

Required fields are shown with yellow backgrounds and asterisks.

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| Page 1 of * 140                       | SECURITIES AND EXCHANGE COMMISSION<br>WASHINGTON, D.C. 20549<br>Form 19b-4 | File No.* SR - 2021 - * 801 |
| Amendment No. (req. for Amendments *) |  |                             |

Filing by Options Clearing Corporation  
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

|   |                                      |                                     |   |  |  |
|---|--------------------------------------|-------------------------------------|---|--|--|
| Initial * <input checked="" type="checkbox"/>                             | Amendment * <input type="checkbox"/> | Withdrawal <input type="checkbox"/> | Section 19(b)(2) * <input type="checkbox"/> | Section 19(b)(3)(A) * <input type="checkbox"/> | Section 19(b)(3)(B) * <input type="checkbox"/> |
| Pilot <input type="checkbox"/>  |                                      |                                     | Rule  |  |  |
| Extension of Time Period for Commission Action * <input type="checkbox"/> |                                      | Date Expires * <input type="text"/> | <input type="checkbox"/> 19b-4(f)(1)        | <input type="checkbox"/> 19b-4(f)(4)           |  |
|   |                                      |                                     | <input type="checkbox"/> 19b-4(f)(2)        | <input type="checkbox"/> 19b-4(f)(5)           |  |
|   |                                      |                                     | <input type="checkbox"/> 19b-4(f)(3)        | <input type="checkbox"/> 19b-4(f)(6)           |  |

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| Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 | Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 |
| Section 806(e)(1) * <input checked="" type="checkbox"/>                                 | Section 3C(b)(2) * <input type="checkbox"/>                                    |
| Section 806(e)(2) * <input type="checkbox"/>  |  |

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| Exhibit 2 Sent As Paper Document <input type="checkbox"/> | Exhibit 3 Sent As Paper Document <input type="checkbox"/> |
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**Description**

Provide a brief description of the action (limit 250 characters, required when Initial is checked \*).

Advance Notice Relating to The Options Clearing Corporation's Establishment of Persistent Minimum Skin-In-The-Game

**Contact Information**

Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name \* Mark Last Name \* Brown

Title \* Assistant General Counsel

E-mail \* mcbrown@theocc.com

Telephone \* (312) 322-1801 Fax

**Signature**

Pursuant to the requirements of the Securities Exchange Act of 1934,

has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title \*)

Date 02/10/2021 Assistant General Counsel

By Mark C. Brown

(Name \*)

Mark C. Brown, mcbrown@theocc.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

**Form 19b-4 Information \***

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

**Exhibit 1 - Notice of Proposed Rule Change \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies \***

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

**Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications**

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Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

**Exhibit 3 - Form, Report, or Questionnaire**

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Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

**Exhibit 4 - Marked Copies**

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The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

**Exhibit 5 - Proposed Rule Text**

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The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

**Partial Amendment**

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

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Form 19b-4

Advance Notice  
by

**THE OPTIONS CLEARING CORPORATION**

Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934

**Item 1. Text of the Advance Notice**

In accordance with 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”),<sup>1</sup> and Rule 19b-4(n)(i)<sup>2</sup> of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”),<sup>3</sup> this advance notice is filed by The Options Clearing Corporation (“OCC”) in connection with proposed amendments to OCC’s Rules, Capital Management Policy, and certain other OCC policies to establish a persistent minimum level of OCC’s own pre-funded financial resources (commonly referred to as “skin-in-the-game”) that OCC would contribute to cover default losses or liquidity shortfalls. Amendments to OCC’s Rules are included in Exhibit 5a of filing SR-OCC-2021-801. Amendments to OCC’s Capital Management Policy are included in confidential Exhibit 5b of filing SR-OCC-2021-801. OCC would also make conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and Recovery and Orderly Wind-Down Plan (“RWD Plan”), which can be found in confidential Exhibits 5c, 5d, and 5e of filing SR-OCC-2021-801, respectively, to reflect the amended default waterfall (i.e., the financial resources OCC would use to address default losses and liquidity shortfalls, listed in the order OCC would utilize them). Material proposed to be added is marked by underlining, and material proposed to be deleted is marked with

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a et seq.

strikethrough text. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>4</sup>

**Item 2. Procedures of the Self-Regulatory Organization**

The advance notice was approved for filing with the Securities and Exchange Commission (“SEC”) by OCC’s Compensation and Performance Committee at a meeting on July 15, 2020, pursuant to authority delegated by the Board of Directors (“Board”) at a meeting held on April 29, 2020. OCC’s stockholders unanimously approved the amendments to the Capital Management Policy by written consents effective July 15, 2020.

Questions should be addressed to Mark C. Brown, Director & Senior Counsel, at (312) 322-1801.

**Item 3. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

Not applicable.

**Item 4. Self-Regulatory Organization’s Statement on Burden on Competition**

Not applicable.

**Item 5. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others**

Written comments were not and are not intended to be solicited with respect to the advance notice, and none have been received.

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<sup>4</sup> OCC’s By-Laws and Rules can be found on OCC’s public website: <https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules>.

**Item 6. Extension of Time Period for Commission Action**

Not applicable.

**Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)**

Not applicable.

**Item 8. Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission**

Not applicable.

**Item 9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act**

Not applicable.

**Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act**

**Description of the Change**

This advance notice concerns proposed amendments to OCC's Rules, Capital Management Policy, and certain other policies to establish a persistent minimum level of skin-in-the-game that OCC would contribute to cover default losses or liquidity shortfalls, which would consist of a minimum amount of OCC's own pre-funded resources that OCC would charge prior to charging a loss to the Clearing Fund (as defined below, the "Minimum Corporate Contribution") and, as OCC's Rules currently provide, applicable funds held in trust in respect to OCC's Executive Deferred Compensation Plan ("EDCP") (such funds, as defined in OCC's Rules, being the "EDCP Unvested Balance") that would be charged pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. The persistent minimum level of skin-in-the-game would establish a floor for the pre-funded resources OCC would contribute to cover

default losses and liquidity shortfalls: In addition to this minimum, OCC would continue to commit its liquid net assets funded by equity (“LNAFBE”)<sup>5</sup> greater than 110% of its Target Capital Requirement prior to charging a loss to the Clearing Fund.

## Background

In January 2020, OCC implemented its Capital Management Policy, by which OCC (a) determines the amount of Equity<sup>6</sup> sufficient for OCC to meet its regulatory obligations and to serve market participants and the public interest (as defined in OCC’s Rules, the “Target Capital Requirement”), (b) monitors Equity and LNAFBE levels to help ensure adequate financial resources are available to meet general business obligations; and (c) manages Equity levels, including by (i) adjusting OCC’s fee schedule (as appropriate) and (ii) establishing a plan for accessing additional capital should OCC’s Equity fall below certain thresholds (the “Replenishment Plan”).<sup>7</sup> In addition, OCC’s Rules, the Capital Management Policy, and associated policies provide for the use of OCC’s current and retained earnings in excess of 110% of the Target Capital Requirement (i.e., the “Early Warning” threshold under OCC’s

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<sup>5</sup> International standards and the Commission’s Rules established minimum LNAFBE requirements for financial market infrastructures and covered clearing agencies, respectively. See CPSS-IOSCO, Principles for financial market infrastructures, at Principle 15 (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>; 17 CFR 240.17Ad-22(e)(15). The Capital Management Policy defines “LNAFBE” as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments (i.e., agency-related liabilities such as Section 31 fees held by OCC).

<sup>6</sup> The Capital Management Policy defines “Equity” as shareholders’ equity as shown on OCC’s Statement of Financial Condition.

<sup>7</sup> See Exchange Act Release No. 88029 (Jan. 24, 2020), 85 FR 5500 (Jan. 30, 2020) (File No. SR-OCC-2019-007) (hereinafter, “Order Approving Capital Management Policy”).

Replenishment Plan) to cover losses arising from a Clearing Member's default.<sup>8</sup> While OCC's Rules previously provided for OCC to contribute its own capital to cover default losses at the Board's discretion, the Capital Management Policy changes made the contribution of such excess capital obligatory.<sup>9</sup>

In the event of a Clearing Member default, OCC would contribute excess capital to cover losses remaining after applying the margin assets and Clearing Fund contribution of the defaulting Clearing Member and before charging the Clearing Fund contributions of non-defaulting Clearing Members. Should OCC's excess capital be insufficient to cover the loss, OCC also has another tranche of OCC resources in addition to the Clearing Fund; namely, the EDCP Unvested Balance.<sup>10</sup> In the event of a default loss, the EDCP Unvested Balance is contributed pari passu with the Clearing Fund contributions of non-defaulting Clearing Members.

The implementation of OCC's Capital Management Policy marked the first time OCC committed OCC's own pre-funded financial resources into OCC's approach to capital management and resiliency. In particular, OCC believes that the inclusion of the EDCP Unvested Balance is a powerful alignment of interest between management and Clearing

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<sup>8</sup> Id. at 5502.

<sup>9</sup> Use of excess capital to cover losses arising from the default of a bank or other clearing agency that is not otherwise associated with a Clearing Member default remains at the Board's discretion. See Rule 1006(e)(ii).

<sup>10</sup> As defined in OCC's Rules, the EDCP Unvested Balance consists of funds (x) deposited on or after January 1, 2020 in respect of its EDCP and (y) in excess of amounts necessary to pay for benefits accrued and vested under the EDCP at such time.

Members. OCC takes seriously the interest of the industry and international regulators in seeing more significant skin-in-the-game commitments at central counterparties.

To that end, OCC has reviewed feedback received in connection with the initial filing of the Capital Management Plan, relevant papers from industry participants and stakeholders concerning skin-in-the-game, and regulatory regimes in jurisdictions outside the United States. For one, a comment submitted in connection with the Capital Management Policy’s filing urged OCC to implement a “minimum amount of skin-in-the-game that ‘scales with risk and is defined and funded upfront’ and . . . ‘to define a level of [skin-in-the-game] ex ante that would always be readily available in case of a default loss.”<sup>11</sup> OCC has also reviewed the paper, “A Path Forward for CCP Resilience, Recover, and Resolution,” originally released in October 2019 with nine signatories and re-released in March of 2020 with ten additional signatories, representing major buy-side and sell-side firms in the markets OCC serves.<sup>12</sup> One of the paper’s significant recommendations is that central counterparties should have skin-in-the-game in a more defined manner.<sup>13</sup> In contrast, OCC’s current variable approach to skin-in-the-game does not guarantee a defined amount would be available as skin-in-the-game. Additionally, as OCC seeks

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<sup>11</sup> Order Approving Capital Management Policy, 85 FR at 5507 (quoting comments submitted by FIA).

<sup>12</sup> See ABN AMRO Clearing Bank N.V., et al., A Path Forward for CCP Resilience, Recovery, and Resolution (March 10, 2020), available at <https://www.jpmorgan.com/solutions/cib/markets/a-path-forward-for-ccp-resilience-recovery-and-resolution>.

<sup>13</sup> While OCC agrees with the paper’s authors that central counterparties should have meaningful skin-in-the-game, OCC does not agree with the level of skin-in-the-game recommended in the paper. See Optimizing Incentives, Resilience and Stability in Central Counterparty Clearing: Perspectives on CCP Issues from a Utility Model Clearinghouse (September 22, 2020), available at <https://www.theocc.com/Newsroom/Insights/2020/09-22-Optimizing-Incentives,-Resilience-and-Stabil>.

recognition in the European Union and the United Kingdom, OCC is cognizant of the European Market Infrastructure Regulation's ("EMIR") expectation that skin-in-the-game be a minimum of 25% of the central counterparty's regulatory capital requirement.<sup>14</sup> Under the current Capital Management Policy, excess capital is not dedicated solely as skin-in-the-game and it is possible that OCC's capital in excess of 110% of its Target Capital Requirement would be less than 25% of OCC's Target Capital Requirement.

