



October 8, 2020

**VIA ELECTRONIC MAIL**

Christopher J. Kirkpatrick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Rule Filing SR-OCC-2020-011 Rule Certification**

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and Commodity Futures Trading Commission (“CFTC”) Regulation 40.6, enclosed is a copy of the above-referenced rule filing submitted by The Options Clearing Corporation (“OCC”). The date of implementation of the rule is at least 10 business days following receipt of the rule filing by the CFTC or the date the proposed rule is approved by the Securities and Exchange Commission (“SEC”) or otherwise becomes effective under the Securities Exchange Act of 1934 (“Exchange Act”). This rule filing has been submitted to the SEC under the Exchange Act. Additionally, this rule filing contains a contract between OCC and the Chicago Mercantile Exchange (“CME”). Once both OCC and CME confirm that all necessary regulatory requirements are complete, OCC and CME will coordinate execution of the Second Amended and Restated Cross Margining Agreement (“Proposed X-M Agreement”). The XM Agreement will become effective upon execution.

OCC has requested confidential treatment for Exhibits 3 and 5 to SR-OCC-2020-011 (contained in pages 61-168 of SR-OCC-2020-011).

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

Explanation and Analysis

The proposed changes to the XM Agreement are contained in confidential Exhibit 5. Material proposed to be added to the XM Agreement as currently in effect is underlined and material proposed to be deleted is marked in strikethrough text. All capitalized terms not defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>1</sup>

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<sup>1</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>.

## Background

OCC and CME are currently parties to an Amended and Restated Cross-Margining Agreement dated May 28, 2008, as further amended by Amendment No. 1 dated October 23, 2008<sup>2</sup> and Amendment No. 2 dated May 20, 2009<sup>3</sup> (the “Existing X-M Agreement”). OCC and CME first implemented their cross-margining program (the “X-M Program”) in 1989. The purpose of the X-M Program is to: (1) facilitate the cross-margining of positions in options cleared by OCC with positions in futures and commodity options cleared by CME and (2) address the fact that Clearing Members may have been required to meet higher margin requirements at each clearinghouse than were warranted by the risk of combined positions, because each portfolio was margined separately without regard to positions held in the other portfolio.<sup>4</sup> After the 1987 Market Break, several government reports recommending market structure reforms found that cross-margining arrangements between clearinghouses should be implemented or expanded, because they could have a profound effect on mitigating liquidity stress to key market participants at critical times.<sup>5</sup> For example, the Bachmann Task Force, which was formed at the request of SEC Chairman Breeden to address the issue of safety and soundness of the clearance and settlement system in the United States, published a report on Clearance and Settlement Reform in the U.S. Securities Markets, and the staff of the SEC’s Division of Market Regulation<sup>6</sup> also published its own report to analyze factors involved in the depth and rapidity of the market decline. Both reports noted that the existence of separate clearinghouses for each market segment increases systemic exposure because no single clearinghouse is able to accurately assess intermarket exposure among its clearing members and among their customers.<sup>7</sup> Accordingly, the Bachmann Report specifically advanced that the cross-

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<sup>2</sup> Securities Exchange Act Release No. 58258 (July 30, 2008), 73 FR 46133 (August 7, 2008) (SR-OCC-2008-12) (amending the agreement to, among other things, permit money market fund shares as margin). This proposed change was certified with the CFTC on June 10, 2008.

<sup>3</sup> Securities Exchange Act Release No. 60063 (June 8, 2009), 74 FR 28738 (June 17, 2009) (SR-OCC-2009-10) (amending the agreement to redefine the term “Eligible Contracts” and deleting the list of such contracts attached as Schedule A). This proposed change was certified with the CFTC on May 22, 2009.

<sup>4</sup> Securities Exchange Act Release Nos. 26607 (March 7, 1989), 48 FR 10608 (March 14, 1989) (SR-OCC-89-1); 27296 (September 26, 1989) (SR-OCC-89-11).

<sup>5</sup> See Report of the Bachmann Task Force on Clearance and Settlement Reform in U.S. Securities Markets, Submitted to The Chairman of the U.S. Securities and Exchange Commission (May 1992) (the “Bachmann Report”); The October 1987 Market Break, A Report by the Division of Market Regulation, U.S. Securities and Exchange Commission (February 1988) (the “1987 Market Break Report”).

<sup>6</sup> This Division is now known as the Division of Trading and Markets.

<sup>7</sup> See Bachmann Report at 11 citing the Report of the Presidential Task Force on Market Mechanisms at 64 (January 1988); 1987 Market Break Report at 10-57 (stating that “[i]n a fully integrated cross-margin account, margin requirements could be fixed to reflect more accurately the net risk of such positions taken as a whole, thus reducing certain margin requirements . . .”).

margin agreement in place between OCC and CME benefited dual participants with hedged positions with the respective clearing organizations,<sup>8</sup> and it stated that OCC and relevant futures exchanges should be encouraged to expand their cross-margining programs because they “reduce clearing system risk by substituting correlated positions for cash or cash equivalent margins and provide financing relief and settlement harmonization.”<sup>9</sup> Since the X-M Program was implemented, the parties have amended it twice<sup>10</sup>

The purpose of this proposed rule change is to adopt a new Second Amended and Restated Cross-Margining Agreement between OCC and CME, that would: (1) update the Existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements.

### **The Existing X-M Agreement**

The Existing X-M Agreement governs OCC and CME’s participation in the X-M Program, which permits positions in certain futures and futures options contracts cleared by CME to be cleared in a special proprietary or non-proprietary cross-margining account (an “X-M Account”) at CME, which is then paired with a corresponding X-M Account (proprietary or non-proprietary, as the case may be) at OCC, in which securities options contracts are cleared (such contracts, “Eligible Contracts”). OCC Clearing Members that are also CME members (“Joint Clearing Members”), or that have qualified affiliates that are CME members (“Affiliated Clearing Members”), provided that they have signed the required X-M Program clearing member participation agreement, are permitted to participate in the X-M Program. Currently, there are nine Joint Clearing Members and one pair of Affiliated Clearing Members that participate in the X-M Program. Each Joint Clearing Member or pair of Affiliated Clearing Members electing to participate in the X-M Program and establish a pair of X-M Accounts is required to execute the appropriate account agreements in the forms prescribed by OCC and CME and to designate the account as either “proprietary” or “non-proprietary.”<sup>11</sup>

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<sup>8</sup> See Bachmann Report at 12.

<sup>9</sup> See Bachmann Report at 31.

<sup>10</sup> See, e.g., Securities Exchange Act Release Nos. 32534 (June 28, 1993), 58 FR 36234 (July 6, 1993) (SR-OCC-92-98); 38584 (May 8, 1997), 62 FR 26602 (May 14, 1997); See also *supra* notes 2 and 3.

<sup>11</sup> The Existing X-M Agreement also permits the establishment of “X-M Pledge Accounts,” which are X-M Accounts in respect of which the Clearing Member grants a security interest in all contracts purchased or carried in the particular account to a bank, as security for a loan. X-M Pledge Accounts may be either proprietary or non-proprietary. The New X-M Agreement would eliminate the ability to establish such X-M Pledge Accounts because they are no longer being used. Historically, pledge accounts were only used for the purpose of supporting the pledging of money market mutual fund

Proprietary X-M accounts are confined to the confirmed trades and positions of non-customers of Clearing Members and other proprietary “market professionals.”<sup>12</sup> A non-proprietary X-M Account is limited to options market-makers and other “market professionals.”

Non-proprietary X-M Accounts are treated as futures customer accounts, because they are carried subject to the segregation provisions of Section 4d of the Commodity Exchange Act<sup>13</sup> rather than as securities accounts subject to Rule 15c3-3<sup>14</sup> and other customer protection rules under the Securities Exchange Act of 1934.<sup>15</sup> X-M Accounts that are paired for purposes of the X-M Program are treated for margin purposes as if they were a single account, making it possible to margin the paired X-M Accounts based on the net risk of the potentially offsetting positions within them. The Existing X-M Agreement governs the calculation, collection, and holding of margin with respect to the paired X-M Accounts, as well as the handling of daily settlement.

The Existing X-M Agreement also addresses how OCC and CME may use the contracts and margin held in X-M Accounts in the event of the default of a Joint Clearing Member or Affiliated Clearing Member. Upon suspending a Joint Clearing Member or Affiliated Clearing Member, the suspending clearinghouse is required to immediately notify the other clearinghouse of the suspension. Both OCC and CME would then immediately liquidate the contracts and margin in each X-M Account carried for the suspended Joint Clearing Member or the Affiliated Clearing Members, unless OCC and CME otherwise agree to delay liquidation or to transfer the contracts. OCC and CME are required to use their best efforts to coordinate the transfer or liquidation of such contracts and to close out any hedged positions simultaneously or, if transferring the positions, to transfer them to the same clearing firm or pair of affiliated clearing firms.

Any funds received by either OCC or CME upon liquidation of the proprietary and non-proprietary X-M Accounts, respectively, may be used to offset expenses arising from the liquidation of such account, and any net proceeds thereafter are to be deposited in a corresponding proprietary or non-proprietary liquidating account established jointly by OCC and CME. The funds in a proprietary or non-proprietary liquidating account are to be used only to set off any liquidating deficits or settlement obligations remaining with respect to the corresponding proprietary or non-proprietary X-M Account, respectively. To the extent the proprietary liquidating account has a surplus, after satisfying all deficits and obligations, the proceeds may be applied to set off any net liquidating deficits or settlement obligations arising from the Clearing Member’s non-proprietary X-M Accounts at OCC or CME.

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shares as collateral. Now that money market mutual fund shares are not acceptable collateral for the XM Program, there is no longer a need for the use of X-M Pledge Accounts.

