCC's Rules and By-Laws, available at <https://www.theocc.com/about/publications/bylaws.jsp>.

⁷ See Exchange Act Release No. 85924 (May 23, 2019), 84 Fed. Reg. 25089 (May 30, 2019) (SR-OCC-2019-803).

⁸ See Exchange Act Release No. 88317 (Mar. 4, 2020), 85 Fed. Reg. 13681 (Mar. 9, 2020) (SR-OCC-2020-801).

⁹ See OCC Rule 1002 (requiring Clearing Members to collectively contribute \$3 billion in cash to the Clearing Fund), available at https://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_rules.pdf.

¹⁰ See Exchange Act Release No. 73979 (Jan. 2, 2015), 80 Fed. Reg. 1062 (Jan. 8, 2015) (SR-OCC-2014-809) ("Notice of No Objection to 2014 Advance Notice"); Exchange Act Release No. 76821 (Jan. 4, 2016), 81 Fed. Reg. 3208 (Jan. 20, 2016) (SR-2015-805) ("Notice of No Objection to 2015 Advance Notice").

Clearing Member. In the event that one funding source changes, OCC has flexibility to adjust its other sources accordingly. For example, if one of OCC's Non-Bank Repo Facility commitments expires, OCC would have several options to replace that commitment within OCC's liquidity plan, including (i) executing one or more other commitments under the Non-Bank Repo Facility, (ii) exercising the accordion feature under the syndicated credit facility,¹¹ (iii) temporarily increasing the Cash Clearing Fund Requirement, and (iv) executing a new master repurchase agreement with other bank counterparties, similar to the current Bank Repo Facility.

Each counterparty that participates in OCC's Non-Bank Repo Facility executes an industry standard master repurchase agreement ("MRA") as well as an individual confirmation containing the tailored terms and conditions of transactions executed between OCC and that specific counterparty.¹² The specific parameters that OCC may accept in an individual confirmation are limited as part of the Non-Bank Repo Facility program. As discussed in more detail below, OCC now proposes to modify those parameters so that the Non-Bank Repo Facility could encompass confirmations for committed repurchase transactions of different funding commitment amounts with a

¹¹ An accordion is an uncommitted expansion of a credit facility generally on the same terms as the credit facility. See Securities Exchange Act Release No. 88690 (Apr. 20, 2020), 85 Fed. Reg. 23095, 23098 n. 12] (Apr. 24, 2020) (File No. SR-OCC-2020-003). For example, the existing master confirmations under OCC's Non-Bank Repo Facility, totaling \$1 billion, expired on January 2, 2020 and January 6, 2020. In anticipation of their expiration, OCC exercised an accordion feature under its syndicated credit facility to increase the amount from \$2 billion to \$2.5 billion. See Notice of Filing, 85 Fed. Reg. at 31236.

¹² While the form and content of the MRAs signed by all counterparties would include the same terms, the individual confirmation signed by a specific counterparty would vary in that it would set forth the term and maximum dollar amounts of the transactions permitted under the relevant MRA.

range of commitment term periods, something that is not permitted under the current Non-Bank Repo Facility program.

Current Non-Bank Repo Facility program. Commitments under the current Non-Bank Repo Facility program reduce the concentration of OCC's counterparty exposure by diversifying its lender base. OCC may only enter into confirmations with institutional investors that are not Clearing Members or affiliated banks, such as pension funds or insurance companies, which commits OCC to obtaining funding without further concentrating its exposure to funding sources such as banks, broker/dealers, or futures commission merchants that are affiliated with Clearing Members. Further, commitments provided as part of the existing Non-Bank Repo Facility program are required to include certain terms and conditions. For example, an institutional investor participating in the Non-Bank Repo Facility is obligated to enter into repurchase transactions even if OCC experiences a material adverse change.¹³ Additionally, a counterparty is required to make funds available to OCC within 60 minutes of OCC's delivering eligible securities, and the counterparty is not permitted to rehypothecate purchased securities.¹⁴ None of these existing requirements would change in connection with OCC's proposed modifications to the Non-Bank Repo Facility program. The parameters of the current Non-Bank Repo Facility program also include the aggregate funding commitment amount that OCC may

¹³ When included in a contract, a "material adverse change" is typically defined as a change that would have a materially adverse effect on the business or financial condition of a company.