To address the concerns raised by these market participants, further strengthen OCC's pre-funded financial resources, further align the interests of OCC's management and Clearing Members, and align OCC's skin-in-the-game with international standards, OCC is filing this advance notice, which would establish a persistent minimum amount of skin-in-the-game that would be used to cover default losses and liquidity shortfalls. This skin-in-the-game proposal is part of a broader set of decisions announced by OCC to lower the cost of clearing for its members,<sup>15</sup> including a fee decrease effective September 1, 2020.<sup>16</sup> OCC also discussed these

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<sup>14</sup> Though OCC, as a non-EU central counterparty, would not be subject directly to the EMIR standards or the supervision of the European Securities and Markets Authority ("ESMA"), OCC has considered the EMIR standards as part of its bid to seek third-country recognition in Europe and the United Kingdom. OCC is seeking recognition to address European bank capital requirements set to go into effect next year that would require European banks to set aside additional capital for exposure to central counterparties that are not "qualified CCPs" in Europe. In order to become a qualified CCP, ESMA and the regulatory authority in a non-EU jurisdiction must reach an agreement that their regulatory regimes for central counterparties are equivalent. As of the date of this filing, the Commodity Futures Trading Commission ("CFTC") has reached an agreement with ESMA on the equivalence of their regulatory regimes.

<sup>15</sup> OCC announced these decisions in a press release and letter to Clearing Members. See Press Release, OCC To Lower Costs for Users of U.S. Equity Derivatives Markets (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Press-Releases/2020/08-03-OCC-To-Lower-Costs-for-Users-of-US-Equity-De>; "Letter to Clearing Member Firms –

changes on calls with OCC's Non-Equity Exchanges, Clearing Members, and other market participants, including discussions with the SIFMA Options Committee and FIA and open calls with OCC Clearing Members. Members expressed that the proposed addition of a minimum level of skin-in-the-game would be a welcome enhancement by OCC. One market participant expressed its appreciation for OCC's commitment to resiliency, but renewed concerns it had raised in connection with OCC's Capital Management Policy about increases in OCC's capital and, if OCC were sold, a more commercial orientation monetized with higher fees. As OCC stated with respect to the establishment of the Capital Management Policy,<sup>17</sup> OCC believes that this view is well outside the scope of the Capital Management Policy and this advance notice, but will continue to engage with Clearing Members and other market participants to address any concerns. While questions were raised in these conversations, no specific suggestions were made.

### **Proposed Changes**

In order to establish a persistent minimum amount of skin-in-the-game, OCC is proposing to: (a) amend OCC's Rules to define the Minimum Corporate Contribution, insert the Minimum Corporate Contribution in OCC's default waterfall as provided in Rule 1006, provide for how OCC would calculate any LNAFBE greater than 110% of its Target Capital

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OCC to Lower Costs for Users of U.S. Equity Derivative Markets" (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Views/2020/08-03-Letter-to-Clearing-Member-Firms>.

<sup>16</sup> See Exchange Act Release No. 89534 (Aug. 12, 2020), 85 FR 50858 (Aug. 18, 2020) (File No. SR-OCC-2020-009).

<sup>17</sup> See Exhibit 3g to File No. SR-OCC-2019-007.

Requirement OCC would contribute in addition to the Minimum Corporate Contribution, and provide a time by which OCC would reestablish the Minimum Corporate Contribution if and when OCC uses it to cover default losses; (b) amend the Capital Management Policy to exclude the Minimum Corporate Contribution from OCC's measurement of its LNAFBE against its Target Capital Requirement and from OCC's calculation of the Early Warning and Trigger Event, to ensure that OCC may maintain the Minimum Corporate Contribution exclusively for default losses while retaining access to replenishment capital in the event OCC suffers an operational loss that reduces its Equity below those thresholds; and (c) apply conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and the RWD Plan to reflect that in the event of a default loss or liquidity shortfall, the Minimum Corporate Contribution would be charged after contributing the margin and Clearing Fund deposit of a default member and before the contribution of OCC's LNAFBE in excess of 110% of OCC's Target Capital Requirement, both before OCC charges the Clearing Fund deposits of non-default Clearing Members and the EDCP Unvested Balance on a pro rata basis.

(a) Amendments to OCC's Rules

To establish and maintain a persistent minimum level of skin-in-the-game, OCC proposes to amend its Rules to (1) define the Minimum Corporate Contribution; (2) revise OCC's default waterfall to more clearly define the skin-in-the-game resources OCC would contribute to a default loss; (3) provide for how OCC would calculate any LNAFBE greater than 110% of the Target Capital Requirement it would contribute after exhausting the Minimum Corporate

Contribution; and (4) provide for how OCC would replenish the Minimum Corporate Contribution after each chargeable default loss.

(1) *Defining the Minimum Corporate Contribution*

OCC would establish a persistent minimum level of skin-in-the-game by first amending OCC's Rules to define the Minimum Corporate Contribution in Chapter I of the Rules to mean the minimum level of OCC's own funds maintained exclusively to cover credit losses or liquidity shortfalls, the level of which OCC's Board shall determine from time to time. As OCC's own funds, OCC would hold the Minimum Corporate Contribution in accordance with OCC's By-Laws governing the investment of OCC's funds<sup>18</sup> and OCC's policies and procedures governing cash and investment management. Specifically, OCC maintains uninvested OCC cash in demand deposits and any investments of funds maintained to satisfy the Minimum Corporate Contribution would be limited to overnight reverse repurchase agreements involving U.S. Government Treasury Securities, consistent with OCC's same-day liquidity needs for such funds.

While the proposed definition would give OCC's Board discretion in setting the Minimum Corporate Contribution, the Board has approved an initial Minimum Corporate Contribution that sets OCC's total persistent skin-in-the-game (*i.e.*, the sum of the Minimum Corporate Contribution and OCC's current EDCP Unvested Balance) at 25% of OCC's Target Capital Requirement. In setting the initial Minimum Corporate Contribution, OCC's Board considered factors including, but not limited to, the regulatory requirements in each jurisdiction

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<sup>18</sup> See OCC By-Laws Art. IX, Sec. 1.

in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to address participant defaults, the EDCP Unvested Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses, and other projected capital needs.

(2) *Revising OCC's Default Waterfall*

OCC would also amend OCC Rule 1006 to insert the Minimum Corporate Contribution in OCC's default waterfall after contributing a defaulting Clearing Member's margin and Clearing Fund deposit, and before contributing OCC's LNAFBE greater than 110% of OCC's Target Capital Requirement, both of which OCC would exhaust before charging a loss to the Clearing Fund and the EDCP Unvested Balance, pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. So placed, OCC believes that the Minimum Corporate Contribution would demonstrate OCC's institutional commitment to its ongoing financial surveillance of clearing members and the establishment and maintenance of a prudent and effective margin methodology. A draw against the Minimum Corporate Contribution and the associated requirement to replenish, as discussed below, would provide fewer resources to meet other corporate commitments. Accordingly, the proposal would further align OCC's and its management's interests with those of non-defaulting Clearing Members.

OCC would also remove references to "retained earnings" or "current or retained earnings" in OCC Rule 1006(b), Rule 1006(e)(i), Rule 1006(e)(ii), and the second sentence of Rule 1006(e)(iii), and replace them with references to the contribution of the "Minimum Corporate Contribution" and "the Corporation's liquid net assets funded by equity that are

greater than 110% of its Target Capital Requirement.” The references to “retained earnings” or “current or retained earnings” are legacy terms used prior to OCC’s implementation of the Capital Management Policy.<sup>19</sup> OCC is proposing to replace these references in OCC’s Rules to better identify the funds OCC’s would contribute in terms that align with OCC’s Capital Management Policy.

(3) *Calculating LNAFBE Available as Skin-In-The-Game*

Because OCC proposes to replace references to “current or retained earnings,” OCC would also delete the first sentence of Rule 1006(e)(iii), which currently provides for how OCC determines its “current earnings” for purposes of the amount available to cover losses under Rule 1006(e)(i) and Rule 1006(e)(ii). In its place, the first sentence of Rule 1006(e)(iii) would set out how OCC would determine its LNAFBE for purposes of contributing LNAFBE greater than 110% of the Target Capital Requirement to cover default losses and liquidity shortfalls. Specifically, similar to how the Rules currently provide for the calculation of “current earnings,” OCC would determine its LNAFBE based on OCC’s unaudited financial statements at the close of the calendar month immediately preceding the occurrence of the loss or deficiency under paragraphs (e)(i) or (e)(ii), less an amount equal to the aggregate of all refunds made or authorized to be made or deemed to have been made during the fiscal year in which such loss or

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<sup>19</sup> OCC first established discretionary use of OCC’s current or retained earnings to cover default losses in Article VIII (Clearing Fund) of OCC’s By-Laws. See Exchange Act Release No. 15493 (Jan. 4, 1979), 44 FR 3802 (Jan. 18, 1979) (File No. SR-OCC-79-01). When OCC moved the provisions governing the Clearing Fund from OCC’s By-Laws to the Rules in 2018, the provisions governing the usage of the Clearing Fund became Rule 1006(e). See Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (Aug. 2, 2018) (File No. SR-OCC-2018-008).

deficiency occurs if the refund is not reflected on such unaudited financial statements.

Accordingly, OCC would retain the priority given to the payment of refunds that OCC has declared, but not yet issued, as currently provided by OCC Rule 1106(e)(iii), when calculating the amount of LNAFBE available to cover a default loss after contributing the Minimum Corporate Contribution.

OCC would further amend Rule 1006(e)(iii) to provide that in no event shall OCC be required to contribute an amount that would cause OCC's LNAFBE to fall below 110% of the Target Capital Requirement at the time changed. The Capital Management Policy, in accordance with SEC Rule 17Ad-22(e)(15)(ii)(A),<sup>20</sup> currently requires that the funds OCC maintains to satisfy its Target Capital Requirement be separate from OCC's resources to cover participant defaults and liquidity shortfalls. Accordingly, should a default occur in a month during which OCC suffers an operational loss that decreases the value of its excess capital available as skin-in-the-game below what is reflected on the unaudited financial statement at the close of the previous month,<sup>21</sup> OCC would be able to take into account the decrease in its excess capital when calculating its available LNAFBE above 110% of the Target Capital Requirement. In addition, OCC would renumber as Rule 1006(e)(iv) the last sentence of Rule 1006(e)(iii). That sentence, which concerns a defaulting Clearing Member's continuing obligation for losses OCC

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<sup>20</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>21</sup> Under OCC's current rules, LNAFBE greater than 110% of the Target Capital Requirement and the EDCP Unvested Balance are committed to cover both operational losses and default losses. In the event OCC experiences operational losses and default losses in short succession, OCC would contribute these resources in the manner specified by OCC's Rules to the event that occurred first.

charges to OCC's own capital, is conceptually distinct from the rest of Rule 1006(e)(iii) and, accordingly, deserves to be addressed separately.

(4) *Replenishing the Minimum Corporate Contribution*

Finally, OCC would add a new paragraph to Rule 1006(e)—Rule 1006(e)(v)—to provide for a 270 calendar-day period during which the Minimum Corporate Contribution, once charged, would be reduced to the remaining unused portion. OCC believes that 270 calendar days, or approximately nine months, is sufficient time for OCC to accumulate the funds necessary to reestablish the Minimum Corporate Contribution. In making this determination, OCC used the same analysis employed to set the Early Warning and Trigger Event under its Replenishment Plan, both of which are based on the time OCC estimates it would take to accumulate 10% of its Target Capital Requirement.<sup>22</sup> Specifically, OCC took into account its typical monthly earnings and the amount of earnings that would be needed to replenish the Minimum Corporate Contribution on an after-tax basis. Proposed Rule 1006(e)(v) would also provide that OCC shall notify Clearing Members of any such reduction to the Minimum Corporate Contribution.