<sup>12</sup> See OCC By-Laws Article I, Section 1.O.(1).

<sup>13</sup> 7 U.S.C. 6d.

<sup>14</sup> 17 CFR 240.15c3-3.

<sup>15</sup> 17 CFR 240.8c-1; 17 CFR 240.15c2-1.

After these offsets, if a liquidating account still has a deficit, each of OCC and CME bear 50% of the remaining shortfall. If a proprietary liquidating account has a surplus, OCC and CME each are entitled to 50% of the surplus to satisfy any losses whatsoever arising from the other obligations of the defaulting Clearing Member. However, if one clearinghouse's net loss is less than 50% of the remaining surplus and the other's is greater, the former is only entitled to the surplus up to the amount of its loss, and the latter is entitled to receive the balance up to the amount of its loss. After all of this, if any amounts remain in the liquidating accounts, such funds are returned to the Joint Clearing Member or pair of Affiliated Clearing Members or their respective representatives.

### **The Proposed X-M Agreement**

The Proposed X-M Agreement retains the same basic framework described above regarding the Existing X-M Agreement, and it would not fundamentally alter the scope of the X-M Program or the rights and responsibilities of OCC and CME. The primary purposes for proposing to update the Existing X-M Agreement with the Proposed X-M Agreement are to: (1) bring the Existing X-M Agreement into conformity with current operational procedures; (2) eliminate provisions in the Existing X-M Agreement that are out-of-date; and (3) improve the clarity and readability of the agreement by consolidating redundant provisions. The Proposed X-M Agreement would also move several of the operational details regarding the X-M Accounts to the OCC-CME Cross-Margining Service Level Agreement ("SLA"). OCC and CME believe that having such operational details in a separate document produces a more streamlined Proposed X-M Agreement that would be easier to comprehend and that would therefore allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement. OCC believes that these changes would make the Proposed X-M Agreement and SLA easier to read and comprehend and would promote consistency with the requirement in Rule 17Ad-22(e)(1)<sup>16</sup> that OCC must establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, provide for a well-founded, clear and transparent legal basis for each aspect of its activities.

Key changes from the Existing X-M Agreement to the Proposed X-M Agreement are described in detail below.

### **Eligible Contracts and Accepted Transactions**

The Proposed X-M Agreement would not change the scope of products eligible for participation in the X-M Program. However, it would include a definition of "Eligible Contracts" in Section 1 that conforms with the substance of the definition that was adopted in 2009 as part of Amendment No. 2 to the Existing X-M Agreement.<sup>17</sup> Consistent with these changes, the definition

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<sup>16</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>17</sup> See supra note 10.

of “Eligible Contracts” in the Proposed X-M Agreement would include any contracts that have been “jointly designated” by OCC and CME as eligible for inclusion in the list of eligible contracts jointly maintained by OCC and CME. Prior to designating a new set of contracts as Eligible Contracts, OCC and CME would be required to evaluate and approve the additional contracts through internal processes that consider each clearing organization’s risk policies.

Section 1 of the Proposed X-M Agreement would also be amended to introduce the new defined term “Accepted Transaction” and to provide a mechanism for confirming what specific transactions are subject to the Proposed X-M Agreement. The purpose of this change is not to change the scope of the X-M Program but rather to provide certainty and clarity regarding the specific transactions – the “Accepted Transactions” – for which OCC and CME would be jointly responsible. “Accepted Transactions” would be defined to include all positions that are Eligible Contracts and have been included on the “daily margin detail report” generated by OCC and transmitted to CME. Positions included in the “daily margin detail report” would be deemed to be the final record of positions in which OCC and CME are obligated under the Proposed X-M Agreement.

### **The Service Level Agreement**

As part of the update to the Proposed X-M Agreement, certain operational terms previously covered in the Existing X-M Agreement would be addressed in the SLA. For example, this includes provisions from the Existing X-M Agreement in Section 6 regarding acceptable forms of collateral, Section 7 regarding the timing, methods and forms of daily settlement procedures, and Section 15 regarding OCC and CME’s commitment to share information regarding Joint and Affiliated Clearing Members, banks, and their own financial status. The Proposed X-M Agreement would address the existence of this SLA in a proposed Section 2, stating that all “times, methods and forms of deliveries, notification and consents” pertaining to the X-M Program and X-M Accounts are provided for in the SLA. CME and OCC would also agree to review the SLA at least annually.

### **Account Structure**

The same basic account structure in Section 2 of the Existing X-M Agreement would still be used in Section 3 of the Proposed X-M Agreement. Proprietary and/or non-proprietary paired clearing accounts would still be established for Joint and Affiliated Clearing Members that participate in the X-M Program, and OCC and CME would continue to have a joint security interest in the contracts, margin, and other property held in the joint accounts. However, as noted above, the Proposed X-M Agreement would remove all references to X-M Pledge Accounts because such accounts are no longer in use. Along with removing all references to such accounts throughout the Proposed X-M Agreement, Section 3 of the Existing X-M Agreement, entitled “Establishment of X-M Pledge Accounts,” would be deleted in its entirety.

The Proposed X-M Agreement would also change some of the defined terms that are used to describe the accounts related to the X-M Program to describe their purpose more accurately. For

example, the “Proprietary Joint Settlement Account” and “Segregated Joint Margin Account” would be referred to as the “Proprietary Joint Margin Cash Account” and “Segregated Joint Margin Cash Account,” and the “Proprietary Joint Custody Account” and “Segregated Joint Custody Account” would be referred to as the “Proprietary Joint Margin Custody Account” and “Segregated Joint Margin Custody Account.” The terms “Proprietary Bank Account” and “Segregated Funds Bank Account” would also be added to the defined terms section for readability and consistency, though they were already used in the body of the Existing X-M Agreement. The proposed addition of such terms to the defined terms section would not change for the purposes of the agreement. The defined term “Liquidating Accounts” would also be added to the agreement to cover the Non-Proprietary and Proprietary Liquidating Accounts created in the event of a Clearing Member suspension and liquidation.

### **Margin and Posted Collateral**

The Proposed X-M Agreement would replace the provisions in Section 5 of the Existing X-M Agreement regarding the methodology for determining the initial margin requirements for each X-M Account with a statement that, with respect to each pair of X-M Accounts, the amount of cash, securities or other property required to be deposited as collateral would be determined by using OCC’s approved margin methodology, as in effect as of the date of the Proposed X-M Agreement. As a practical matter, this change would not represent a change from the existing operation of the X-M Program because, consistent with the authority in Section 5, CME already elects to use the margin calculation that is produced by OCC. The Proposed X-M Agreement would also require OCC to provide 30 calendar days prior notice to CME of any proposed changes to OCC’s margin methodology, and any changes to the way collateral requirements are calculated with respect to X-M Accounts would be required to be agreed upon in writing in advance by OCC and CME. The Proposed X-M Agreement would also specify that OCC and CME would each determine the net amount of premiums, exercise settlement amounts, and variation margin due for its respective products because the determination is made based upon the products cleared by OCC and CME, and adopts the defined terms “Net Pay/Collect” to refer to such amount. Each clearinghouse would be required to notify the other of the Net Pay/Collect amount in accordance with the SLA.

Like under the Existing X-M Agreement, OCC and CME would each still have the ability to charge additional margin at any amount as it deems appropriate without the consent of the other and each would be responsible for determining the adequacy of the margin requirement for each cross-margin account.

As discussed above, Section 6 of the Proposed X-M Agreement would no longer specify the eligible forms of initial margin, instead referring to the SLA. The SLA would revise the list of eligible collateral to include cash, treasuries, and letters of credit from pre-approved U.S. depository institutions, and eliminate the eligibility of government sponsored entity debt and money market funds. OCC and CME are proposing to eliminate the eligibility of these instruments because, in practice, OCC no longer accepts them as collateral for the X-M Program. This is because no money market mutual funds currently meet OCC’s requirements for such margin assets set forth in OCC

Rule 604(b)(3), and OCC's liquidity facilities do not currently accept government sponsored entity debt as collateral. Consequently, all references to government sponsored entity debt and money market funds are removed from the Proposed X-M Agreement. The Proposed X-M Agreement would also clarify that the more conservative limits would apply to the extent OCC and CME's rules with respect to concentration limits for eligible margin differ. Furthermore, if OCC reduces any of its required haircuts for eligible margin below CME's required haircuts, OCC is required to provide prompt notice to CME.

The Proposed X-M Agreement would also provide that OCC and CME would each be permitted to invest any cash deposited as collateral in their joint margin cash accounts overnight in certain eligible investments and with certain custodians, depositories, and counterparties, as OCC and CME may mutually agree, with each clearinghouse sharing equally in any proceeds received, or losses incurred, from such overnight investments. This formalizes the existing practice of OCC and CME and provides clarity that OCC and CME share equally in any proceeds or losses from overnight investments.

Additionally, the Proposed X-M Agreement would no longer use the term "Margin" or "Initial Margin" with respect to the collateral deposited in an X-M Account. Instead, it would use the term "Posted Collateral." OCC proposes the change because it is a more accurate characterization of the margin requirement set by OCC's System for Theoretical Analysis and Numerical Simulations ("STANS") – which is the methodology used to determine the collateral requirement for the X-M Program and does not produce a separate Initial Margin requirement. References to margin requirements and deficits or surpluses in respect to such requirements are proposed to be replaced with references to the defined terms "Collateral Requirement," "Collateral Deficit," and "Collateral Excess," respectively.