¹⁴ See Notice of No Objection to 2014 Advance Notice, 80 Fed. Reg. at 1064.

seek as well as the duration of commitments made under the Non-Bank Repo Facility.¹⁵ Currently, under the Non-Bank Repo Facility program, OCC may seek aggregate commitment amounts of no less than \$1 billion and no greater than \$1.5 billion.¹⁶ Confirmations under the current Non-Bank Repo Facility program are limited to a commitment term greater than or equal to 364-days. These parameters—aggregate commitment amount and commitment term—are the primary subject of the Advance Notice.

Proposed changes. OCC has determined that it is necessary to amend the terms of the Non-Bank Repo Facility to give itself more flexibility in negotiating and obtaining a broader range of funding arrangements across a broader range of counterparties. Those amendments would result in two changes to the parameters of the Non-Bank Repo Facility. First, OCC proposes to set the new aggregate commitment amount it may seek under the Non-Bank Repo Facility program at \$1 billion, lowered from \$1.5 billion, so that OCC may negotiate individual commitment amounts, each less than \$1 billion, with multiple counterparties. OCC's Board has consistently authorized OCC to seek commitment amounts up to an aggregate amount of \$1 billion since 2016 even though the Non-Bank Repo Facility gives OCC discretion to seek aggregate commitment

¹⁵ See Notice of No Objection to 2015 Advance Notice, 81 Fed. Reg. at 3208.

¹⁶ The parameter under the facility was initially \$1 billion. OCC altered the parameters of the facility to allow it to seek aggregate commitment amounts between \$1 billion and \$1.5 billion. See Notice of No Objection to 2015 Advance Notice, 81 Fed. Reg. at 3208. The increase to the aggregate commitment amount was made as part of OCC's plan to transition from a single \$1 billion confirmation to two confirmations of \$500 million with staggered expiration dates. See *id.* at 3209 (discussing the extension of the existing confirmation and the execution of a second confirmation).

amounts of up to \$1.5 billion. OCC proposes to modify the Non-Bank Repo Facility program to align the program's parameters with the commitment amount approved by OCC's Board (i.e., \$1 billion). The proposal would allow OCC to seek commitments even if such commitments would not bring the aggregate commitment amount of the Non-Bank Repo Facility up to \$1 billion.

Second, OCC proposes to provide more flexibility in its ability to negotiate different terms for different individual commitments that make up the Non-Bank Repo Facility. Based on negotiations with potential institutional investors, OCC believes there would be an interest from OCC's potential counterparties for committing to a term of less than one year.¹⁷ OCC proposes to provide itself flexibility to execute different commitments with different terms that could be less than 364 days, as opposed to the current uniform 364-day term period, so that OCC can negotiate to obtain funding commitment from a given counterparty. For example, such a term could be for a fixed duration of less than one year or an open-ended term that allows for termination subject to a notice period.

The proposal would require that, to execute or renew a transaction under the Non-Bank Repo Facility, the OCC Board would review the proposed commitment term and authorize OCC management to enter into or renew such transactions. The length of the term or notice period OCC would be willing to accept would be conditioned on factors including, but not limited to, the initial committed length of the term, market conditions,

¹⁷ See Notice of Filing, 85 Fed. Reg. at 31237 n. 18. OCC provided information about the current status of negotiations with potential counterparties in a confidential Exhibit 3b to File No. SR-OCC-2020-803. See id.

and OCC's liquidity needs. OCC represented that it would be unlikely to accept a fixed term shorter than three months or a rolling term with a notice period shorter than six months.¹⁸

Other than these two amendments OCC is not proposing changes to any other parameters or requirements of the Non-Bank Repo Facility.

III. COMMISSION FINDINGS AND NOTICE OF NO OBJECTION

Although the Clearing Supervision Act does not specify a standard of review for an advance notice, the stated purpose of the Clearing Supervision Act is instructive: to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.¹⁹

Section 805(a)(2) of the Clearing Supervision Act authorizes the Commission to prescribe regulations containing risk management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency.²⁰ Section 805(b) of the Clearing Supervision Act provides the following objectives and principles for the Commission's

¹⁸ In 2019, OCC's only counterparty under the Non-Bank Repo Facility decided not to renew its commitments, and two master confirmations totaling \$1 billion expired on January 2, 2020 and January 6, 2020. Based on this experience, OCC believes that a six-month notice period provides sufficient time to allow OCC to reallocate liquidity resources to address a confirmation's termination. See Notice of Filing, 85 Fed. Reg. at 31237.