Each chargeable loss would trigger a new 270-day period. As such, proposed Rule 1006(e)(v) is designed to allow OCC to manage multiple defaults within a 270-day period by eliminating the risk that a successive default would exhaust the resources needed to reestablish the Minimum Corporate Contribution by the end of the initial 270-day period. And while a

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<sup>22</sup> See Order Approving Capital Management Policy, 85 FR at 5510-11. OCC has included this analysis as part of confidential Exhibit 3 to File No. SR-OCC-2021-801.

successive default loss that does not impact excess LNAFBE<sup>23</sup> available to replenish the Minimum Corporation Contribution would nevertheless trigger another 270-day period during which the Minimum Corporate Contribution would be reduced to the remaining unused portion after the first two defaults, any LNAFBE greater than 110% of the Target Capital Requirement would continue to be available to cover successive default losses. In the very unlikely event that OCC experiences an operational loss or a drop in revenue from clearing fees that threatens its ability to reestablish the Minimum Corporate Contribution at the end of the 270-day period, OCC would likely file a rule change to extend the period rather than act to lower the Minimum Corporate Contribution, dependent on the Board's consideration of the same non-exclusive list of factors that the Board would consider when determining whether to adjust the Minimum Corporate Contribution, discussed below.

(b) Amendments to the Capital Management Policy

Consistent with the proposed changes to OCC's Rules, OCC would amend the portions of the Capital Management Policy that concern OCC's usage of excess capital to cover default losses to more specifically identify the resources OCC would contribute to default losses; namely, the Minimum Corporate Contribution and LNAFBE above 110% of the Target Capital Requirement. OCC would clarify that after exhausting the Minimum Corporate Contribution, OCC would continue to offset default losses with LNAFBE, rather than "Equity," above 110% of the Target Capital requirement. This change is not intended to change OCC's current

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<sup>23</sup> As described below, OCC is proposing to amend the Capital Management Policy to exclude the Minimum Corporate Contribution from the definition of LNAFBE. As a result, a second default loss covered exclusively by the Minimum Corporate Contribution would not impact OCC's level of LNAFBE.

obligations. Rather, OCC intends to conform the Capital Management Policy so that the terms are consistent with those used in the proposed Rules, other requirements in the Capital Management Policy, and OCC's regulatory obligations. Specifically, the Capital Management Policy provides that the resources held to meet the Target Capital Requirement must be liquid assets separate from OCC's resources to cover participant defaults and liquidity shortfalls, consistent with SEC Rule 17Ad-22(e)(15)(ii)(A).<sup>24</sup> Because Equity typically exceeds LNAFBE and because any funds OCC would contribute to cover a default loss would need to be liquid assets, contributing liquid assets in excess of LNAFBE greater than 110% of the Target Capital Requirement would be inconsistent with the Capital Management Policy.

In addition, OCC would amend the Capital Management Policy's list of capital management actions with a material impact on current or future levels of Equity, replacing "use of current and retained earnings greater than 100% of the Target Capital Requirement" with "use of excess capital," to align with the title of the Capital Management Policy's "Excess Capital Usage" section. That section would also be updated to include a discussion of the factors that the Board would consider in establishing and adjusting the Minimum Corporate Contribution. Factors the Board would consider include, but are not limited to, the regulatory requirements in each jurisdiction in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to address participant defaults, the current and projected level of the EDCP Unvested Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses,

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<sup>24</sup> See 17 CFR 240.17Ad-22(e)(15)(ii)(A).

and other projected capital needs. While the Capital Management Policy would provide that the Board would review Minimum Corporate Contribution annually, the Board would retain authority to change the Minimum Corporate at its discretion. In addition, the Capital Management Policy would be updated to include the substance of and references to proposed Rule 1006(e)(v), which, as discussed above, provides for a 270-day period following a chargeable loss during which the Minimum Corporate Contribution is reduced to its remaining unused portion.

OCC would also amend the definition of LNAFBE in the Capital Management Policy to specifically exclude the Minimum Corporate Contribution, which would be dedicated to cover default losses. The Capital Management Policy defines LNAFBE as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments. The definition currently specifies the exclusion of “agency-related liabilities, such as Section 31 fees” as the only approved adjustment. OCC would amend the definition to add the Minimum Corporate Contribution as another example of an approved exemption to the calculation of LNAFBE. As discussed in more detail in the discussion of the statutory basis for these proposed changes below, this proposed amendment to the definition of LNAFBE is intended to ensure that OCC does not double count resources committed to cover default losses as resources available to satisfy regulatory requirements concerning the amount of LNAFBE or other financial resources OCC must maintain to cover operational costs and potential business losses. For similar reasons, OCC would amend the Capital Management Policy’s discussion of OCC’s Replenishment Plan to add that in the event of an operational loss, OCC shall first use Equity, “less the Minimum

Corporate Contribution,” above 110% of Target Capital. This amendment reflects that the funds maintained for the Minimum Corporate Contribution are not funds available to cover operational losses.

With respect to OCC’s Replenishment Plan, OCC would also amend the definitions of the Early Warning and Trigger Event to exclude the Minimum Corporate Contribution from the calculation of those thresholds so that OCC maintains access to replenishment capital in the event operational losses materialize while still maintaining the Minimum Corporate Contribution exclusively to cover default losses. As described above, the Early Warning and Trigger Event are the thresholds for actions under OCC’s Replenishment Plan. Currently, the Early Warning and Trigger Event thresholds are defined with respect to OCC’s Equity falling below certain thresholds. OCC is proposing to amend those definitions so that the Early Warning and Trigger Event occur when Equity “less the Minimum Corporate Contribution” falls below those same thresholds. These changes would ensure that OCC may maintain the Minimum Corporate Contribution exclusively to address default losses—the effect of which would be to increase Equity relative to LNAFBE—while still maintaining access to its Replenishment Plan should OCC’s Equity, less the Minimum Corporate Contribution, fall close to or below the Target Capital Requirement.

(c) Amendments to the Default Management Policy, Clearing Fund Methodology Policy, and RWD Plan

To accommodate the proposed establishment of the Minimum Corporate Contribution, OCC proposes conforming changes to other rule-filed policies that describe OCC’s default waterfall, as set forth in OCC Rule 1006. In the Default Management Policy, OCC would delete

the passage concerning “Current and Retained Earnings” in the current discussion of OCC’s default waterfall and replace it with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, as provided in the proposed amendments to Rule 1006 above. OCC would also amend the Default Management Policy’s definition of “financial resources” to include the Minimum Corporate Contribution as among those available to address Clearing Member defaults and suspensions. In the Clearing Fund Methodology Policy, OCC would similarly revise the discussion of the default waterfall in that policy’s section covering Clearing Fund charges and assessments to incorporate the Minimum Corporate Contribution, consistent with the proposed amendments to Rule 1006 above. OCC would also amend the Clearing Fund Methodology Policy’s definitions of OCC’s “Pre-Funded Financial Resources” for the purposes of sizing or measuring the sufficiency of the Clearing Fund to include the Minimum Corporate Contribution. Finally, OCC would amend the RWD Plan to replace all references to “current or retained earnings” with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, or “skin-in-the-game” for short, modify certain example scenarios concerning use of OCC’s Enhanced Risk Management and Recovery Tools to account for the proposed Minimum Corporate Contribution, and make certain other conforming changes concerning use of skin-in-the-game to address liquidity shortfalls and, in the case of LNAFBE greater than 110% of the Target Capital Requirement, OCC’s authority to use skin-in-the-game to address losses resulting from bank or securities or commodities clearing organization failures, including custody or investment losses.

**Anticipated Effect On and Management of Risk**

OCC believes that the proposed changes would reduce the nature and level of risk presented by OCC because they would enhance the overall resilience of OCC's capital management and default management processes. Establishing a Minimum Corporate Contribution, which OCC would apply after a defaulting Clearing Member's margin and Clearing Fund deposits, would ensure a minimum level of OCC's own pre-funded financial resources available to cover credit losses. By applying the Minimum Corporate Contribution before charging the Clearing Fund, the proposed change helps protect non-defaulting Clearing Members from default losses of another Clearing Member, which in turn helps reduce OCC's overall level of risk and ensure the prompt and accurate clearance and settlement of its cleared products. In addition, the proposed changes to OCC's Rules, Capital Management Policy and other rule-filed policies intended to account for the use of OCC's Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement would help ensure that OCC continues to hold LNAFBE sufficient to meet its regulatory obligations and maintain access to its Replenishment Plan in the event that an operational loss causes Equity, less the Minimum Corporate Contribution reserved for default losses, to fall close to or below regulatory requirements. Together these features of the Capital Management Policy help ensure that OCC maintains levels of capital sufficient to allow it to absorb substantial business losses and meet its responsibilities as a systemically important financial market utility, which in turn helps reduce OCC's overall level of risk.

**Consistency with the Clearing Supervision Act**

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>25</sup> Section 805(a)(2) of the Clearing Supervision Act<sup>26</sup> also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>27</sup> states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Exchange Act in furtherance of these objectives and principles.<sup>28</sup> Rule 17Ad-22 requires registered clearing agencies, like OCC, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an

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<sup>25</sup> 12 U.S.C. 5461(b).

<sup>26</sup> 12 U.S.C. 5464(a)(2).

<sup>27</sup> 12 U.S.C. 5464(b).

<sup>28</sup> 17 CFR 240.17Ad-22. See Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”).

ongoing basis.<sup>29</sup> Therefore, the Commission has stated<sup>30</sup> that it believes it is appropriate to review changes proposed in advance notices against Rule 17Ad-22 and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.<sup>31</sup>

OCC believes the proposed changes are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.<sup>32</sup> The proposed changes are generally designed to enhance OCC's resiliency by establishing a Minimum Corporate Contribution that would be used to absorb losses or liquidity shortfalls arising from the default of a Clearing Member. While OCC's current rules commit OCC to contribute a contingent amount of capital to address default losses or liquidity shortfalls, the proposed changes would commit to a minimum amount, subject to a replenishment period if OCC charges a loss to the Minimum Corporate Contribution. Ensuring a minimum amount of skin-in-the-game would reduce the amount OCC may need to charge the Clearing Fund deposits of non-defaulting Clearing Member. In this way, OCC believes that the proposed establishment of the Minimum Corporate Contribution and attendant changes would improve OCC's resilience as a systemically important market utility by promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.

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<sup>29</sup> 17 CFR 240.17Ad-22.

<sup>30</sup> See, e.g., Exchange Act Release No. 86182 (June 24, 2019), 84 FR 31128, 31129 (June 28, 2019) (SR-OCC-2019-803).

<sup>31</sup> 12 U.S.C. 5464(b).

<sup>32</sup> Id.

OCC also believes that the proposed changes are consistent with the risk management standards adopted by the Commission under Section 805(a)(2) of the Clearing Supervision Act;<sup>33</sup> specifically, Rules 17Ad-22(e)(4),<sup>34</sup> 17Ad-22(e)(15)(ii)(A),<sup>35</sup> 17Ad-22(e)(15)(iii),<sup>36</sup> Rules 17Ad-22(e)(2)(i),<sup>37</sup> and 17Ad-22(e)(23)<sup>38</sup> thereunder for the reasons described below.

Rule 17Ad-22(e)(4) under the Exchange Act provides, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>39</sup> By providing that OCC shall maintain a minimum level of skin-in-the-game—in addition to OCC’s LNAFBE greater than 110% of its Target Capital Requirement, contributed prior to charging the Clearing Fund, as OCC’s Rules currently provide—OCC is providing for a minimum level of pre-funded financial resources available to cover losses in the event of a Clearing Member default, and reducing the amount OCC would charge the Clearing Fund contributions of non-defaulting Clearing Members. Therefore, OCC believes the amendments to

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<sup>33</sup> 12 U.S.C. 5464(a)(2).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>35</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>36</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>37</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>38</sup> 17 CFR 240.17Ad-22(e)(23).

<sup>39</sup> 17 CFR 240.17Ad-22(e)(4)(i).

its Rules, the Capital Management Policy, and other related policies to establish the Minimum Corporate Contribution are consistent with Rule 17Ad-22(e)(4).