## **Daily Settlement**

Section 7 of the Proposed X-M Agreement would be revised to increase the time OCC and CME would have to provide approval or non-approval of revised Settlement Instructions from 15 minutes to 30 minutes. Based on OCC and CME's experience operating the X-M Program, OCC believes the change from 15 to 30 minutes would provide additional time which would be useful during the process of performing a full review of any revised Settlement Instructions and making determinations for approval or non-approval of the revised Settlement Instructions. Furthermore, OCC has determined that the proposed change to add additional time to review revised Settlement Instructions will not negatively impact on the timing of other processes performed under the Proposed X-M Agreement.

As described above, details regarding the timing, methods, and form of daily settlement in the X-M Accounts have been moved to the SLA, and Section 7 of the Proposed X-M Agreement would be amended to reflect that fact. Section 7 would also be amended to conform to existing reporting practices for OCC and CME with respect to settlement. For example, under the Existing X-M Agreement each clearing organization issues a "Margin and Settlement Report" to each Joint



Clearing Member or pair of Affiliated Clearing Members for which it is the Designated Clearing Organization. However, in practice, OCC has been the only Designated Clearing Organization. Accordingly, the related provisions would be modified so that the information contained in that report is only provided by OCC to the Clearing Members. The definition of “Margin and Settlement Report” in Section 1 of the Proposed X-M Agreement is correspondingly modified and would refer to the report more specifically as the “Account Summary by Clearing Corporation Report.”

The Proposed X-M Agreement would also update Section 7 to provide for the communication of intra-day instructions to X-M clearing banks with respect to the X-M Accounts, to facilitate the deposit of collateral in response to an intra-day margin call from CME or OCC. A defined term for “Intra-day Instruction” would also be added to Section 1 to accommodate this change.

### **Suspension and Liquidation**

Section 8 of the Proposed X-M Agreement essentially retains the Existing X-M Agreement’s procedures for the handling of X-M Accounts in the event of the default of a Joint Clearing Member or pair of Affiliated Clearing Members, as described above, with certain modifications. First, paragraphs 8(a) and (b) would be revised to state more generally that each clearinghouse will follow its own rules with respect to the default of a Clearing Member; provided, however, that each clearinghouse would also use its best efforts to coordinate with the other clearinghouse regarding the liquidation or transfer of Accepted Transactions. The proposed changes that expressly provide that each clearinghouse would follow its own rules with respect to the default of a Clearing Member are not intended to substantively change the terms in the Existing X-M Agreement. Instead, they are meant to provide each clearinghouse with greater flexibility to amend their suspension and liquidation procedures pursuant to the normal rule change process without having to also amend the Proposed X-M Agreement. The Proposed X-M Agreement also now expressly contemplates the potential use of a joint liquidating auction with respect to X-M Accounts during a Clearing Member default scenario.

Second, new sections 8(c) and (d) would be added to the Proposed X-M Agreement to provide that upon the suspension of a defaulted Clearing Member, the clearinghouses would establish a plan pursuant to which Accepted Transactions of the Clearing Member would be liquidated or transferred. The plan would be required, at a minimum, to (i) identify the primary point of contact at each clearinghouse responsible for coordinating communications and actions related to the plan; (ii) current-day settlement information related to the suspended Clearing Member; and (iii) whether any transactions in addition to Accepted Transactions would be guaranteed. If by the close of the markets on the business day that follows the last successful margin collection for the suspended Clearing Member the clearinghouses do not take action under a plan or have not otherwise established a plan, then the clearinghouses would be required to take certain steps to transfer cleared contracts prior to the open of trading on the next business day. Specifically, contracts cleared by each respective clearinghouse would be transferred into an account under its control to allow that clearinghouse to liquidate or transfer the contracts pursuant to its rules. The

closing prices for the cleared contracts used to determine final proceeds and any liquidity obligations of the clearinghouses would be the prices as of the business day that immediately follows the last successful margin collection for the suspended Clearing Member.

Third, Section 8 would also be revised to provide that each of OCC and CME agree to enter into any agreements reasonably necessary to ensure that the other can obtain liquidity during a default scenario and will be jointly and equally responsible for providing liquidity to ensure all obligations of a non-defaulting Clearing Member with respect to the X-M Accounts on a timely basis. OCC believes this change would help ensure OCC and CME have sufficient access to liquidity and thereby provide for efficient and effective default management in the event of a Clearing Member default.

Finally, OCC and CME also would agree to conduct joint default management drills for the cross-margin accounts at least annually. OCC believes that this change would promote consistency with the requirement in Rule 17Ad-22(e)(13) that OCC as a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to “[e]nsure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring [its] participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedure, at least annually and following material changes thereto.”<sup>18</sup>

### **Miscellaneous Changes**

Regarding other changes, first the “Recitals” to the Proposed X-M Agreement would be updated to reflect OCC and CME’s respective SEC and CFTC registration statuses and designations as systemically important by the Financial Stability Oversight Council. Related to this, defined terms would be added for “FSOC,” “Dodd Frank Act,” “DCO,” “Exchange Act,” and “SEC.”

Second, Section 9 of the Proposed X-M Agreement would be amended to clarify that the requirement that one clearinghouse notify the other when it becomes subject to a court order to disclose “confidential information” is only required if it is permitted by law.

Third, Section 10 of the Proposed X-M Agreement would rephrase the section to only reference Losses because the definition of Losses under the Proposed X-M Agreement would be revised to include claims and other potential loss events.

Fourth, Section 13 of the proposed agreement would change the process and timing related to termination of the agreement because OCC and CME believe the revised language would reduce risk in the event of a termination.

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<sup>18</sup> 17 CFR 240.17Ad-22(e)(13).

Fifth, the Proposed X-M Agreement would also revise Section 14, to clarify that while OCC and CME are not permitted to reject any transaction effected in an X-M Account without the other's express consent, this condition would not interfere with their respective abilities to implement recovery and orderly wind-down plans under their own rules, as required under Rule 17Ad-22(e)(3)(ii)<sup>19</sup> and CFTC Rule 39.39(b).<sup>20</sup>

Sixth, as discussed above in the description of the SLA, Section 15 of the Existing X-M Agreement regarding information sharing between OCC and CME would be deleted from the Proposed X-M Agreement and moved to the SLA. OCC believes the more succinctly drafted language in the SLA maintains consistent rights and/or obligations for OCC and CME to share information which will continue to allow OCC and CME to efficiently manage the risks presented by Joint and Affiliated Clearing Members.

Seventh, Section 15 of the Proposed X-M Agreement regarding notifications differs from the corresponding provisions in Section 16 of the Existing X-M Agreement, in that it would allow for the use of electronic mail to satisfy notice requirements, except with respect to notifications relating to the termination of the Proposed X-M Agreement. It would also eliminate facsimile as an appropriate method of communication. OCC believes this change conforms to current communication procedures and standards and ensures notices will be received in a timely manner through a communication method that is monitored regularly.

Finally, the Proposed X-M Agreement would also add Section 17 to clarify that each of OCC and CME would be responsible for obtaining their own regulatory approvals in connection with the implementation of the Proposed X-M Agreement.

### **Additional Changes to Defined Terms**

In addition to the proposed and modified defined terms described above, the Proposed X-M Agreement would make certain additional modifications to Section 1 of the Existing X-M Agreement. Many of these are non-substantive, including adding defined terms that are already used and defined elsewhere in the Existing X-M Agreement but that are not currently listed in Section 1 – e.g., the defined terms “AAA,” “Affiliated Clearing Member,” “CME Clearing Member,” “CME Rules,” “Confidential Information,” “Indemnitor,” “Indemnified Party,” “Losses,” “OCC Clearing Member,” and “OCC Rules.” The Proposed X-M Agreement would also modify the definition of “Affiliate” to remove the statement that 10% ownership of common stock will be deemed *prima facie* control of that entity for purposes of determining whether an entity is under direct or indirect control of a Clearing Member, to instead reflect that OCC and CME believe that a facts-and-circumstances approach is more appropriate. The definition of “Business Day” would be modified to provide that when one or more markets on which cleared contracts trade are closed but banks are

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<sup>19</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>20</sup> 17 CFR 39.39(b).

open, OCC and CME would each make their own determination regarding whether and to what extent to treat any such day as a Business Day for purposes of Section 7 of the Proposed X-M Agreement regarding daily settlements.

### **Clearing Member Agreements**

In conjunction with the streamlining efforts at the heart of the Proposed X-M Agreement, OCC is proposing to consolidate certain of the template Clearing Member agreements that it maintains for the X-M Program. As noted above, a Clearing Member that intends to participate in the X-M Program must execute the appropriate Clearing Member agreement. Currently, there are six such template agreements, and the appropriate agreement for the participating Clearing Member depends on the type of account it will be using as its X-M Account (*i.e.*, proprietary, non-proprietary, or market professional) and whether the Clearing Member will be participating in the X-M Program as a Joint Clearing Member or with an Affiliated Clearing Member. To maintain fewer templates and streamline the Clearing Member documentation, the six template agreements would be consolidated into three. Specifically, Joint Clearing Members and Affiliated Clearing Members would use the same template agreement for the appropriate account type (*i.e.*, proprietary, non-proprietary, or market professional). The revised Clearing Member agreements include language providing for OCC and CME's ability to move positions between Clearing Member accounts, as necessary, based upon Clearing Member instruction, to maintain positions in the appropriate account type. The substance of the agreements is not otherwise being altered.

OCC reviewed the derivatives clearing organization ("DCO") core principles as set forth in the Act ("Core Principles"). During this review, OCC identified the following Core Principles as potentially being impacted:

**Risk management.** OCC believes that implementing the proposed rule change will be aligned with the requirements of Core Principle D.<sup>21</sup> Core Principle D requires, in part, that each DCO limit, through the use of margin and other risk control mechanisms, its potential losses from defaults by members and participants of the DCO to ensure that its operations would not be disrupted and that its non-defaulting members or participants are not exposed to losses they cannot anticipate or control.<sup>22</sup>

As described above, the proposed rule change would: (1) update the Existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements. OCC believes the Proposed X-M Agreement provides a more clear and concise presentation of the X-M Program and its important risk management function. OCC believes the

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<sup>21</sup> 7 U.S.C. 7a-1(c)(2)(D).