¹⁹ See 12 U.S.C. 5461(b).

²⁰ 12 U.S.C. 5464(a)(2).

risk management standards prescribed under Section 805(a):²¹

- to promote robust risk management;
- to promote safety and soundness;
- to reduce systemic risks; and
- to support the stability of the broader financial system.

Section 805(c) provides, in addition, that the Commission’s risk management standards may address such areas as risk management and default policies and procedures, among other areas.²²

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and Section 17A of the Exchange Act (the “Clearing Agency Rules”).²³ The Clearing Agency Rules require, among other things, each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for its operations and risk management practices on an ongoing basis.²⁴ As such, it is appropriate for the Commission to review advance notices against the Clearing Agency Rules and the objectives and principles of these risk management standards as described

²¹ 12 U.S.C. 5464(b).

²² 12 U.S.C. 5464(c).

²³ 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (Oct. 22, 2012), 77 Fed. Reg. 66220 (Nov. 2, 2012) (S7-08-11). See also Covered Clearing Agency Standards, 81 Fed. Reg. 70786. The Commission established an effective date of December 12, 2016 and a compliance date of April 11, 2017 for the Covered Clearing Agency Standards. OCC is a “covered clearing agency” as defined in Rule 17Ad-22(a)(5).

²⁴ 17 CFR 240.17Ad-22.

in Section 805(b) of the Clearing Supervision Act. As discussed below, the Commission believes the changes proposed in the Advance Notice are consistent with the objectives and principles described in Section 805(b) of the Clearing Supervision Act,²⁵ and in the Clearing Agency Rules, in particular Rule 17Ad-22(e)(7).²⁶

A. Consistency with Section 805(b) of the Clearing Supervision Act

The Commission believes that the proposal contained in OCC's Advance Notice is consistent with the stated objectives and principles of Section 805(b) of the Clearing Supervision Act. Specifically, as discussed below, the Commission believes that the changes proposed in the Advance Notice are consistent with promoting robust risk management in the area of liquidity risk, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.²⁷

The Commission believes that the proposed changes are consistent with promoting robust risk management, in particular the management of liquidity risk presented to OCC. As a central counterparty and a SIFMU,²⁸ it is imperative that OCC have adequate resources to be able to satisfy liquidity needs arising from its settlement obligations, including in the event of a Clearing Member default.²⁹ To support this

²⁵ 12 U.S.C. 5464(b).

²⁶ 17 CFR 240.17Ad-22(e)(7).

²⁷ 12 U.S.C. 5464(b).

²⁸ See Financial Stability Oversight Council ("FSOC") 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

²⁹ See Notice of No Objection to 2014 Advance Notice, 80 Fed. Reg. at 1065.

objective, OCC proposes to amend the existing provisions of the Non-Bank Repo Facility in two ways. First, OCC proposes to reduce the aggregate commitment amount it may seek under the Non-Bank Repo Facility program so that OCC may negotiate individual commitment amounts, each less than \$1 billion, with multiple counterparties rather than being effectively required to coordinate negotiations to obtain one or more funding commitment amounts—all executed concurrently—totaling at least \$1 billion. Second, OCC proposes to expand the scope of the permissible commitment term for confirmations executed under the Non-Bank Repo Facility program to offset institutional investors’ reservations about committing liquidity for extended periods of time. The Commission believes that approving these two changes would give OCC greater flexibility under the Non-Bank Repo Facility to obtain additional liquidity resources in the form of commitments under the Non-Bank Repo Facility. Further, the Commission believes that the flexibility to obtain resources specifically through the Non-Bank Repo Facility would help OCC maintain diversity among its liquidity resources because a counterparty under the Non-Bank Repo Facility could not be a Clearing Member or affiliated bank. Therefore, the Commission believes that the Advance Notice enhances and further diversifies OCC’s access to liquidity resources, which in turn would strengthen OCC’s overall ability to manage its liquidity risk exposures. As such, the Commission believes that the proposal would promote robust liquidity risk management at OCC consistent with Section 805(b) of the Clearing Supervision Act.³⁰

The Commission also believes that the changes proposed in the Advance Notice are consistent with promoting safety and soundness, reducing systemic risks, and

³⁰ 12 U.S.C. 5464(b).