OCC also believes that the proposed changes to the definition of LNAFBE in OCC's Capital Management Policy, which exclude the Minimum Corporate Contribution from the calculation of LNAFBE, are consistent with Rule 17Ad-22(e)(15)(ii)(A) under the Exchange Act.<sup>40</sup> Rule 17Ad-22(e)(15)(ii)(A) requires that the LNAFBE held by OCC to satisfy the minimum LNAFBE required by Rule 17Ad-22(e)(15)(ii)<sup>41</sup> shall be in addition to resources held to cover participant defaults or other credit or liquidity risks.<sup>42</sup> The proposed revision to OCC's definition of LNAFBE is designed to satisfy Rule 17Ad-22(e)(15)(ii)(A) by providing that the

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<sup>40</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>41</sup> Rule 17Ad-22(e)(15)(ii), in turn, requires that OCC hold LNAFBE to the greater of (x) six months of OCC's current operating expenses, or (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services. 17 CFR 240.17Ad-22(e)(15)(ii). OCC's Capital Management Policy is reasonably designed to meet this requirement, and Rule 17Ad-22(e)(15) more broadly, by providing that OCC sets its Target Capital Requirement at a level sufficient to maintain LNAFBE at least equal to the greater of: (x) six months of OCC's current operating expenses, (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly winddown of critical operations and services, and (z) the amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize. See Order Approving Capital Management Policy, 85 FR at 5501-02. In addition, in setting the Target Capital Requirement, OCC's Board considers OCC's projected rolling twelve-months' operating expenses to ensure that OCC maintains Equity and other financial resources approved by the CFTC, as required by CFTC Rule 39.11(a)(2). See id. at 5501 n.19 (citing 17 CFR 39.11(a)(2)).

<sup>42</sup> Id. Similarly, CFTC Rule 39.11(b)(3) provides that a derivatives clearing organization ("DCO") may allocate financial resources to satisfy requirements that the DCO possess financial resources (i) to enable the DCO to meet obligations notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions, and (ii) to enable the DCO to cover its operational costs, but not both. See 17 CFR 39.11(b)(3).

proposed Minimum Corporate Contribution, which would be held exclusively to cover participant defaults and liquidity shortfalls, would be in addition to the LNAFBE that OCC holds to meet or exceed its regulatory capital requirements under Rule 17Ad-22(e)(15)(ii)—i.e., LNAFBE in an amount equal to 110% of OCC’s Target Capital Requirement. In addition, the proposed revisions to OCC Rule 1006(e)(iii) and the Capital Management Policy—which would specify that OCC’s committed skin-in-the-game shall include the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirements—are reasonably designed to ensure that OCC would not be obligated to contribute an amount of skin-in-the-game that would cause its LNAFBE to fall below the Early Warning threshold intended to ensure OCC maintains sufficient LNAFBE to meet its regulatory obligations. As a result, OCC believes the proposed amendments to the Capital Management Policy are designed to comply with Rule 17Ad-22(e)(15)(ii)(A).

In addition, OCC believes that the proposed amendments to OCC’s definition of the Early Warning and Trigger Event thresholds under OCC’s Replenishment Plan are consistent with Rule 17Ad-22(e)(15)(iii)<sup>43</sup> because excluding the Minimum Corporate Contribution from those thresholds would ensure that OCC may continue to access replenishment capital in the unlikely event that OCC experiences an operational loss while continuing to maintain the Minimum Corporate Contribution exclusively to cover default losses. Rule 17Ad-22(e)(15)(iii) requires, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage OCC’s general business risk,

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<sup>43</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

including by maintaining a viable plan for raising additional Equity should its Equity fall close to or below the amount required under Rule 17Ad-22(e)(15)(ii).<sup>44</sup> By setting the threshold triggers by reference to the Target Capital Requirement, OCC's Replenishment Plan is designed to require OCC to act to raise capital should its Equity fall close to or below the amounts required under Rule 17Ad-22(e)(15)(ii). However, the effect of holding the Minimum Corporate Contribution would be to increase OCC's Equity relative to LNAFBE available to cover potential operational losses. To help ensure that OCC holds LNAFBE above its Target Capital Requirement and maintains access to replenishment capital, the proposed change would exclude the Minimum Corporate Contribution when measuring OCC's Equity against the Early Warning and Trigger Event thresholds under its Replenishment Plan. Accordingly, OCC believes that the proposed amendments to the definitions of the Early Warning and Trigger Event thresholds are consistent with Rule 17Ad-22(e)(15)(iii).

OCC also believe that the proposed changes are consistent with Rule 17Ad-22(e)(2)(i), which requires that covered clearing agencies maintain written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent.<sup>45</sup> The proposed changes would align the terminology used in OCC's Rules and other rule-filed policies with the terminology of the Capital Management Policy, providing better clarity and consistency between OCC's governing documents. Specifically, OCC would amend its Rules, Capital Management Policy, Default Management Policy, Clearing Fund Methodology Policy and RWD Plan to identify

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<sup>44</sup> Id. As discussed in note 41, supra, OCC's Target Capital Requirement is reasonably designed to meet or exceed the minimum LNAFBE required to satisfy Rule 17Ad-22(e)(15)(ii).

<sup>45</sup> 17 CFR 240.17Ad-22(e)(2)(i).

OCC's sources of skin-in-the-game (the Minimum Corporation Contribution, LNAFBE greater than 110% of the Target Capital Requirement, and the EDCP Unvested Balance) and their places within OCC's default waterfall. The proposed amendments to the Capital Management Policy would also identify factors the Board would consider in setting and adjusting the Minimum Corporate Contribution. Accordingly, OCC believes conforming the terms in these governance arrangements and identifying factors OCC would consider in adjusting the Minimum Corporate Contribution is consistent with Rule 17Ad-22(e)(2)(i).

Finally, OCC believe that the proposed changes are consistent with Rule 17Ad-22(e)(23), which requires covered clearing agencies to maintain written policies and procedures reasonably designed to, among other things, provide for publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures.<sup>46</sup> The proposed changes would amend OCC's Rules to remove the pre-Capital Management Policy references to use of "retained earnings" or "current and retained earnings" with respect to the sources of OCC's skin-in-the-game, and instead identify the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement. The proposed changes would also provide greater clarity about how OCC calculates the amount of LNAFBE greater than 110% of the Target Capital Requirement based upon the unaudited financial statements from the close of the prior month; provided, however, that OCC would not be required to contribute an amount that would cause its LNAFBE to fall below 110% of the Target Capital Requirement at the time charged. The proposed changes to OCC Rules would, in turn, be made available on OCC's website. Therefore,

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<sup>46</sup> 17 CFR 240.17Ad-22(e)(23).

OCC believes the proposed changes would disclose relevant default rules and procedures to the public and to Clearing Members.

For the foregoing reasons, OCC believes that the proposed changes are consistent with Section 805(b) of the Clearing Supervision Act<sup>47</sup> and Rules 17Ad-22(e)(4),<sup>48</sup> 17Ad-22(e)(15)(ii)(A),<sup>49</sup> 17Ad-22(e)(15)(iii),<sup>50</sup> Rules 17Ad-22(e)(2)(i),<sup>51</sup> and 17Ad-22(e)(23)<sup>52</sup> under the Exchange Act.

**Item 11. Exhibits**

- Exhibit 1A. Completed Notice of Advance Notice for publication in the Federal Register
- Exhibit 3. Confidential Data and Analysis
- Exhibit 5a. OCC Rules
- Exhibit 5b. Capital Management Policy
- Exhibit 5c. Default Management Policy
- Exhibit 5d. Clearing Fund Methodology Policy
- Exhibit 5e. Recovery and Orderly Wind-Down Plan

**CONFIDENTIAL TREATMENT IS REQUESTED FOR EXHIBITS  
3, 5b, 5c, 5d, and 5e PURSUANT TO SEC RULE 24b-2**

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<sup>47</sup> 12 U.S.C. 5464(b).

<sup>48</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>49</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>50</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>51</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>52</sup> 17 CFR 240.17Ad-22(e)(23).

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

**THE OPTIONS CLEARING CORPORATION**

**By:** \_\_\_\_\_  
Mark C. Brown  
Assistant General Counsel

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-[\_\_\_\_\_]; File No. SR-OCC-2021-801)

[February \_\_ ], 2021

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Relating to OCC's Establishment of Persistent Minimum Skin-In-The-Game

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")<sup>1</sup> and Rule 19b-4(n)(1)(i)<sup>2</sup> of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>3</sup> notice is hereby given that on February 10, 2021, The Options Clearing Corporation ("OCC" or "Corporation") filed with the Securities and Exchange Commission ("SEC" or "Commission") an advance notice as described in Items I, II and III below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is submitted in connection with proposed changes that would amend OCC's Rules, Capital Management Policy, and certain other OCC policies to establish a persistent minimum level of OCC's own pre-funded financial resources (commonly referred to as "skin-in-the-game") that OCC would contribute to cover

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<sup>1</sup> 12 U.S.C. 5465(e)(1).

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> 15 U.S.C. 78a et seq.

default losses or liquidity shortfalls. Amendments to OCC's Rules are included in Exhibit 5a of filing SR-OCC-2021-801. Amendments to OCC's Capital Management Policy are included in confidential Exhibit 5b of filing SR-OCC-2021-801. OCC would also make conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and Recovery and Orderly Wind-Down Plan ("RWD Plan"), which can be found in confidential Exhibits 5c, 5d, and 5e of filing SR-OCC-2021-801, respectively, to reflect the amended default waterfall (i.e., the financial resources OCC would use to address default losses and liquidity shortfalls, listed in the order OCC would utilize them). Material proposed to be added is marked by underlining, and material proposed to be deleted is marked with strikethrough text. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>4</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections A and B below, of the most significant aspects of these statements.

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<sup>4</sup> OCC's By-Laws and Rules can be found on OCC's public website: <https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules>.

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments were not and are not intended to be solicited with respect to the advance notice and none have been received. OCC will notify the Commission of any written comments received by OCC.

B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing, and Settlement Supervision Act

**Description of the Proposed Change**

OCC is proposing to amend OCC's Rules, Capital Management Policy, and certain other policies to establish a persistent minimum level of skin-in-the-game that OCC would contribute to cover default losses or liquidity shortfalls, which would consist of a minimum amount of OCC's own pre-funded resources that OCC would charge prior to charging a loss to the Clearing Fund (as defined below, the "Minimum Corporate Contribution") and, as OCC's Rules currently provide, applicable funds held in trust in respect to OCC's Executive Deferred Compensation Plan ("EDCP") (such funds, as defined in OCC's Rules, being the "EDCP Unvested Balance") that would be charged pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. The persistent minimum level of skin-in-the-game would establish a floor for the pre-funded resources OCC would contribute to cover default losses and liquidity shortfalls. In addition to this minimum, OCC would continue to commit its liquid net assets funded by equity ("LNAFBE")<sup>5</sup> greater than 110% of its Target Capital Requirement prior to charging a loss to the Clearing Fund.

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<sup>5</sup> International standards and the Commission's Rules established minimum LNAFBE requirements for financial market infrastructures and covered clearing agencies, respectively. See CPSS-IOSCO, Principles for financial market

## Background

In January 2020, OCC implemented its Capital Management Policy, by which OCC (a) determines the amount of Equity<sup>6</sup> sufficient for OCC to meet its regulatory obligations and to serve market participants and the public interest (as defined in OCC's Rules, the "Target Capital Requirement"), (b) monitors Equity and LNAFBE levels to help ensure adequate financial resources are available to meet general business obligations; and (c) manages Equity levels, including by (i) adjusting OCC's fee schedule (as appropriate) and (ii) establishing a plan for accessing additional capital should OCC's Equity fall below certain thresholds (the "Replenishment Plan").<sup>7</sup> In addition, OCC's Rules, the Capital Management Policy, and associated policies provide for the use of OCC's current and retained earnings in excess of 110% of the Target Capital Requirement (*i.e.*, the "Early Warning" threshold under OCC's Replenishment Plan) to cover losses arising from a Clearing Member's default.<sup>8</sup> While OCC's Rules previously provided for OCC to contribute its own capital to cover default losses at the Board's

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infrastructures, at Principle 15 (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>; 17 CFR 240.17Ad-22(e)(15). The Capital Management Policy defines "LNAFBE" as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments (*i.e.*, agency-related liabilities such as Section 31 fees held by OCC).