<sup>22</sup> 7 U.S.C. 7a-1(c)(2)(D)(iii).

proposed rule change is therefore designed to ensure that OCC appropriately administers the X-M Program and its associated margin requirements that serve to limit its exposures to potential losses from defaults by its participants under normal market conditions so that the operations of OCC would not be disrupted, and non-defaulting participants would not be exposed to losses that they cannot anticipate or control. In this way, OCC believes the proposed change promotes compliance with Core Principle D under the Act.<sup>23</sup>

Opposing Views

No opposing views were expressed related to the rule amendments.

Notice of Pending Rule Certification

OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of the submission on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rule set forth at Item 1 of the enclosed filing complies with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,



Michelle Weiler  
Associate General Counsel

Enclosure

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<sup>23</sup> 7 U.S.C. 7a-1(c)(2)(D).

Required fields are shown with yellow backgrounds and asterisks.

|                 |  |                             |                                       |
|-----------------|--|-----------------------------|---------------------------------------|
| Page 1 of * 168 | SECURITIES AND EXCHANGE COMMISSION<br>WASHINGTON, D.C. 20549<br>Form 19b-4 | File No.* SR - 2020 - * 011 | Amendment No. (req. for Amendments *) |
|-----------------|--|-----------------------------|---------------------------------------|

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

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|--|--|--|---|---|---|
| Initial *<br><input checked="" type="checkbox"/> | Amendment *<br><input type="checkbox"/>                                      | Withdrawal<br><input type="checkbox"/> | Section 19(b)(2) *<br><input checked="" type="checkbox"/> | Section 19(b)(3)(A) *<br><input type="checkbox"/> | Section 19(b)(3)(B) *<br><input type="checkbox"/> |
|  |  |  | Rule  |   |   |
| Pilot<br><input type="checkbox"/>                | Extension of Time Period for Commission Action *<br><input type="checkbox"/> | Date Expires *<br><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) *<br><input type="checkbox"/>   | Section 806(e)(2) *<br><input type="checkbox"/>                                |
| Section 3C(b)(2) *<br><input type="checkbox"/>  |  |

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

**Description**

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

This proposed rule change by OCC would adopt a new Second Amended and Restated Cross-Margining Agreement between OCC and the Chicago Mercantile Exchange.

**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 \* Michelle Last Name \* Weiler

Title \* Associate General Counsel

E-mail \* mweiler@theocc.com

Telephone \* (312) 998-4604 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 09/22/2020 Associate General Counsel

By Michelle Weiler

(Name \*)

Michelle Weiler, mweiler@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 EFFF website.

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

Add Remove View

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 \***

Add Remove View

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 \***

Add Remove View

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**

Add Remove View

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 Sent As Paper Document

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

Add Remove View

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 Sent As Paper Document

**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**

Add Remove View

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**

Add Remove View

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

Proposed Rule Change  
by

**THE OPTIONS CLEARING CORPORATION**

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



**Item 1. Text of the Proposed Rule Change**

This proposed rule change by The Options Clearing Corporation (“OCC”) would adopt a new Second Amended and Restated Cross-Margining Agreement (“Proposed X-M Agreement”) between OCC and the Chicago Mercantile Exchange (“CME”). This proposal is designed to: (1) update the existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details from the existing X-M Agreement to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements.

The Proposed X-M Agreement is attached hereto as Exhibit 5. The Proposed X-M Agreement includes the following as appendices each of which is marked to show changes: Proprietary Cross-Margin Account Agreement and Security Agreement; Non-Proprietary Cross-Margin Account Agreement and Security Agreement; and Market Professional’s Agreement for Cross-Margining.<sup>1</sup>

This proposed rule change does not require any changes to the text of OCC’s By-Laws or Rules. All terms with initial capitalization that are not defined herein have the same meaning as set forth in OCC’s By-Laws and Rules.<sup>2</sup>

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<sup>1</sup> Each of the Clearing Member agreement forms includes a version for Joint and Affiliated Clearing Members.

<sup>2</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#rule-filings>.

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

The proposed rule change was approved for filing with the Commission by OCC's Board of Directors ("Board") at a meeting held on July 12, 2017.

Questions should be addressed to Michelle Weiler, Vice President, Associate General Counsel, at (312) 998-4604.

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

A. Purpose

The purpose of this proposed rule change is to adopt a new Second Amended and Restated Cross-Margining Agreement between OCC and CME, that would: (1) update the existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements.

Background

OCC and CME are currently parties to an Amended and Restated Cross-Margining Agreement dated May 28, 2008, as further amended by Amendment No. 1 dated October 23,

2008<sup>3</sup> and Amendment No. 2 dated May 20, 2009<sup>4</sup> (the “Existing X-M Agreement”). OCC and CME first implemented their cross-margining program (the “X-M Program”) in 1989. The purpose of the X-M Program is to: (1) facilitate the cross-margining of positions in options cleared by OCC with positions in futures and commodity options cleared by CME and (2) address the fact that Clearing Members may have been required to meet higher margin requirements at each clearinghouse than were warranted by the risk of combined positions, because each portfolio was margined separately without regard to positions held in the other portfolio.<sup>5</sup> After the 1987 Market Break, several government reports recommending market structure reforms found that cross-margining arrangements between clearinghouses should be implemented or expanded, because they could have a profound effect on mitigating liquidity stress to key market participants at critical times.<sup>6</sup> For example, the Bachmann Task Force, which was formed at the request of SEC Chairman Breeden to address the issue of safety and

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<sup>3</sup> Securities Exchange Act Release No. 58258 (July 30, 2008), 73 FR 46133 (August 7, 2008) (SR-OCC-2008-12) (amending the agreement to, among other things, permit money market fund shares as margin).

<sup>4</sup> Securities Exchange Act Release No. 60063 (June 8, 2009), 74 FR 28738 (June 17, 2009) (SR-OCC-2009-10) (amending the agreement to redefine the term “Eligible Contracts” and deleting the list of such contracts attached as Schedule A).

<sup>5</sup> Securities Exchange Act Release Nos. 26607 (March 7, 1989), 48 FR 10608 (March 14, 1989) (SR-OCC-89-1); 27296 (September 26, 1989) (SR-OCC-89-11).

<sup>6</sup> See Report of the Bachmann Task Force on Clearance and Settlement Reform in U.S. Securities Markets, Submitted to The Chairman of the U.S. Securities and Exchange Commission (May 1992) (the “Bachmann Report”); The October 1987 Market Break, A Report by the Division of Market Regulation, U.S. Securities and Exchange Commission (February 1988) (the “1987 Market Break Report”).

soundness of the clearance and settlement system in the United States, published a report on Clearance and Settlement Reform in the U.S. Securities Markets, and the staff of the SEC's Division of Market Regulation<sup>7</sup> also published its own report to analyze factors involved in the depth and rapidity of the market decline. Both reports noted that the existence of separate clearinghouses for each market segment increases systemic exposure because no single clearinghouse is able to accurately assess intermarket exposure among its clearing members and among their customers.<sup>8</sup> Accordingly, the Bachmann Report specifically advanced that the cross-margining agreement in place between OCC and CME benefited dual participants with hedged positions with the respective clearing organizations,<sup>9</sup> and it stated that OCC and relevant futures exchanges should be encouraged to expand their cross-margining programs because they “reduce clearing system risk by substituting correlated positions for cash or cash equivalent margins and provide financing relief and settlement harmonization.”<sup>10</sup> Since the X-M Program was

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<sup>7</sup> This Division is now known as the Division of Trading and Markets.

<sup>8</sup> See Bachmann Report at 11 citing the Report of the Presidential Task Force on Market Mechanisms at 64 (January 1988); 1987 Market Break Report at 10-57 (stating that “[i]n a fully integrated cross-margin account, margin requirements could be fixed to reflect more accurately the net risk of such positions taken as a whole, thus reducing certain margin requirements . . .”).

<sup>9</sup> See Bachmann Report at 12.

<sup>10</sup> See Bachmann Report at 31.

implemented, the parties have amended it twice<sup>11</sup>

The Existing X-M Agreement

The Existing X-M Agreement governs OCC and CME's participation in a cross-margining program (the "X-M Program"), which permits positions in certain futures and futures options contracts cleared by CME to be cleared in a special proprietary or non-proprietary cross-margining account (an "X-M Account") at CME, which is then paired with a corresponding X-M Account (proprietary or non-proprietary, as the case may be) at OCC, in which securities options contracts are cleared (such contracts, "Eligible Contracts"). OCC Clearing Members that are also CME members ("Joint Clearing Members"), or that have qualified affiliates that are CME members ("Affiliated Clearing Members"), provided that they have signed the required X-M Program clearing member participation agreement, are permitted to participate in the X-M Program. Currently, there are nine Joint Clearing Members and one pair of Affiliated Clearing Members that participate in the X-M Program. Each Joint Clearing Member or pair of Affiliated Clearing Members electing to participate in the X-M Program and establish a pair of X-M Accounts is required to execute the appropriate account agreements in the forms prescribed by OCC and CME and to designate the account as either "proprietary" or "non-proprietary."<sup>12</sup>

Proprietary X-M accounts are confined to the confirmed trades and positions of non-

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<sup>11</sup> See, e.g., Securities Exchange Act Release Nos. 32534 (June 28, 1993), 58 FR 36234 (July 6, 1993) (SR-OCC-92-98); 38584 (May 8, 1997), 62 FR 26602 (May 14, 1997); See also supra notes 3 and 4.