promoting the stability of the broader financial system. As described above, the proposal would give OCC more flexibility to negotiate liquidity commitments across a range of potential counterparties that are not otherwise Clearing Members. As previously discussed, to address liquidity needs arising from a Clearing Member default, OCC maintains as liquidity resources the Bank Repo Facility (where the counterparty is an affiliate of two Clearing Members), the syndicated credit facility (where many of the lenders are Clearing Members), and the Cash Clearing Fund Requirement (which is funded exclusively by Clearing Members).³¹ Giving OCC more flexibility to diversify liquidity providers in the form of new funding commitments under the Non-Bank Repo Facility reduces the potential concentration of liquidity pressure that OCC, the Clearing Members and their clients could face in the event of a Clearing Member default. This reduced reliance upon the Clearing Members as the primary source of liquidity resources available to OCC to manage a Clearing Member default in turn enhances OCC's overall ability to manage the liquidity needs arising from such an event or other events that could arise contemporaneously. Therefore, the Commission believes that the Advance Notice promotes the safety and soundness of OCC, enhances OCC's ability to manage systemic risk that could arise in the event of a Clearing Member default, and thus supports the broader financial system. As such, the Commission believes it is consistent with promoting safety and soundness, reducing systemic risks, and promoting the stability of the broader financial system as contemplated in Section 805(b) of the Clearing

³¹ See Exchange Act Release No. 88120 (Feb. 5, 2020), 85 Fed. Reg. 7812, 7814 n. 19 (Feb. 11, 2020) (File No. SR-OCC-2020-801) (stating that OCC exercised an accordion feature under its syndicated credit facility in anticipation of the expiration of confirmations under the Non-Bank Repo Facility).

Supervision Act.³²

Accordingly, and for the reasons stated above, the Commission believes the changes proposed in the Advance Notice are consistent with Section 805(b) of the Clearing Supervision Act.³³

B. Consistency with Rule 17Ad-22(e)(7) under the Exchange Act

Rule 17Ad-22(e)(7)(ii) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively measure, monitor, and manage the liquidity risk that arises in or is borne by the covered clearing agency, including measuring, monitoring, and managing its settlement and funding flows on an ongoing and timely basis, and its use of intraday liquidity by, at a minimum, holding qualifying liquid resources sufficient to meet the minimum liquidity resource requirement under Rule 17Ad-22(e)(7)(i) in each relevant currency for which the covered clearing agency has payment obligations owed to clearing members.³⁴ The term “qualifying liquid resources” includes assets that are readily available and convertible into cash through prearranged funding arrangements, such as, committed arrangements without material adverse change provisions, including, among others, repurchase agreements.³⁵

Because the Non-Bank Repo Facility provides OCC with prearranged

³² 12 U.S.C. 5464(b).

³³ 12 U.S.C. 5464(b).

³⁴ 17 CFR 240.17Ad-22(e)(7)(ii).

³⁵ 17 CFR 240.17Ad-22(a)(14)(ii)(3).

commitments to convert assets into cash even if OCC experiences a material adverse change, the Commission believes that the Non-Bank Repo Facility provides OCC access to qualifying liquid resources to the extent that OCC has sufficient collateral to access the facility.³⁶ The Commission believes, therefore, that the proposed changes to the aggregate commitment level of and potential term of commitments under the Non-Bank Repo Facility program are reasonably designed to support OCC's ability to hold qualifying liquid resources to meet its liquidity resource requirements consistent with the requirements of Rule 17Ad-22(e)(7)(ii) under the Exchange Act.³⁷

Accordingly, the Commission believes that implementation of the Non-Bank Repo Facility would be consistent with Rule 17Ad-22(e)(7) under the Exchange Act.³⁸

IV. CONCLUSION

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act, that the Commission DOES NOT OBJECT to Advance Notice (SR-OCC-2020-803) and that OCC is AUTHORIZED to implement the proposed change as of the date of this notice.

By the Commission.

J. Matthew DeLesDernier
Assistant Secretary

³⁶ OCC would use U.S. government securities that are included in Clearing Fund contributions by Clearing Members and margin deposits of any Clearing Member that has been suspended by OCC for the repurchase arrangements. See Notice of Filing, 85 Fed. Reg. at 31235 n. 9.

³⁷ 17 CFR 240.17Ad-22(e)(7)(ii).

³⁸ 17 CFR 240.17Ad-22(e)(7).