<sup>6</sup> The Capital Management Policy defines "Equity" as shareholders' equity as shown on OCC's Statement of Financial Condition.

<sup>7</sup> See Exchange Act Release No. 88029 (Jan. 24, 2020), 85 FR 5500 (Jan. 30, 2020) (File No. SR-OCC-2019-007) (hereinafter, "Order Approving Capital Management Policy").

<sup>8</sup> *Id.* at 5502.

discretion, the Capital Management Policy changes made the contribution of such excess capital obligatory.<sup>9</sup>

In the event of a Clearing Member default, OCC would contribute excess capital to cover losses remaining after applying the margin assets and Clearing Fund contribution of the defaulting Clearing Member and before charging the Clearing Fund contributions of non-defaulting Clearing Members. Should OCC's excess capital be insufficient to cover the loss, OCC also has another tranche of OCC resources in addition to the Clearing Fund; namely, the EDCP Unvested Balance.<sup>10</sup> In the event of a default loss, the EDCP Unvested Balance is contributed pari passu with the Clearing Fund contributions of non-defaulting Clearing Members.

The implementation of OCC's Capital Management Policy marked the first time OCC committed OCC's own pre-funded financial resources into OCC's approach to capital management and resiliency. In particular, OCC believes that the inclusion of the EDCP Unvested Balance is a powerful alignment of interest between management and Clearing Members. OCC takes seriously the interest of the industry and international regulators in seeing more significant skin-in-the-game commitments at central counterparties.

To that end, OCC has reviewed feedback received in connection with the initial filing of the Capital Management Plan, relevant papers from industry participants and

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<sup>9</sup> Use of excess capital to cover losses arising from the default of a bank or other clearing agency that is not otherwise associated with a Clearing Member default remains at the Board's discretion. See Rule 1006(e)(ii).

<sup>10</sup> As defined in OCC's Rules, the EDCP Unvested Balance consists of funds (x) deposited on or after January 1, 2020 in respect of its EDCP and (y) in excess of amounts necessary to pay for benefits accrued and vested under the EDCP at such time.

stakeholders concerning skin-in-the-game, and regulatory regimes in jurisdictions outside the United States. For one, a comment submitted in connection with the Capital Management Policy’s filing urged OCC to implement a “minimum amount of skin-in-the-game that ‘scales with risk and is defined and funded upfront’ and . . . ‘to define a level of [skin-in-the-game] ex ante that would always be readily available in case of a default loss.’”<sup>11</sup> OCC has also reviewed the paper, “A Path Forward for CCP Resilience, Recover, and Resolution,” originally released in October 2019 with nine signatories and re-released in March of 2020 with ten additional signatories, representing major buy-side and sell-side firms in the markets OCC serves.<sup>12</sup> One of the paper’s significant recommendations is that central counterparties should have skin-in-the-game in a more defined manner.<sup>13</sup> In contrast, OCC’s current variable approach to skin-in-the-game does not guarantee a defined amount would be available as skin-in-the-game. Additionally, as OCC seeks recognition in the European Union and the United Kingdom, OCC is cognizant of the European Market Infrastructure Regulation’s (“EMIR”) expectation that skin-in-the-game be a minimum of 25% of the central counterparty’s regulatory capital

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<sup>11</sup> Order Approving Capital Management Policy, 85 FR at 5507 (quoting comments submitted by FIA).

<sup>12</sup> See ABN AMRO Clearing Bank N.V., et al., A Path Forward for CCP Resilience, Recovery, and Resolution (March 10, 2020), available at <https://www.jpmorgan.com/solutions/cib/markets/a-path-forward-for-ccp-resilience-recovery-and-resolution>.

<sup>13</sup> While OCC agrees with the paper’s authors that central counterparties should have meaningful skin-in-the-game, OCC does not agree with the level of skin-in-the-game recommended in the paper. See Optimizing Incentives, Resilience and Stability in Central Counterparty Clearing: Perspectives on CCP Issues from a Utility Model Clearinghouse (September 22, 2020), available at <https://www.theocc.com/Newsroom/Insights/2020/09-22-Optimizing-Incentives,-Resilience-and-Stabil>.

requirement.<sup>14</sup> Under the current Capital Management Policy, excess capital is not dedicated solely as skin-in-the-game and it is possible that OCC's capital in excess of 110% of its Target Capital Requirement would be less than 25% of OCC's Target Capital Requirement.

To address the concerns raised by these market participants, further strengthen OCC's pre-funded financial resources, further align the interests of OCC's management and Clearing Members, and align OCC's skin-in-the-game with international standards, OCC is filing an advance notice, which would establish a persistent minimum amount of skin-in-the-game that would be used to cover default losses and liquidity shortfalls. This skin-in-the-game proposal is part of a broader set of decisions announced by OCC to lower the cost of clearing for its members,<sup>15</sup> including a fee decrease effective September

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<sup>14</sup> Though OCC, as a non-EU central counterparty, would not be subject directly to the EMIR standards or the supervision of the European Securities and Markets Authority ("ESMA"), OCC has considered the EMIR standards as part of its bid to seek third-country recognition in Europe and the United Kingdom. OCC is seeking recognition to address European bank capital requirements set to go into effect next year that would require European banks to set aside additional capital for exposure to central counterparties that are not "qualified CCPs" in Europe. In order to become a qualified CCP, ESMA and the regulatory authority in a non-EU jurisdiction must reach an agreement that their regulatory regimes for central counterparties are equivalent. As of the date of this filing, the Commodity Futures Trading Commission ("CFTC") has reached an agreement with ESMA on the equivalence of their regulatory regimes.

<sup>15</sup> OCC announced these decisions in a press release and letter to Clearing Members. See Press Release, OCC To Lower Costs for Users of U.S. Equity Derivatives Markets (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Press-Releases/2020/08-03-OCC-To-Lower-Costs-for-Users-of-US-Equity-De>; "Letter to Clearing Member Firms – OCC to Lower Costs for Users of U.S. Equity Derivative Markets" (Aug. 3, 2020), available at <https://www.theocc.com/Newsroom/Views/2020/08-03-Letter-to-Clearing-Member-Firms>.

1, 2020.<sup>16</sup> OCC also discussed these changes on calls with OCC's Non-Equity Exchanges, Clearing Members, and other market participants, including discussions with the SIFMA Options Committee and FIA and open calls with OCC Clearing Members. Members expressed that the proposed addition of a minimum level of skin-in-the-game would be a welcome enhancement by OCC. One market participant expressed its appreciation for OCC's commitment to resiliency, but renewed concerns it had raised in connection with OCC's Capital Management Policy about increases in OCC's capital and, if OCC were sold, a more commercial orientation monetized with higher fees. As OCC stated with respect to the establishment of the Capital Management Policy,<sup>17</sup> OCC believes that this view is well outside the scope of the Capital Management Policy and this advance notice, but will continue to engage with Clearing Members and other market participants to address any concerns. While questions were raised in these conversations, no specific suggestions were made.

### **Proposed Changes**

In order to establish a persistent minimum amount of skin-in-the-game, OCC is proposing to: (a) amend OCC's Rules to define the Minimum Corporate Contribution, insert the Minimum Corporate Contribution in OCC's default waterfall as provided in Rule 1006, provide for how OCC would calculate any LNAFBE greater than 110% of its Target Capital Requirement OCC would contribute in addition to the Minimum Corporate Contribution, and provide a time by which OCC would reestablish the

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<sup>16</sup> See Exchange Act Release No. 89534 (Aug. 12, 2020), 85 FR 50858 (Aug. 18, 2020) (File No. SR-OCC-2020-009).

<sup>17</sup> See Exhibit 3g to File No. SR-OCC-2019-007.

Minimum Corporate Contribution if and when OCC uses it to cover default losses; (b) amend the Capital Management Policy to exclude the Minimum Corporate Contribution from OCC's measurement of its LNAFBE against its Target Capital Requirement and from OCC's calculation of the Early Warning and Trigger Event, to ensure that OCC may maintain the Minimum Corporate Contribution exclusively for default losses while retaining access to replenishment capital in the event OCC suffers an operational loss that reduces its Equity below those thresholds; and (c) apply conforming changes to the Default Management Policy, Clearing Fund Methodology Policy, and the RWD Plan to reflect that in the event of a default loss or liquidity shortfall, the Minimum Corporate Contribution would be charged after contributing the margin and Clearing Fund deposit of a default member and before the contribution of OCC's LNAFBE in excess of 110% of OCC's Target Capital Requirement, both before OCC charges the Clearing Fund deposits of non-default Clearing Members and the EDCP Unvested Balance on a pro rata basis.

(a) Amendments to OCC's Rules

To establish and maintain a persistent minimum level of skin-in-the-game, OCC proposes to amend its Rules to (1) define the Minimum Corporate Contribution; (2) revise OCC's default waterfall to more clearly define the skin-in-the-game resources OCC would contribute to a default loss; (3) provide for how OCC would calculate any LNAFBE greater than 110% of the Target Capital Requirement it would contribute after exhausting the Minimum Corporate Contribution; and (4) provide for how OCC would replenish the Minimum Corporate Contribution after each chargeable default loss.

(1) *Defining the Minimum Corporate Contribution*

OCC would establish a persistent minimum level of skin-in-the-game by first amending OCC's Rules to define the Minimum Corporate Contribution in Chapter I of the Rules to mean the minimum level of OCC's own funds maintained exclusively to cover credit losses or liquidity shortfalls, the level of which OCC's Board shall determine from time to time. As OCC's own funds, OCC would hold the Minimum Corporate Contribution in accordance with OCC's By-Laws governing the investment of OCC's funds<sup>18</sup> and OCC's policies and procedures governing cash and investment management. Specifically, OCC maintains uninvested OCC cash in demand deposits and any investments of funds maintained to satisfy the Minimum Corporate Contribution would be limited to overnight reverse repurchase agreements involving U.S. Government Treasury Securities, consistent with OCC's same-day liquidity needs for such funds.

While the proposed definition would give OCC's Board discretion in setting the Minimum Corporate Contribution, the Board has approved an initial Minimum Corporate Contribution that sets OCC's total persistent skin-in-the-game (i.e., the sum of the Minimum Corporate Contribution and OCC's current EDCP Unvested Balance) at 25% of OCC's Target Capital Requirement. In setting the initial Minimum Corporate Contribution, OCC's Board considered factors including, but not limited to, the regulatory requirements in each jurisdiction in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to address participant defaults, the EDCP Unvested

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<sup>18</sup> See OCC By-Laws Art. IX, Sec. 1.

Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses, and other projected capital needs.

(2) *Revising OCC's Default Waterfall*

OCC would also amend OCC Rule 1006 to insert the Minimum Corporate Contribution in OCC's default waterfall after contributing a defaulting Clearing Member's margin and Clearing Fund deposit, and before contributing OCC's LNAFBE greater than 110% of OCC's Target Capital Requirement, both of which OCC would exhaust before charging a loss to the Clearing Fund and the EDCP Unvested Balance, pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. So placed, OCC believes that the Minimum Corporate Contribution would demonstrate OCC's institutional commitment to its ongoing financial surveillance of clearing members and the establishment and maintenance of a prudent and effective margin methodology. A draw against the Minimum Corporate Contribution and the associated requirement to replenish, as discussed below, would provide fewer resources to meet other corporate commitments. Accordingly, the proposal would further align OCC's and its management's interests with those of non-defaulting Clearing Members.

OCC would also remove references to "retained earnings" or "current or retained earnings" in OCC Rule 1006(b), Rule 1006(e)(i), Rule 1006(e)(ii), and the second sentence of Rule 1006(e)(iii), and replace them with references to the contribution of the "Minimum Corporate Contribution" and "the Corporation's liquid net assets funded by equity that are greater than 110% of its Target Capital Requirement." The references to "retained earnings" or "current or retained earnings" are legacy terms used prior to

OCC's implementation of the Capital Management Policy.<sup>19</sup> OCC is proposing to replace these references in OCC's Rules to better identify the funds OCC's would contribute in terms that align with OCC's Capital Management Policy.