<sup>12</sup> The Existing X-M Agreement also permits the establishment of "X-M Pledge Accounts," which are X-M Accounts in respect of which the Clearing Member grants a security interest in all contracts purchased or carried in the particular account to a bank, as security for a loan. X-M Pledge Accounts may be either proprietary or non-proprietary.

customers of Clearing Members and other proprietary “market professionals.”<sup>13</sup> A non-proprietary X-M Account is limited to options market-makers and other “market professionals.”

Non-proprietary X-M Accounts are treated as futures customer accounts, because they are carried subject to the segregation provisions of Section 4d of the Commodity Exchange Act<sup>14</sup> rather than as securities accounts subject to Rule 15c3-3<sup>15</sup> and other customer protection rules under the Securities Exchange Act of 1934.<sup>16</sup> X-M Accounts that are paired for purposes of the X-M Program are treated for margin purposes as if they were a single account, making it possible to margin the paired X-M Accounts based on the net risk of the potentially offsetting positions within them. The Existing X-M Agreement governs the calculation, collection, and holding of margin with respect to the paired X-M Accounts, as well as the handling of daily settlement.

The Existing X-M Agreement also addresses how OCC and CME may use the contracts and margin held in X-M Accounts in the event of the default of a Joint Clearing Member or Affiliated Clearing Member. Upon suspending a Joint Clearing Member or Affiliated Clearing

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The New X-M Agreement would eliminate the ability to establish such X-M Pledge Accounts because they are no longer being used. Historically, pledge accounts were only used for the purpose of supporting the pledging of money market mutual fund shares as collateral. Now that money market mutual fund shares are not acceptable collateral for the XM Program, there is no longer a need for the use of X-M Pledge Accounts.

<sup>13</sup> See OCC By-Laws Article I, Section 1.O.(1).

<sup>14</sup> 7 U.S.C. 6d.

<sup>15</sup> 17 CFR 240.15c3-3.

<sup>16</sup> 17 CFR 240.8c-1; 17 CFR 240.15c2-1.

Member, the suspending clearinghouse is required to immediately notify the other clearinghouse of the suspension. Both OCC and CME would then immediately liquidate the contracts and margin in each X-M Account carried for the suspended Joint Clearing Member or the Affiliated Clearing Members, unless OCC and CME otherwise agree to delay liquidation or to transfer the contracts. OCC and CME are required to use their best efforts to coordinate the transfer or liquidation of such contracts and to close out any hedged positions simultaneously or, if transferring the positions, to transfer them to the same clearing firm or pair of affiliated clearing firms.

Any funds received by either OCC or CME upon liquidation of the proprietary and non-proprietary X-M Accounts, respectively, may be used to offset expenses arising from the liquidation of such account, and any net proceeds thereafter are to be deposited in a corresponding proprietary or non-proprietary liquidating account established jointly by OCC and CME. The funds in a proprietary or non-proprietary liquidating account are to be used only to set off any liquidating deficits or settlement obligations remaining with respect to the corresponding proprietary or non-proprietary X-M Account, respectively. To the extent the proprietary liquidating account has a surplus, after satisfying all deficits and obligations, the proceeds may be applied to set off any net liquidating deficits or settlement obligations arising from the Clearing Member's non-proprietary X-M Accounts at OCC or CME.

After these offsets, if a liquidating account still has a deficit, each of OCC and CME bear 50% of the remaining shortfall. If a proprietary liquidating account has a surplus, OCC and CME each are entitled to 50% of the surplus to satisfy any losses whatsoever arising from the other

obligations of the defaulting Clearing Member. However, if one clearinghouse's net loss is less than 50% of the remaining surplus and the other's is greater, the former is only entitled to the surplus up to the amount of its loss, and the latter is entitled to receive the balance up to the amount of its loss. After all of this, if any amounts remain in the liquidating accounts, such funds are returned to the Joint Clearing Member or pair of Affiliated Clearing Members or their respective representatives.

#### The Proposed X-M Agreement

The Proposed X-M Agreement retains the same basic framework described above regarding the Existing X-M Agreement, and it would not fundamentally alter the scope of the X-M Program or the rights and responsibilities of OCC and CME. The primary purposes for proposing to update the Existing X-M Agreement with the Proposed X-M Agreement are to: (1) bring the Existing X-M Agreement into conformity with current operational procedures; (2) eliminate provisions in the Existing X-M Agreement that are out-of-date; and (3) improve the clarity and readability of the agreement by consolidating redundant provisions. The Proposed X-M Agreement would also move several of the operational details regarding the X-M Accounts to the OCC-CME Cross-Margining Service Level Agreement ("SLA"). OCC and CME believe that having such operational details in a separate document produces a more streamlined Proposed X-M Agreement that would be easier to comprehend and that would therefore allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement. OCC believes that these changes would make the Proposed X-M Agreement and SLA easier to read and comprehend and would promote



consistency with the requirement in Rule 17Ad-22(e)(1)<sup>17</sup> that OCC must establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, provide for a well-founded, clear and transparent legal basis for each aspect of its activities.

Key changes from the Existing X-M Agreement to the Proposed X-M Agreement are described in detail below.

#### Eligible Contracts and Accepted Transactions

The Proposed X-M Agreement would not change the scope of products eligible for participation in the X-M Program. However, it would include a definition of “Eligible Contracts” in Section 1 that conforms with the substance of the definition that was adopted in 2009 as part of Amendment No. 2 to the Existing X-M Agreement.<sup>18</sup> Consistent with these changes, the definition of “Eligible Contracts” in the Proposed X-M Agreement would include any contracts that have been “jointly designated” by OCC and CME as eligible for inclusion in the list of eligible contracts jointly maintained by OCC and CME. Prior to designating a new set of contracts as Eligible Contracts, OCC and CME would be required to evaluate and approve the additional contracts through internal processes that consider each clearing organization’s risk policies.

Section 1 of the Proposed X-M Agreement would also be amended to introduce the new defined term “Accepted Transaction” and to provide a mechanism for confirming what specific transactions are subject to the Proposed X-M Agreement. The purpose of this change is not to

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<sup>17</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>18</sup> See supra note 11.

change the scope of the X-M Program but rather to provide certainty and clarity regarding the specific transactions – the “Accepted Transactions” – for which OCC and CME would be jointly responsible. “Accepted Transactions” would be defined to include all positions that are Eligible Contracts and have been included on the “daily margin detail report” generated by OCC and transmitted to CME. Positions included in the “daily margin detail report” would be deemed to be the final record of positions in which OCC and CME are obligated under the Proposed X-M Agreement.

#### The Service Level Agreement

As part of the update to the Proposed X-M Agreement, certain operational terms previously covered in the Existing X-M Agreement would be addressed in the SLA. For example, this includes provisions from the Existing X-M Agreement in Section 6 regarding acceptable forms of collateral, Section 7 regarding the timing, methods and forms of daily settlement procedures, and Section 15 regarding OCC and CME’s commitment to share information regarding Joint and Affiliated Clearing Members, banks, and their own financial status. The Proposed X-M Agreement would address the existence of this SLA in a proposed Section 2, stating that all “times, methods and forms of deliveries, notification and consents” pertaining to the X-M Program and X-M Accounts are provided for in the SLA. CME and OCC would also agree to review the SLA at least annually.

#### Account Structure

The same basic account structure in Section 2 of the Existing X-M Agreement would still be used in Section 3 of the Proposed X-M Agreement. Proprietary and/or non-proprietary paired

clearing accounts would still be established for Joint and Affiliated Clearing Members that participate in the X-M Program, and OCC and CME would continue to have a joint security interest in the contracts, margin, and other property held in the joint accounts. However, as noted above, the Proposed X-M Agreement would remove all references to X-M Pledge Accounts because such accounts are no longer in use. Along with removing all references to such accounts throughout the Proposed X-M Agreement, Section 3 of the Existing X-M Agreement, entitled “Establishment of X-M Pledge Accounts,” would be deleted in its entirety.

The Proposed X-M Agreement would also change some of the defined terms that are used to describe the accounts related to the X-M Program to describe their purpose more accurately. For example, the “Proprietary Joint Settlement Account” and “Segregated Joint Margin Account” would be referred to as the “Proprietary Joint Margin Cash Account” and “Segregated Joint Margin Cash Account,” and the “Proprietary Joint Custody Account” and “Segregated Joint Custody Account” would be referred to as the “Proprietary Joint Margin Custody Account” and “Segregated Joint Margin Custody Account.” The terms “Proprietary Bank Account” and “Segregated Funds Bank Account” would also be added to the defined terms section for readability and consistency, though they were already used in the body of the Existing X-M Agreement. The proposed addition of such terms to the defined terms section would not change for the purposes of the agreement. The defined term “Liquidating Accounts” would also be added to the agreement to cover the Non-Proprietary and Proprietary Liquidating Accounts

created in the event of a Clearing Member suspension and liquidation.

Margin and Posted Collateral

The Proposed X-M Agreement would replace the provisions in Section 5 of the Existing X-M Agreement regarding the methodology for determining the initial margin requirements for each X-M Account with a statement that, with respect to each pair of X-M Accounts, the amount of cash, securities or other property required to be deposited as collateral would be determined by using OCC's approved margin methodology, as in effect as of the date of the Proposed X-M Agreement. As a practical matter, this change would not represent a change from the existing operation of the X-M Program because, consistent with the authority in Section 5, CME already elects to use the margin calculation that is produced by OCC. The Proposed X-M Agreement would also require OCC to provide 30 calendar days prior notice to CME of any proposed changes to OCC's margin methodology, and any changes to the way collateral requirements are calculated with respect to X-M Accounts would be required to be agreed upon in writing in advance by OCC and CME. The Proposed X-M Agreement would also specify that OCC and CME would each determine the net amount of premiums, exercise settlement amounts, and variation margin due for its respective products because the determination is made based upon the products cleared by OCC and CME, and adopts the defined terms "Net Pay/Collect" to refer to such amount. Each clearinghouse would be required to notify the other of the Net Pay/Collect amount in accordance with the SLA.