(3) *Calculating LNAFBE Available as Skin-In-The-Game*

Because OCC proposes to replace references to "current or retained earnings," OCC would also delete the first sentence of Rule 1006(e)(iii), which currently provides for how OCC determines its "current earnings" for purposes of the amount available to cover losses under Rule 1006(e)(i) and Rule 1006(e)(ii). In its place, the first sentence of Rule 1006(e)(iii) would set out how OCC would determine its LNAFBE for purposes of contributing LNAFBE greater than 110% of the Target Capital Requirement to cover default losses and liquidity shortfalls. Specifically, similar to how the Rules currently provide for the calculation of "current earnings," OCC would determine its LNAFBE based on OCC's unaudited financial statements at the close of the calendar month immediately preceding the occurrence of the loss or deficiency under paragraphs (e)(i) or (e)(ii), less an amount equal to the aggregate of all refunds made or authorized to be made or deemed to have been made during the fiscal year in which such loss or deficiency occurs if the refund is not reflected on such unaudited financial statements. Accordingly, OCC would retain the priority given to the payment of refunds that OCC has declared, but not yet issued, as currently provided by OCC Rule 1106(e)(iii), when

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<sup>19</sup> OCC first established discretionary use of OCC's current or retained earnings to cover default losses in Article VIII (Clearing Fund) of OCC's By-Laws. See Exchange Act Release No. 15493 (Jan. 4, 1979), 44 FR 3802 (Jan. 18, 1979) (File No. SR-OCC-79-01). When OCC moved the provisions governing the Clearing Fund from OCC's By-Laws to the Rules in 2018, the provisions governing the usage of the Clearing Fund became Rule 1006(e). See Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (Aug. 2, 2018) (File No. SR-OCC-2018-008).

calculating the amount of LNAFBE available to cover a default loss after contributing the Minimum Corporate Contribution.

OCC would further amend Rule 1006(e)(iii) to provide that in no event shall OCC be required to contribute an amount that would cause OCC's LNAFBE to fall below 110% of the Target Capital Requirement at the time changed. The Capital Management Policy, in accordance with SEC Rule 17Ad-22(e)(15)(ii)(A),<sup>20</sup> currently requires that the funds OCC maintains to satisfy its Target Capital Requirement be separate from OCC's resources to cover participant defaults and liquidity shortfalls. Accordingly, should a default occur in a month during which OCC suffers an operational loss that decreases the value of its excess capital available as skin-in-the-game below what is reflected on the unaudited financial statement at the close of the previous month,<sup>21</sup> OCC would be able to take into account the decrease in its excess capital when calculating its available LNAFBE above 110% of the Target Capital Requirement. In addition, OCC would renumber as Rule 1006(e)(iv) the last sentence of Rule 1006(e)(iii). That sentence, which concerns a defaulting Clearing Member's continuing obligation for losses OCC charges to OCC's own capital, is conceptually distinct from the rest of Rule 1006(e)(iii) and, accordingly, deserves to be addressed separately.

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<sup>20</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>21</sup> Under OCC's current rules, LNAFBE greater than 110% of the Target Capital Requirement and the EDCP Unvested Balance are committed to cover both operational losses and default losses. In the event OCC experiences operational losses and default losses in short succession, OCC would contribute these resources in the manner specified by OCC's Rules to the event that occurred first.

(4) *Replenishing the Minimum Corporate Contribution*

Finally, OCC would add a new paragraph to Rule 1006(e)—Rule 1006(e)(v)—to provide for a 270 calendar-day period during which the Minimum Corporate Contribution, once charged, would be reduced to the remaining unused portion. OCC believes that 270 calendar days, or approximately nine months, is sufficient time for OCC to accumulate the funds necessary to reestablish the Minimum Corporate Contribution. In making this determination, OCC used the same analysis employed to set the Early Warning and Trigger Event under its Replenishment Plan, both of which are based on the time OCC estimates it would take to accumulate 10% of its Target Capital Requirement.<sup>22</sup> Specifically, OCC took into account its typical monthly earnings and the amount of earnings that would be needed to replenish the Minimum Corporate Contribution on an after-tax basis. Proposed Rule 1006(e)(v) would also provide that OCC shall notify Clearing Members of any such reduction to the Minimum Corporate Contribution.

Each chargeable loss would trigger a new 270-day period. As such, proposed Rule 1006(e)(v) is designed to allow OCC to manage multiple defaults within a 270-day period by eliminating the risk that a successive default would exhaust the resources needed to reestablish the Minimum Corporate Contribution by the end of the initial 270-day period. And while a successive default loss that does not impact excess LNAFBE<sup>23</sup>

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<sup>22</sup> See Order Approving Capital Management Policy, 85 FR at 5510-11. OCC has included this analysis as part of confidential Exhibit 3 to File No. SR-OCC-2021-801.

<sup>23</sup> As described below, OCC is proposing to amend the Capital Management Policy to exclude the Minimum Corporate Contribution from the definition of LNAFBE. As a result, a second default loss covered exclusively by the Minimum Corporate Contribution would not impact OCC's level of LNAFBE.

available to replenish the Minimum Corporation Contribution would nevertheless trigger another 270-day period during which the Minimum Corporate Contribution would be reduced to the remaining unused portion after the first two defaults, any LNAFBE greater than 110% of the Target Capital Requirement would continue to be available to cover successive default losses. In the very unlikely event that OCC experiences an operational loss or a drop in revenue from clearing fees that threatens its ability to reestablish the Minimum Corporate Contribution at the end of the 270-day period, OCC would likely file a rule change to extend the period rather than act to lower the Minimum Corporate Contribution, dependent on the Board's consideration of the same non-exclusive list of factors that the Board would consider when determining whether to adjust the Minimum Corporate Contribution, discussed below.

(b) Amendments to the Capital Management Policy

Consistent with the proposed changes to OCC's Rules, OCC would amend the portions of the Capital Management Policy that concern OCC's usage of excess capital to cover default losses to more specifically identify the resources OCC would contribute to default losses; namely, the Minimum Corporate Contribution and LNAFBE above 110% of the Target Capital Requirement. OCC would clarify that after exhausting the Minimum Corporate Contribution, OCC would continue to offset default losses with LNAFBE, rather than "Equity," above 110% of the Target Capital requirement. This change is not intended to change OCC's current obligations. Rather, OCC intends to conform the Capital Management Policy so that the terms are consistent with those used in the proposed Rules, other requirements in the Capital Management Policy, and OCC's regulatory obligations. Specifically, the Capital Management Policy provides that the

resources held to meet the Target Capital Requirement must be liquid assets separate from OCC's resources to cover participant defaults and liquidity shortfalls, consistent with SEC Rule 17Ad-22(e)(15)(ii)(A).<sup>24</sup> Because Equity typically exceeds LNAFBE and because any funds OCC would contribute to cover a default loss would need to be liquid assets, contributing liquid assets in excess of LNAFBE greater than 110% of the Target Capital Requirement would be inconsistent with the Capital Management Policy.

In addition, OCC would amend the Capital Management Policy's list of capital management actions with a material impact on current or future levels of Equity, replacing "use of current and retained earnings greater than 100% of the Target Capital Requirement" with "use of excess capital," to align with the title of the Capital Management Policy's "Excess Capital Usage" section. That section would also be updated to include a discussion of the factors that the Board would consider in establishing and adjusting the Minimum Corporate Contribution. Factors the Board would consider include, but are not limited to, the regulatory requirements in each jurisdiction in which OCC is registered or in which OCC is actively seeking recognition, the amount similarly situated central counterparties commit of their own resources to address participant defaults, the current and projected level of the EDCP Unvested Balance, OCC's LNAFBE greater than 110% of its Target Capital Requirement, projected revenue and expenses, and other projected capital needs. While the Capital Management Policy would provide that the Board would review Minimum Corporate Contribution annually, the Board would retain authority to change the Minimum Corporate at its discretion. In addition, the Capital Management Policy would be updated

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<sup>24</sup> See 17 CFR 240.17Ad-22(e)(15)(ii)(A).

to include the substance of and references to proposed Rule 1006(e)(v), which, as discussed above, provides for a 270-day period following a chargeable loss during which the Minimum Corporate Contribution is reduced to its remaining unused portion.

OCC would also amend the definition of LNAFBE in the Capital Management Policy to specifically exclude the Minimum Corporate Contribution, which would be dedicated to cover default losses. The Capital Management Policy defines LNAFBE as the level of cash and cash equivalents, no greater than Equity, less any approved adjustments. The definition currently specifies the exclusion of “agency-related liabilities, such as Section 31 fees” as the only approved adjustment. OCC would amend the definition to add the Minimum Corporate Contribution as another example of an approved exemption to the calculation of LNAFBE. As discussed in more detail in the discussion of the statutory basis for these proposed changes below, this proposed amendment to the definition of LNAFBE is intended to ensure that OCC does not double count resources committed to cover default losses as resources available to satisfy regulatory requirements concerning the amount of LNAFBE or other financial resources OCC must maintain to cover operational costs and potential business losses. For similar reasons, OCC would amend the Capital Management Policy’s discussion of OCC’s Replenishment Plan to add that in the event of an operational loss, OCC shall first use Equity, “less the Minimum Corporate Contribution,” above 110% of Target Capital. This amendment reflects that the funds maintained for the Minimum Corporate Contribution are not funds available to cover operational losses.

With respect to OCC’s Replenishment Plan, OCC would also amend the definitions of the Early Warning and Trigger Event to exclude the Minimum Corporate

Contribution from the calculation of those thresholds so that OCC maintains access to replenishment capital in the event operational losses materialize while still maintaining the Minimum Corporate Contribution exclusively to cover default losses. As described above, the Early Warning and Trigger Event are the thresholds for actions under OCC's Replenishment Plan. Currently, the Early Warning and Trigger Event thresholds are defined with respect to OCC's Equity falling below certain thresholds. OCC is proposing to amend those definitions so that the Early Warning and Trigger Event occur when Equity "less the Minimum Corporate Contribution" falls below those same thresholds. These changes would ensure that OCC may maintain the Minimum Corporate Contribution exclusively to address default losses—the effect of which would be to increase Equity relative to LNAFBE—while still maintaining access to its Replenishment Plan should OCC's Equity, less the Minimum Corporate Contribution, fall close to or below the Target Capital Requirement.

(c) Amendments to the Default Management Policy, Clearing Fund Methodology Policy, and RWD Plan

To accommodate the proposed establishment of the Minimum Corporate Contribution, OCC proposes conforming changes to other rule-filed policies that describe OCC's default waterfall, as set forth in OCC Rule 1006. In the Default Management Policy, OCC would delete the passage concerning "Current and Retained Earnings" in the current discussion of OCC's default waterfall and replace it with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, as provided in the proposed amendments to Rule 1006 above. OCC would also amend the Default Management Policy's definition of "financial resources" to include the Minimum Corporate Contribution as among those available to address

Clearing Member defaults and suspensions. In the Clearing Fund Methodology Policy, OCC would similarly revise the discussion of the default waterfall in that policy's section covering Clearing Fund charges and assessments to incorporate the Minimum Corporate Contribution, consistent with the proposed amendments to Rule 1006 above. OCC would also amend the Clearing Fund Methodology Policy's definitions of OCC's "Pre-Funded Financial Resources" for the purposes of sizing or measuring the sufficiency of the Clearing Fund to include the Minimum Corporate Contribution. Finally, OCC would amend the RWD Plan to replace all references to "current or retained earnings" with the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement, or "skin-in-the-game" for short, modify certain example scenarios concerning use of OCC's Enhanced Risk Management and Recovery Tools to account for the proposed Minimum Corporate Contribution, and make certain other conforming changes concerning use of skin-in-the-game to address liquidity shortfalls and, in the case of LNAFBE greater than 110% of the Target Capital Requirement, OCC's authority to use skin-in-the-game to address losses resulting from bank or securities or commodities clearing organization failures, including custody or investment losses.