Like under the Existing X-M Agreement, OCC and CME would each still have the ability to charge additional margin at any amount as it deems appropriate without the consent of the

other and each would be responsible for determining the adequacy of the margin requirement for each cross-margin account.

As discussed above, Section 6 of the Proposed X-M Agreement would no longer specify the eligible forms of initial margin, instead referring to the SLA. The SLA would revise the list of eligible collateral to include cash, treasuries, and letters of credit from pre-approved U.S. depository institutions, and eliminate the eligibility of government sponsored entity debt and money market funds. OCC and CME are proposing to eliminate the eligibility of these instruments because, in practice, OCC no longer accepts them as collateral for the X-M Program. This is because no money market mutual funds currently meet OCC's requirements for such margin assets set forth in OCC Rule 604(b)(3), and OCC's liquidity facilities do not currently accept government sponsored entity debt as collateral. Consequently, all references to government sponsored entity debt and money market funds are removed from the Proposed X-M Agreement. The Proposed X-M Agreement would also clarify that the more conservative limits would apply to the extent OCC and CME's rules with respect to concentration limits for eligible margin differ. Furthermore, if OCC reduces any of its required haircuts for eligible margin below CME's required haircuts, OCC is required to provide prompt notice to CME.

The Proposed X-M Agreement would also provide that OCC and CME would each be permitted to invest any cash deposited as collateral in their joint margin cash accounts overnight in certain eligible investments and with certain custodians, depositories, and counterparties, as OCC and CME may mutually agree, with each clearinghouse sharing equally in any proceeds received, or losses incurred, from such overnight investments. This formalizes the existing

practice of OCC and CME and provides clarity that OCC and CME share equally in any proceeds or losses from overnight investments.

Additionally, the Proposed X-M Agreement would no longer use the term “Margin” or “Initial Margin” with respect to the collateral deposited in an X-M Account. Instead, it would use the term “Posted Collateral.” OCC proposes the change because it is a more accurate characterization of the margin requirement set by OCC’s System for Theoretical Analysis and Numerical Simulations (“STANS”) – which is the methodology used to determine the collateral requirement for the X-M Program and does not produce a separate Initial Margin requirement. References to margin requirements and deficits or surpluses in respect to such requirements are proposed to be replaced with references to the defined terms “Collateral Requirement,” “Collateral Deficit,” and “Collateral Excess,” respectively.

#### Daily Settlement

Section 7 of the Proposed X-M Agreement would be revised to increase the time OCC and CME would have to provide approval or non-approval of revised Settlement Instructions from 15 minutes to 30 minutes. Based on OCC and CME’s experience operating the X-M Program, OCC believes the change from 15 to 30 minutes would provide additional time which would be useful during the process of performing a full review of any revised Settlement Instructions and making determinations for approval or non-approval of the revised Settlement Instructions. Furthermore, OCC has determined that the proposed change to add additional time to review revised Settlement Instructions will not negatively impact on the timing of other

processes performed under the Proposed X-M Agreement.

As described above, details regarding the timing, methods, and form of daily settlement in the X-M Accounts have been moved to the SLA, and Section 7 of the Proposed X-M Agreement would be amended to reflect that fact. Section 7 would also be amended to conform to existing reporting practices for OCC and CME with respect to settlement. For example, under the Existing X-M Agreement each clearing organization issues a “Margin and Settlement Report” to each Joint Clearing Member or pair of Affiliated Clearing Members for which it is the Designated Clearing Organization. However, in practice, OCC has been the only Designated Clearing Organization. Accordingly, the related provisions would be modified so that the information contained in that report is only provided by OCC to the Clearing Members. The definition of “Margin and Settlement Report” in Section 1 of the Proposed X-M Agreement is correspondingly modified and would refer to the report more specifically as the “Account Summary by Clearing Corporation Report.”

The Proposed X-M Agreement would also update Section 7 to provide for the communication of intra-day instructions to X-M clearing banks with respect to the X-M Accounts, to facilitate the deposit of collateral in response to an intra-day margin call from CME or OCC. A defined term for “Intra-day Instruction” would also be added to Section 1 to accommodate this change.

#### Suspension and Liquidation

Section 8 of the Proposed X-M Agreement essentially retains the Existing X-M Agreement’s procedures for the handling of X-M Accounts in the event of the default of a Joint

Clearing Member or pair of Affiliated Clearing Members, as described above, with certain modifications. First, paragraphs 8(a) and (b) would be revised to state more generally that each clearinghouse will follow its own rules with respect to the default of a Clearing Member; provided, however, that each clearinghouse would also use its best efforts to coordinate with the other clearinghouse regarding the liquidation or transfer of Accepted Transactions. The proposed changes that expressly provide that each clearinghouse would follow its own rules with respect to the default of a Clearing Member are not intended to substantively change the terms in the Existing X-M Agreement. Instead, they are meant to provide each clearinghouse with greater flexibility to amend their suspension and liquidation procedures pursuant to the normal rule change process without having to also amend the Proposed X-M Agreement. The Proposed X-M Agreement also now expressly contemplates the potential use of a joint liquidating auction with respect to X-M Accounts during a Clearing Member default scenario.

Second, new sections 8(c) and (d) would be added to the Proposed X-M Agreement to provide that upon the suspension of a defaulted Clearing Member, the clearinghouses would establish a plan pursuant to which Accepted Transactions of the Clearing Member would be liquidated or transferred. The plan would be required, at a minimum, to (i) identify the primary point of contact at each clearinghouse responsible for coordinating communications and actions related to the plan; (ii) current-day settlement information related to the suspended Clearing Member; and (iii) whether any transactions in addition to Accepted Transactions would be guaranteed. If by the close of the markets on the business day that follows the last successful margin collection for the suspended Clearing Member the clearinghouses do not take action



under a plan or have not otherwise established a plan, then the clearinghouses would be required to take certain steps to transfer cleared contracts prior to the open of trading on the next business day. Specifically, contracts cleared by each respective clearinghouse would be transferred into an account under its control to allow that clearinghouse to liquidate or transfer the contracts pursuant to its rules. The closing prices for the cleared contracts used to determine final proceeds and any liquidity obligations of the clearinghouses would be the prices as of the business day that immediately follows the last successful margin collection for the suspended Clearing Member.

Third, Section 8 would also be revised to provide that each of OCC and CME agree to enter into any agreements reasonably necessary to ensure that the other can obtain liquidity during a default scenario and will be jointly and equally responsible for providing liquidity to ensure all obligations of a non-defaulting Clearing Member with respect to the X-M Accounts on a timely basis. OCC believes this change would help ensure OCC and CME have sufficient access to liquidity and thereby provide for efficient and effective default management in the event of a Clearing Member default.

Finally, OCC and CME also would agree to conduct joint default management drills for the cross-margin accounts at least annually. OCC believes that this change would promote consistency with the requirement in Rule 17Ad-22(e)(13) that OCC as a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to “[e]nsure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring [its] participants and, when practicable, other stakeholders to participate in

the testing and review of its default procedures, including any close-out procedure, at least annually and following material changes thereto.”<sup>19</sup>

#### Miscellaneous Changes

Regarding other changes, first the “Recitals” to the Proposed X-M Agreement would be updated to reflect OCC and CME’s respective SEC and CFTC registration statuses and designations as systemically important by the Financial Stability Oversight Council. Related to this, defined terms would be added for “FSOC,” “Dodd Frank Act,” “DCO,” “Exchange Act,” and “SEC.”

Second, Section 9 of the Proposed X-M Agreement would be amended to clarify that the requirement that one clearinghouse notify the other when it becomes subject to a court order to disclose “confidential information” is only required if it is permitted by law.

Third, Section 10 of the Proposed X-M Agreement would rephrase the section to only reference Losses because the definition of Losses under the Proposed X-M Agreement would be revised to include claims and other potential loss events.

Fourth, Section 13 of the proposed agreement would change the process and timing related to termination of the agreement because OCC and CME believe the revised language would reduce risk in the event of a termination.

Fifth, the Proposed X-M Agreement would also revise Section 14, to clarify that while OCC and CME are not permitted to reject any transaction effected in an X-M Account without the other’s express consent, this condition would not interfere with their respective abilities to

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<sup>19</sup> 17 CFR 240.17Ad-22(e)(13).

implement recovery and orderly wind-down plans under their own rules, as required under Rule 17Ad-22(e)(3)(ii)<sup>20</sup> and CFTC Rule 39.39(b).<sup>21</sup>

Sixth, as discussed above in the description of the SLA, Section 15 of the Existing X-M Agreement regarding information sharing between OCC and CME would be deleted from the Proposed X-M Agreement and moved to the SLA. OCC believes the more succinctly drafted language in the SLA maintains consistent rights and/or obligations for OCC and CME to share information which will continue to allow OCC and CME to efficiently manage the risks presented by Joint and Affiliated Clearing Members.

Seventh, Section 15 of the Proposed X-M Agreement regarding notifications differs from the corresponding provisions in Section 16 of the Existing X-M Agreement, in that it would allow for the use of electronic mail to satisfy notice requirements, except with respect to notifications relating to the termination of the Proposed X-M Agreement. It would also eliminate facsimile as an appropriate method of communication. OCC believes this change conforms to current communication procedures and standards and ensures notices will be received in a timely manner through a communication method that is monitored regularly.