#### **Anticipated Effect on and Management of Risk**

OCC believes that the proposed changes would reduce the nature and level of risk presented by OCC because they would enhance the overall resilience of OCC's capital management and default management processes. Establishing a Minimum Corporate Contribution, which OCC would apply after a defaulting Clearing Member's margin and Clearing Fund deposits, would ensure a minimum level of OCC's own pre-funded financial resources available to cover credit losses. By applying the Minimum Corporate

Contribution before charging the Clearing Fund, the proposed change helps protect non-defaulting Clearing Members from default losses of another Clearing Member, which in turn helps reduce OCC's overall level of risk and ensure the prompt and accurate clearance and settlement of its cleared products. In addition, the proposed changes to OCC's Rules, Capital Management Policy and other rule-filed policies intended to account for the use of OCC's Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement would help ensure that OCC continues to hold LNAFBE sufficient to meet its regulatory obligations and maintain access to its Replenishment Plan in the event that an operational loss causes Equity, less the Minimum Corporate Contribution reserved for default losses, to fall close to or below regulatory requirements. Together these features of the Capital Management Policy help ensure that OCC maintains levels of capital sufficient to allow it to absorb substantial business losses and meet its responsibilities as a systemically important financial market utility, which in turn helps reduce OCC's overall level of risk.

#### **Consistency with the Clearing Supervision Act**

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.<sup>25</sup> Section 805(a)(2) of the Clearing Supervision Act<sup>26</sup> also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities

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<sup>25</sup> 12 U.S.C. 5461(b).

<sup>26</sup> 12 U.S.C. 5464(a)(2).

of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act<sup>27</sup> states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Exchange Act in furtherance of these objectives and principles.<sup>28</sup> Rule 17Ad-22 requires registered clearing agencies, like OCC, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.<sup>29</sup> Therefore, the Commission has stated<sup>30</sup> that it believes it is appropriate to review changes proposed in advance notices against Rule 17Ad-22 and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.<sup>31</sup>

OCC believes the proposed changes are consistent with the objectives and principles of Section 805(b) of the Clearing Supervision Act.<sup>32</sup> The proposed changes

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<sup>27</sup> 12 U.S.C. 5464(b).

<sup>28</sup> 17 CFR 240.17Ad-22. See Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”).

<sup>29</sup> 17 CFR 240.17Ad-22.

<sup>30</sup> See, e.g., Exchange Act Release No. 86182 (June 24, 2019), 84 FR 31128, 31129 (June 28, 2019) (SR-OCC-2019-803).

<sup>31</sup> 12 U.S.C. 5464(b).

<sup>32</sup> Id.

are generally designed to enhance OCC's resiliency by establishing a Minimum Corporate Contribution that would be used to absorb losses or liquidity shortfalls arising from the default of a Clearing Member. While OCC's current rules commit OCC to contribute a contingent amount of capital to address default losses or liquidity shortfalls, the proposed changes would commit to a minimum amount, subject to a replenishment period if OCC charges a loss to the Minimum Corporate Contribution. Ensuring a minimum amount of skin-in-the-game would reduce the amount OCC may need to charge the Clearing Fund deposits of non-defaulting Clearing Member. In this way, OCC believes that the proposed establishment of the Minimum Corporate Contribution and attendant changes would improve OCC's resilience as a systemically important market utility by promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system.

OCC also believes that the proposed changes are consistent with the risk management standards adopted by the Commission under Section 805(a)(2) of the Clearing Supervision Act;<sup>33</sup> specifically, Rules 17Ad-22(e)(4),<sup>34</sup> 17Ad-22(e)(15)(ii)(A),<sup>35</sup> 17Ad-22(e)(15)(iii),<sup>36</sup> Rules 17Ad-22(e)(2)(i),<sup>37</sup> and 17Ad-22(e)(23)<sup>38</sup> thereunder for the reasons described below.

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<sup>33</sup> 12 U.S.C. 5464(a)(2).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(4).

<sup>35</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>36</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>37</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>38</sup> 17 CFR 240.17Ad-22(e)(23).

Rule 17Ad-22(e)(4) under the Exchange Act provides, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor and manage its credit exposures to participants and those arising from its payment, clearing and settlement processes, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.<sup>39</sup> By providing that OCC shall maintain a minimum level of skin-in-the-game—in addition to OCC’s LNAFBE greater than 110% of its Target Capital Requirement, contributed prior to charging the Clearing Fund, as OCC’s Rules currently provide—OCC is providing for a minimum level of pre-funded financial resources available to cover losses in the event of a Clearing Member default, and reducing the amount OCC would charge the Clearing Fund contributions of non-defaulting Clearing Members. Therefore, OCC believes the amendments to its Rules, the Capital Management Policy, and other related policies to establish the Minimum Corporate Contribution are consistent with Rule 17Ad-22(e)(4).

OCC also believes that the proposed changes to the definition of LNAFBE in OCC’s Capital Management Policy, which exclude the Minimum Corporate Contribution from the calculation of LNAFBE, are consistent with Rule 17Ad-22(e)(15)(ii)(A) under the Exchange Act.<sup>40</sup> Rule 17Ad-22(e)(15)(ii)(A) requires that the LNAFBE held by OCC to satisfy the minimum LNAFBE required by Rule 17Ad-22(e)(15)(ii)<sup>41</sup> shall be in

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<sup>39</sup> 17 CFR 240.17Ad-22(e)(4)(i).

<sup>40</sup> 17 CFR 240.17Ad-22(e)(15)(ii)(A).

<sup>41</sup> Rule 17Ad-22(e)(15)(ii), in turn, requires that OCC hold LNAFBE to the greater of (x) six months of OCC’s current operating expenses, or (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services. 17 CFR 240.17Ad-22(e)(15)(ii). OCC’s

addition to resources held to cover participant defaults or other credit or liquidity risks.<sup>42</sup> The proposed revision to OCC's definition of LNAFBE is designed to satisfy Rule 17Ad-22(e)(15)(ii)(A) by providing that the proposed Minimum Corporate Contribution, which would be held exclusively to cover participant defaults and liquidity shortfalls, would be in addition to the LNAFBE that OCC holds to meet or exceed its regulatory capital requirements under Rule 17Ad-22(e)(15)(ii)—i.e., LNAFBE in an amount equal to 110% of OCC's Target Capital Requirement. In addition, the proposed revisions to OCC Rule 1006(e)(iii) and the Capital Management Policy—which would specify that OCC's committed skin-in-the-game shall include the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirements—are reasonably designed to ensure that OCC would not be obligated to contribute an amount of skin-in-the-game that would cause its LNAFBE to fall below the Early Warning threshold

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Capital Management Policy is reasonably designed to meet this requirement, and Rule 17Ad-22(e)(15) more broadly, by providing that OCC sets its Target Capital Requirement at a level sufficient to maintain LNAFBE at least equal to the greater of: (x) six months of OCC's current operating expenses, (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly winddown of critical operations and services, and (z) the amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize. See Order Approving Capital Management Policy, 85 FR at 5501-02. In addition, in setting the Target Capital Requirement, OCC's Board considers OCC's projected rolling twelve-months' operating expenses to ensure that OCC maintains Equity and other financial resources approved by the CFTC, as required by CFTC Rule 39.11(a)(2). See id. at 5501 n.19 (citing 17 CFR 39.11(a)(2)).

<sup>42</sup> Id. Similarly, CFTC Rule 39.11(b)(3) provides that a derivatives clearing organization ("DCO") may allocate financial resources to satisfy requirements that the DCO possess financial resources (i) to enable the DCO to meet obligations notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions, and (ii) to enable the DCO to cover its operational costs, but not both. See 17 CFR 39.11(b)(3).

intended to ensure OCC maintains sufficient LNAFBE to meet its regulatory obligations. As a result, OCC believes the proposed amendments to the Capital Management Policy are designed to comply with Rule 17Ad-22(e)(15)(ii)(A).

In addition, OCC believes that the proposed amendments to OCC's definition of the Early Warning and Trigger Event thresholds under OCC's Replenishment Plan are consistent with Rule 17Ad-22(e)(15)(iii)<sup>43</sup> because excluding the Minimum Corporate Contribution from those thresholds would ensure that OCC may continue to access replenishment capital in the unlikely event that OCC experiences an operational loss while continuing to maintain the Minimum Corporate Contribution exclusively to cover default losses. Rule 17Ad-22(e)(15)(iii) requires, in part, that OCC establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage OCC's general business risk, including by maintaining a viable plan for raising additional Equity should its Equity fall close to or below the amount required under Rule 17Ad-22(e)(15)(ii).<sup>44</sup> By setting the threshold triggers by reference to the Target Capital Requirement, OCC's Replenishment Plan is designed to require OCC to act to raise capital should its Equity fall close to or below the amounts required under Rule 17Ad-22(e)(15)(ii). However, the effect of holding the Minimum Corporate Contribution would be to increase OCC's Equity relative to LNAFBE available to cover potential operational losses. To help ensure that OCC holds LNAFBE above its Target Capital Requirement and maintains access to replenishment capital, the proposed change

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<sup>43</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>44</sup> Id. As discussed in note 41, supra, OCC's Target Capital Requirement is reasonably designed to meet or exceed the minimum LNAFBE required to satisfy Rule 17Ad-22(e)(15)(ii).

would exclude the Minimum Corporate Contribution when measuring OCC's Equity against the Early Warning and Trigger Event thresholds under its Replenishment Plan. Accordingly, OCC believes that the proposed amendments to the definitions of the Early Warning and Trigger Event thresholds are consistent with Rule 17Ad-22(e)(15)(iii).

OCC also believe that the proposed changes are consistent with Rule 17Ad-22(e)(2)(i), which requires that covered clearing agencies maintain written policies and procedures reasonably designed to provide for governance arrangements that are clear and transparent.<sup>45</sup> The proposed changes would align the terminology used in OCC's Rules and other rule-filed policies with the terminology of the Capital Management Policy, providing better clarity and consistency between OCC's governing documents. Specifically, OCC would amend its Rules, Capital Management Policy, Default Management Policy, Clearing Fund Methodology Policy and RWD Plan to identify OCC's sources of skin-in-the-game (the Minimum Corporation Contribution, LNAFBE greater than 110% of the Target Capital Requirement, and the EDCP Unvested Balance) and their places within OCC's default waterfall. The proposed amendments to the Capital Management Policy would also identify factors the Board would consider in setting and adjusting the Minimum Corporate Contribution. Accordingly, OCC believes conforming the terms in these governance arrangements and identifying factors OCC would consider in adjusting the Minimum Corporate Contribution is consistent with Rule 17Ad-22(e)(2)(i).

Finally, OCC believe that the proposed changes are consistent with Rule 17Ad-22(e)(23), which requires covered clearing agencies to maintain written policies and

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<sup>45</sup> 17 CFR 240.17Ad-22(e)(2)(i).

procedures reasonably designed to, among other things, provide for publicly disclosing all relevant rules and material procedures, including key aspects of its default rules and procedures.<sup>46</sup> The proposed changes would amend OCC's Rules to remove the pre-Capital Management Policy references to use of "retained earnings" or "current and retained earnings" with respect to the sources of OCC's skin-in-the-game, and instead identify the Minimum Corporate Contribution and LNAFBE greater than 110% of the Target Capital Requirement. The proposed changes would also provide greater clarity about how OCC calculates the amount of LNAFBE greater than 110% of the Target Capital Requirement based upon the unaudited financial statements from the close of the prior month; provided, however, that OCC would not be required to contribute an amount that would cause its LNAFBE to fall below 110% of the Target Capital Requirement at the time charged. The proposed changes to OCC Rules would, in turn, be made available on OCC's website. Therefore, OCC believes the proposed changes would disclose relevant default rules and procedures to the public and to Clearing Members.

For the foregoing reasons, OCC believes that the proposed changes are consistent with Section 805(b) of the Clearing Supervision Act<sup>47</sup> and Rules 17Ad-22(e)(4),<sup>48</sup> 17Ad-

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<sup>46</sup> 17 CFR 240.17Ad-22(e)(23).

<sup>47</sup> 12 U.S.C. 5464(b).

<sup>48</sup> 17 CFR 240.17Ad-22(e)(4).

22(e)(15) (ii)(A),<sup>49</sup> 17Ad-22(e)(15)(iii),<sup>50</sup> Rules 17Ad-22(e)(2)(i),<sup>51</sup> and 17Ad-22(e)(23)<sup>52</sup> under the Exchange Act.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The proposed change may be implemented if the Commission does not object to the proposed change within 60 days of the later of (i) the date the proposed change was filed with the Commission or (ii) the date any additional information requested by the Commission is received. OCC shall not implement the proposed change if the Commission has any objection to the proposed change.

The Commission may extend the period for review by an additional 60 days if the proposed change raises novel or complex issues, subject to the Commission providing the clearing agency with prompt written notice of the extension. A proposed change may be implemented in less than 60 days from the date the advance notice is filed, or the date further information requested by the Commission is received, if the Commission notifies the clearing agency in writing that it does not object to the proposed change and authorizes the clearing agency to implement the proposed change on an earlier date, subject to any conditions imposed by the Commission.

OCC shall post notice on its website of proposed changes that are implemented. The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

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<sup>49</sup> 17 CFR 240.17Ad-22(e)(15)(ii).

<sup>50</sup> 17 CFR 240.17Ad-22(e)(15)(iii).

<sup>51</sup> 17 CFR 240.17Ad-22(e)(2)(i).

<sup>52</sup> 17 CFR 240.17Ad-22(e)(23).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the advance notice is consistent with the Clearing Supervision Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2021-801 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-OCC-2021-801. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC

20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at <https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2021-801 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Secretary

**Exhibit 3**

**[Redacted Pursuant to Rule 24b-2]**

Exhibit 5a



**OCC Rules**

## Chapter I - Definitions

### RULE 101 - Definitions

Unless the context otherwise requires, for all purposes of these rules, the terms herein shall have the meanings given them in Article I of the By-Laws of the Corporation or as set forth below:

\* \* \*

#### M.

##### ~~Reserved-~~ Minimum Corporate Contribution

(1) The term "Minimum Corporate Contribution" shall mean the minimum level of OCC funds maintained exclusively to cover credit losses or liquidity shortfalls. The Minimum Corporate Contribution is determined by the Board from time to time.

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## Chapter X - Clearing Fund Contributions

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### RULE 1006 - Purpose and Use of Clearing Fund

(a) *Conditions for Clearing Fund Use.* The Clearing Fund may be used to make good losses or expenses suffered by the Corporation, or losses suffered by the Clearing Fund resulting from borrowings pursuant to the authority in Rule 1006(f), (i) as a result of the failure of any Clearing Member to discharge duly any obligation on or arising from any confirmed trade accepted by the Corporation, (ii) as a result of the failure of any Clearing Member (including any Appointed Clearing Member) or of CDS to perform its obligations (including its obligations to the correspondent clearing corporation) under or arising from any exercised or assigned option contract or matured future or any other contract or obligation issued, undertaken, or guaranteed by the Corporation or in respect of which the Corporation is otherwise liable, (iii) as a result of the failure of any Clearing Member to perform any of its obligations to the Corporation in respect of the stock loan and borrow positions of such Clearing Member, (iv) in connection with any liquidation of a Clearing Member's open positions, (v) in connection with protective transactions effected for the account of the Corporation pursuant to Chapter XI of the Rules, (vi) as a result of the failure of any Clearing Member to make any other required payment or render any other required performance, (vii) as a result of the failure of any bank or securities or commodities clearing organization to perform its obligations to the Corporation for reasons specified in paragraph (c) of this Rule 1006, or (viii) as a result of a borrowing by the Corporation for liquidity needs for same day settlement pursuant to the authority in Rule 1006(f). Notwithstanding the foregoing, in the event that the Corporation performs a Voluntary Tear-Up or a Partial Tear-Up

pursuant to Rule 1111, the Clearing Fund may be used to provide compensation to non-defaulting Clearing Members and their customers as a means of re-allocating the losses, costs and fees imposed upon them as a result of such Voluntary Tear-Up or Partial Tear-Up, but only to the extent that such losses, costs and fees can be reasonably determined by the Corporation.

(b) *Clearing Member Failures.* (i) Upon occurrence of any of the events described in clauses (i) through (vi) of paragraph (a) of this Rule, the Corporation shall (after appropriate application of other funds in the accounts of the Clearing Member) apply the Clearing Member's Clearing Fund contribution to the discharge of the obligation, the reimbursement of such loss or expense, or the making of such payment or the funding of the performance, as applicable. If the sum of all such obligations, losses or expenses, and payments exceeds the sum of the amount of the Clearing Member's total Clearing Fund contribution and the amount of the other funds of the Clearing Member available to the Corporation, and if the Clearing Member fails to pay the Corporation the amount of any such deficiency on demand, the amount of the deficiency shall be first, funded by the ~~Corporation's retained earnings~~ [Minimum Corporate Contribution in accordance with paragraph \(e\) of this Rule; and next funded by the Corporation's liquid net assets funded by equity in excess of 110% of the Target Capital Requirement](#) in accordance with paragraph (e) of this ~~R~~rule; and next, paid out of the Clearing Fund and the EDCP Unvested Balance and charged on a proportionate basis against the sum of the EDCP Unvested Balance and all other Clearing Members' required contributions as calculated at the time, but the Clearing Member who failed to pay the deficiency shall remain liable to the Corporation for the full amount of such deficiency until repayment thereof by such Clearing Member.

(ii) If the Corporation performs a Voluntary Tear-Up or a Partial Tear-Up pursuant to Rule 1111, then, the Corporation may elect to proportionately charge the Clearing Fund and EDCP Unvested Balance in the amount(s) the Corporation reasonably determines necessary to compensate non-defaulting Clearing Members and their customers for the losses, costs or fees imposed upon them as a direct result of such Voluntary Tear-Up or Partial Tear-Up, but only to the extent that such losses, costs and fees can be reasonably determined by the Corporation.

(iii) For purposes of this Rule 1006(b), the share of any Clearing Fund loss or deficiency shall be borne pro rata by each Clearing Member (other than the suspended Clearing Member(s)) and the EDCP Unvested Balance. The percentage attributed to each shall be a fraction, the numerator of which shall be the sum of the fixed amount and variable amount calculated pursuant to Rule 1003 for such Clearing Member (or its initial contribution if applicable) or the EDCP Unvested Balance amount, as applicable, and the denominator of which shall be the sum of the EDCP Unvested Balance and fixed amounts, variable amounts and any initial contributions across all Clearing Members (other than suspended Clearing Member(s)).

(c) *Bank or Clearing Organization Failures.* (i) If any bank or securities or commodities clearing organization shall fail to perform any obligation to the Corporation when due because of its bankruptcy, insolvency, receivership, suspension of operations, or any similar event, and the Corporation shall sustain a loss (whether directly or as a trustee, custodian, or secured party) by reason thereof that is not recoverable out of the Clearing Fund pursuant to paragraph (b), the Corporation may, in its discretion, reimburse itself for such loss out of the Clearing Fund pursuant to this paragraph (c), and the amount of any such reimbursement shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as calculated at the time.

(ii) With respect to any borrowing by the Corporation for liquidity needs for same day settlement pursuant to the authority in paragraph (e) of this Rule, if such borrowing remains outstanding for a period of less than thirty days, the Corporation may, in its discretion, consider such amount an actual loss to the Clearing Fund and the amount of any such loss shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as

calculated at the time, provided however, that if such borrowing remains outstanding on the thirtieth day, the Corporation shall consider such amount an actual loss to the Clearing Fund and the amount of any such loss shall be charged proportionately against all Clearing Members' required contributions to the Clearing Fund as calculated at the time.

(iii) For purposes of this Rule 1006(c), the share of any deficiency to be borne by each Clearing Member (other than the suspended Clearing Member(s)) shall be a fraction, the numerator of which shall be the sum of the fixed amount and variable amount calculated pursuant to Rule 1003 for such Clearing Member (or its initial contribution if applicable) and the denominator of which shall be the sum of the fixed amounts, variable amounts and any initial contributions across all Clearing Members (other than the suspended Clearing Member(s)). To the extent that a loss resulting from any of the events referred to in this paragraph is recoverable out of the Clearing Fund pursuant to paragraph (b), the provisions of paragraph (b) shall control, and this paragraph (c) shall be inapplicable.

(d) *Notice of Charges.* Whenever any proportionate charge is made against Clearing Members' contributions to the Clearing Fund, the Corporation shall promptly notify all Clearing Members of the amount of the charge and the reasons therefor. For the purposes of paragraphs (b) through (d), the amount of any loss sustained by the Corporation shall be determined without reference to the possibility of any subsequent recovery in respect thereof, through insolvency proceedings or otherwise, but the net amount of any such recovery shall be applied in accordance with paragraph (h).

(e) *Use of Earnings.* (i) In advance of charging a loss or deficiency proportionately to the Clearing Fund required contributions of non-defaulting Clearing Members and the EDCP Unvested Balance pursuant to paragraph (b) of this Rule 1006, the Corporation will charge such loss or deficiency first against the ~~Corporation's current and retained earnings~~ Minimum Corporate Contribution, and next against the Corporation's liquid net assets funded by equity that are greater than 110% of its Target Capital Requirement.

(ii) Notwithstanding the provisions of paragraph (c), in lieu of charging a loss or deficiency proportionately to the Clearing Fund required contributions of non-defaulting Clearing Members pursuant thereto, the Corporation may, in its discretion, elect to charge such loss or deficiency in whole or in part against the ~~Corporation's current earnings or retained earnings~~ Minimum Corporate Contribution or the Corporation's liquid net assets funded by equity that are greater than 110% of its Target Capital Requirement. If such charge is made against current earnings, such charge shall be deemed a refund of clearing fees to the non-defaulting Clearing Members to whose Clearing Fund contributions the loss or deficiency would otherwise have been charged, and in that case the Corporation shall notify each such Clearing Member of the aggregate amount of the charge against current earnings, the reasons therefor, and the amount deemed to have been refunded to such Clearing Member.

(iii) ~~As used herein, the term "current earnings" shall mean the Corporation's net income before taxes for the period from the beginning of the fiscal year in which a loss or deficiency occurs to~~ For purposes of determining the amount available to cover a loss or deficiency under paragraphs (e)(i) or (e)(ii), the Corporation's liquid net assets funded by equity shall be determined based on the Corporation's unaudited financial statements at the close of the calendar month immediately preceding the occurrence of such loss or deficiency, less an amount equal to the aggregate of all refunds of clearing fees made or authorized to be made or deemed to have been made ~~for such fiscal year~~ during the fiscal year in which a loss or deficiency occurs if the refund is not reflected on such unaudited financial statements. In no event shall OCC be required to contribute an amount that would cause OCC's liquid net assets funded by equity to fall below 110% of the Target Capital Requirement at the time charged.

(iv) If the Corporation charges a deficiency in a Clearing Member's Clearing Fund contribution against the ~~Corporation's current earnings or retained earnings~~ Minimum Corporate Contribution or the Corporation's liquid net assets funded by equity that are greater than 110% of its Target Capital Requirement, Member shall remain liable to the Corporation for the full amount of such deficiency until repayment thereof by such Clearing Member.

(v) The Minimum Corporate Contribution shall be reduced to the remaining unused portion of the Minimum Corporate Contribution for a period of 270 calendar days after each loss chargeable under paragraph (e)(i). The Corporation shall notify Clearing Members of any such reduction to the Minimum Corporate Contribution.

**Exhibit 5b**

[Redacted Pursuant to Rule 24b-2]

**[Redacted Pursuant to Rule 24b-2]**

**Exhibit 5c**

[Redacted Pursuant to Rule 24b-2]

**[Redacted Pursuant to Rule 24b-2]**

**Exhibit 5d**

[Redacted Pursuant to Rule 24b-2]

**[Redacted Pursuant to Rule 24b-2]**

**Exhibit 5e**

[Redacted Pursuant to Rule 24b-2]

**[Redacted Pursuant to Rule 24b-2]**

**[Redacted Pursuant to Rule 24b-2]**