Finally, the Proposed X-M Agreement would also add Section 17 to clarify that each of OCC and CME would be responsible for obtaining their own regulatory approvals in connection

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<sup>20</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>21</sup> 17 CFR 39.39(b).

with the implementation of the Proposed X-M Agreement.

Additional Changes to Defined Terms

In addition to the proposed and modified defined terms described above, the Proposed X-M Agreement would make certain additional modifications to Section 1 of the Existing X-M Agreement. Many of these are non-substantive, including adding defined terms that are already used and defined elsewhere in the Existing X-M Agreement but that are not currently listed in Section 1 – e.g., the defined terms “AAA,” “Affiliated Clearing Member,” “CME Clearing Member,” “CME Rules,” “Confidential Information,” “Indemnitor,” “Indemnified Party,” “Losses,” “OCC Clearing Member,” and “OCC Rules.” The Proposed X-M Agreement would also modify the definition of “Affiliate” to remove the statement that 10% ownership of common stock will be deemed *prima facie* control of that entity for purposes of determining whether an entity is under direct or indirect control of a Clearing Member, to instead reflect that OCC and CME believe that a facts-and-circumstances approach is more appropriate. The definition of “Business Day” would be modified to provide that when one or more markets on which cleared contracts trade are closed but banks are open, OCC and CME would each make their own determination regarding whether and to what extent to treat any such day as a Business Day for purposes of Section 7 of the Proposed X-M Agreement regarding daily settlements.

Clearing Member Agreements

In conjunction with the streamlining efforts at the heart of the Proposed X-M Agreement, OCC is proposing to consolidate certain of the template Clearing Member agreements that it maintains for the X-M Program. As noted above, a Clearing Member that intends to participate

in the X-M Program must execute the appropriate Clearing Member agreement. Currently, there are six such template agreements, and the appropriate agreement for the participating Clearing Member depends on the type of account it will be using as its X-M Account (i.e., proprietary, non-proprietary, or market professional) and whether the Clearing Member will be participating in the X-M Program as a Joint Clearing Member or with an Affiliated Clearing Member. To maintain fewer templates and streamline the Clearing Member documentation, the six template agreements would be consolidated into three. Specifically, Joint Clearing Members and Affiliated Clearing Members would use the same template agreement for the appropriate account type (i.e., proprietary, non-proprietary, or market professional). The revised Clearing Member agreements include language providing for OCC and CME's ability to move positions between Clearing Member accounts, as necessary, based upon Clearing Member instruction, to maintain positions in the appropriate account type. The substance of the agreements is not otherwise being altered.

B. Statutory Basis

Section 17A(b)(3)(F) of the Securities Exchange Act of 1934 ("Act") requires, among other things, that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.<sup>22</sup> OCC believes that the proposal is consistent with this requirement for the following reasons. The proposed change would improve the clarity and transparency of the Existing X-M Agreement by moving several of the operational details to an SLA to produce a

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<sup>22</sup> 15 U.S.C. 78q-1(b)(3)(F).

more streamlined Proposed X-M Agreement that would be easier to comprehend. Maintaining a separate SLA would also allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement – improving the ease with which the parties would be able to keep the legal requirements of X-M Program consistent with evolving operational needs. Further, as described above, certain aspects of the Existing X-M Agreement would be clarified to reflect current practice. For example, the Proposed X-M Agreement would remove provisions related to the X-M Pledge Accounts to reflect the fact that they are no longer used. Also, the Proposed X-M Agreement would modify provisions related to the calculation of the margin requirements for X-M Accounts to reflect the fact that OCC’s margin methodology has historically been and will continue to be the margin methodology that is used.

Section 17A(b)(3)(F) of the Act also requires that the rules of a clearing agency be designed, in general, to protect investors and the public interest.<sup>23</sup> OCC believes the proposal is consistent with this requirement because, under the Proposed X-M Agreement, the X-M Program would continue to benefit dual participants with hedged positions at the respective clearing organizations by permitting them to meet margin requirements that are based on the risk of the combined positions.

Rule 17Ad-22(e)(20)<sup>24</sup> requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to “identify, monitor,

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<sup>23</sup> Id.

<sup>24</sup> 17 CFR 240.17Ad-22(e)(20).

and manage risks related to any link<sup>25</sup> the covered clearing agency establishes with one or more other clearing agencies, financial market utilities, or trading markets.” OCC and CME have each been designated as systemically important financial market utilities and OCC believes that the X-M Program meets the definition of a “link” for this purpose. Replacing the Existing X-M Agreement with a Proposed X-M Agreement that better reflects OCC and CME’s current operational procedures, and which relocates several of the operational details to an SLA that allows them to be reviewed and updated on a more regular basis, furthers the purpose of identifying and managing risks arising from the OCC-CME linkage and therefore promotes robust risk management and reducing systemic risk. Accordingly, OCC believes that adopting the Proposed X-M Agreement is consistent with Rule 17Ad-22(e)(20).<sup>26</sup>

OCC also believes that the proposed change would promote compliance with Rule 17Ad-22(e)(1),<sup>27</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.” The Proposed X-M Agreement would move several of the operational details

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<sup>25</sup> A “link” for purposes of Rule 17Ad-22(e)(20) means “a set of contractual and operational arrangements between two or more clearing agencies, *financial market utilities*, or trading markets that connect them directly or indirectly for the purposes of participating in settlement, *cross margining*, expanding their services to additional instruments or participants, or for any other purposes material to their business.” [emphasis added.] See 17 CFR 240.17Ad-22(a)(8).

<sup>26</sup> 17 CFR 240.17Ad-22(e)(20).

<sup>27</sup> 17 CFR 240.17Ad-22(e)(1).

regarding the X-M Accounts to a standalone SLA, which OCC believes would produce a more streamlined Proposed X-M Agreement that would be easier to comprehend. The proposed change would also allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement – thereby promoting the ability of the parties to keep the agreements that are the legal basis for the X-M Program consistent with evolving operational needs. Accordingly, OCC believes that the proposed change is consistent with Rule 17Ad-22(e)(1).

OCC further believes that the proposed change would promote compliance with Rule 17Ad-22(e)(13),<sup>28</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “ensure [it] has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring [its] participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedures, at least annually and following material changes thereto.” The Proposed X-M Agreement specifically requires OCC and CME to conduct joint default management drills with respect to the X-M Account at least annually. It also includes new language providing that each of OCC and CME will enter into any agreements reasonably necessary to ensure that the other can obtain liquidity during a default scenario and that they will be jointly and equally responsible for providing liquidity to ensure all obligations of non-defaulting Clearing Members with respect to the X-M Accounts on a timely basis. These changes

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<sup>28</sup> 17 CFR 240.17Ad-22(e)(13).



are specifically designed to ensure OCC and CME retain operational capacity with respect to the X-M Program during a Clearing Member default, and OCC accordingly believes they are consistent with Rule 17Ad-22(e)(13).

OCC also believes that the proposed change would promote compliance with Rule 17Ad-22(e)(17),<sup>29</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “manage the covered clearing agency’s operational risks by,” among other things, “identifying the plausible sources of operational risk . . . and mitigating their impact through the use of appropriate systems, policies, procedures, and controls [and] ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity.” As described above, certain aspects of the Existing X-M Agreement do not reflect current operational realities with respect to the X-M Program, which potentially could be a source of operational risk to OCC. OCC believes that the Proposed X-M Agreement would reduce this potential source of operational risk by removing and updating provisions and requirements that are out of date, like those related to determining the margin requirements for an X-M Account or various required methods of communication and notification. Accordingly, OCC believes that the proposed change is consistent with Rule 17Ad-22(e)(17). In these ways, OCC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act<sup>30</sup> and Rules 17Ad-22(e)(1), (13), (17), and (20).<sup>31</sup>

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

<sup>30</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>31</sup> 17 CFR 240.17Ad-22(e)(1), (13), (17), and (20).

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

Section 17A(b)(3)(I) of the Act<sup>32</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposal would impose any burden on competition.<sup>33</sup> The primary purpose of the proposed rule change is to update and clarify the existing X-M Agreement to reflect current practices and also streamline Clearing Member agreements. The proposed rule change would not affect any individual Clearing Member’s current rights or ability to access OCC services or disadvantage or favor any particular user in relationship to another. As such, OCC believes that the proposed changes would not have any impact or impose any burden on competition.

**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 proposed change and none have been received. OCC will notify the Commission of any written comments received by OCC.

**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.

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<sup>32</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>33</sup> Id.

**Item 8. Proposed Rule Change Based on Rules 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**

Not applicable.

**Item 11. Exhibits**

Exhibit 1A. Completed notice of the proposed rule change for publication in the Federal Register.

Exhibit 3. OCC-CME Cross-Margining Service Level Agreement.

Exhibit 5. Second Amended and Restated Cross-Margining Agreement.

**CONFIDENTIAL TREATMENT IS REQUESTED FOR EXHIBITS 3 AND 5  
PURSUANT TO SEC RULE 24b-2**

**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: \_\_\_\_\_  
**Michelle Weiler**  
**Vice President, Associate General**  
**Counsel**

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-[\_\_\_\_\_]; File No. SR-OCC-2020-011)

September \_\_, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Adopt a New Second Amended and Restated Cross-Margining Agreement Between The Options Clearing Corporation and The Chicago Mercantile Exchange

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 22, 2020, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

This proposed rule change by The Options Clearing Corporation (“OCC”) would adopt a new Second Amended and Restated Cross-Margining Agreement (“Proposed X-M Agreement”) between OCC and the Chicago Mercantile Exchange (“CME”). This proposal is designed to: (1) update the existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details from the existing X-

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

M Agreement to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements.

The Proposed X-M Agreement is attached hereto as Exhibit 5 of filing SR-OCC-2020-011. The Proposed X-M Agreement includes the following as appendices each of which is marked to show changes: Proprietary Cross-Margin Account Agreement and Security Agreement; Non-Proprietary Cross-Margin Account Agreement and Security Agreement; and Market Professional's Agreement for Cross-Margining.<sup>3</sup>

This proposed rule change does not require any changes to the text of OCC's By-Laws or Rules. All terms with initial capitalization that are not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.<sup>4</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. 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), (B), and (C) below, of the most significant aspects of these statements.

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<sup>3</sup> Each of the Clearing Member agreement forms includes a version for Joint and Affiliated Clearing Members.

<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#rule-filings>.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

The purpose of this proposed rule change is to adopt a new Second Amended and Restated Cross-Margining Agreement between OCC and CME, that would: (1) update the existing X-M Agreement with the Proposed X-M Agreement to bring it into conformity with current operational procedures and eliminate provisions that are out-of-date; (2) improve the clarity and readability by consolidating certain redundant provisions and moving certain operational details to a standalone service level agreement; and (3) streamline and consolidate certain related Clearing Member agreements.

Background

OCC and CME are currently parties to an Amended and Restated Cross-Margining Agreement dated May 28, 2008, as further amended by Amendment No. 1 dated October 23, 2008<sup>5</sup> and Amendment No. 2 dated May 20, 2009<sup>6</sup> (the "Existing X-M Agreement"). OCC and CME first implemented their cross-margining program (the "X-M Program") in 1989. The purpose of the X-M Program is to: (1) facilitate the cross-margining of positions in options cleared by OCC with positions in futures and commodity options cleared by CME and (2) address the fact that Clearing Members may have been required to meet higher margin requirements at each clearinghouse than were

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<sup>5</sup> Securities Exchange Act Release No. 58258 (July 30, 2008), 73 FR 46133 (August 7, 2008) (SR-OCC-2008-12) (amending the agreement to, among other things, permit money market fund shares as margin).

<sup>6</sup> Securities Exchange Act Release No. 60063 (June 8, 2009), 74 FR 28738 (June 17, 2009) (SR-OCC-2009-10) (amending the agreement to redefine the term "Eligible Contracts" and deleting the list of such contracts attached as Schedule A).

warranted by the risk of combined positions, because each portfolio was margined separately without regard to positions held in the other portfolio.<sup>7</sup> After the 1987 Market Break, several government reports recommending market structure reforms found that cross-margining arrangements between clearinghouses should be implemented or expanded, because they could have a profound effect on mitigating liquidity stress to key market participants at critical times.<sup>8</sup> For example, the Bachmann Task Force, which was formed at the request of SEC Chairman Breeden to address the issue of safety and soundness of the clearance and settlement system in the United States, published a report on Clearance and Settlement Reform in the U.S. Securities Markets, and the staff of the SEC's Division of Market Regulation<sup>9</sup> also published its own report to analyze factors involved in the depth and rapidity of the market decline. Both reports noted that the existence of separate clearinghouses for each market segment increases systemic exposure because no single clearinghouse is able to accurately assess intermarket exposure among its clearing members and among their customers.<sup>10</sup> Accordingly, the

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<sup>7</sup> Securities Exchange Act Release Nos. 26607 (March 7, 1989), 48 FR 10608 (March 14, 1989) (SR-OCC-89-1); 27296 (September 26, 1989) (SR-OCC-89-11).

<sup>8</sup> See Report of the Bachmann Task Force on Clearance and Settlement Reform in U.S. Securities Markets, Submitted to The Chairman of the U.S. Securities and Exchange Commission (May 1992) (the "Bachmann Report"); The October 1987 Market Break, A Report by the Division of Market Regulation, U.S. Securities and Exchange Commission (February 1988) (the "1987 Market Break Report").

<sup>9</sup> This Division is now known as the Division of Trading and Markets.

<sup>10</sup> See Bachmann Report at 11 citing the Report of the Presidential Task Force on Market Mechanisms at 64 (January 1988); 1987 Market Break Report at 10-57 (stating that "[i]n a fully integrated cross-margin account, margin requirements could be fixed to reflect more accurately the net risk of such positions taken as a whole, thus reducing certain margin requirements . . .").



Bachmann Report specifically advanced that the cross-margining agreement in place between OCC and CME benefited dual participants with hedged positions with the respective clearing organizations,<sup>11</sup> and it stated that OCC and relevant futures exchanges should be encouraged to expand their cross-margining programs because they “reduce clearing system risk by substituting correlated positions for cash or cash equivalent margins and provide financing relief and settlement harmonization.”<sup>12</sup> Since the X-M Program was implemented, the parties have amended it twice<sup>13</sup>

#### The Existing X-M Agreement

The Existing X-M Agreement governs OCC and CME’s participation in a cross-margining program (the “X-M Program”), which permits positions in certain futures and futures options contracts cleared by CME to be cleared in a special proprietary or non-proprietary cross-margining account (an “X-M Account”) at CME, which is then paired with a corresponding X-M Account (proprietary or non-proprietary, as the case may be) at OCC, in which securities options contracts are cleared (such contracts, “Eligible Contracts”). OCC Clearing Members that are also CME members (“Joint Clearing Members”), or that have qualified affiliates that are CME members (“Affiliated Clearing Members”), provided that they have signed the required X-M Program clearing member participation agreement, are permitted to participate in the X-M Program. Currently, there are nine Joint Clearing Members and one pair of Affiliated Clearing Members that

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<sup>11</sup> See Bachmann Report at 12.

<sup>12</sup> See Bachmann Report at 31.

<sup>13</sup> See, e.g., Securities Exchange Act Release Nos. 32534 (June 28, 1993), 58 FR 36234 (July 6, 1993) (SR-OCC-92-98); 38584 (May 8, 1997), 62 FR 26602 (May 14, 1997); See also supra notes 5 and 6.

participate in the X-M Program. Each Joint Clearing Member or pair of Affiliated Clearing Members electing to participate in the X-M Program and establish a pair of X-M Accounts is required to execute the appropriate account agreements in the forms prescribed by OCC and CME and to designate the account as either “proprietary” or “non-proprietary.”<sup>14</sup>

Proprietary X-M accounts are confined to the confirmed trades and positions of non-customers of Clearing Members and other proprietary “market professionals.”<sup>15</sup> A non-proprietary X-M Account is limited to options market-makers and other “market professionals.”

Non-proprietary X-M Accounts are treated as futures customer accounts, because they are carried subject to the segregation provisions of Section 4d of the Commodity Exchange Act<sup>16</sup> rather than as securities accounts subject to Rule 15c3-3<sup>17</sup> and other customer protection rules under the Securities Exchange Act of 1934.<sup>18</sup> X-M Accounts that are paired for purposes of the X-M Program are treated for margin purposes as if

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<sup>14</sup> The Existing X-M Agreement also permits the establishment of “X-M Pledge Accounts,” which are X-M Accounts in respect of which the Clearing Member grants a security interest in all contracts purchased or carried in the particular account to a bank, as security for a loan. X-M Pledge Accounts may be either proprietary or non-proprietary. The New X-M Agreement would eliminate the ability to establish such X-M Pledge Accounts because they are no longer being used. Historically, pledge accounts were only used for the purpose of supporting the pledging of money market mutual fund shares as collateral. Now that money market mutual fund shares are not acceptable collateral for the XM Program, there is no longer a need for the use of X-M Pledge Accounts.

<sup>15</sup> See OCC By-Laws Article I, Section 1.O.(1).

<sup>16</sup> 7 U.S.C. 6d.

<sup>17</sup> 17 CFR 240.15c3-3.

<sup>18</sup> 17 CFR 240.8c-1; 17 CFR 240.15c2-1.

they were a single account, making it possible to margin the paired X-M Accounts based on the net risk of the potentially offsetting positions within them. The Existing X-M Agreement governs the calculation, collection, and holding of margin with respect to the paired X-M Accounts, as well as the handling of daily settlement.

The Existing X-M Agreement also addresses how OCC and CME may use the contracts and margin held in X-M Accounts in the event of the default of a Joint Clearing Member or Affiliated Clearing Member. Upon suspending a Joint Clearing Member or Affiliated Clearing Member, the suspending clearinghouse is required to immediately notify the other clearinghouse of the suspension. Both OCC and CME would then immediately liquidate the contracts and margin in each X-M Account carried for the suspended Joint Clearing Member or the Affiliated Clearing Members, unless OCC and CME otherwise agree to delay liquidation or to transfer the contracts. OCC and CME are required to use their best efforts to coordinate the transfer or liquidation of such contracts and to close out any hedged positions simultaneously or, if transferring the positions, to transfer them to the same clearing firm or pair of affiliated clearing firms.

Any funds received by either OCC or CME upon liquidation of the proprietary and non-proprietary X-M Accounts, respectively, may be used to offset expenses arising from the liquidation of such account, and any net proceeds thereafter are to be deposited in a corresponding proprietary or non-proprietary liquidating account established jointly by OCC and CME. The funds in a proprietary or non-proprietary liquidating account are to be used only to set off any liquidating deficits or settlement obligations remaining with respect to the corresponding proprietary or non-proprietary X-M Account, respectively. To the extent the proprietary liquidating account has a surplus, after satisfying all deficits

and obligations, the proceeds may be applied to set off any net liquidating deficits or settlement obligations arising from the Clearing Member's non-proprietary X-M Accounts at OCC or CME.

After these offsets, if a liquidating account still has a deficit, each of OCC and CME bear 50% of the remaining shortfall. If a proprietary liquidating account has a surplus, OCC and CME each are entitled to 50% of the surplus to satisfy any losses whatsoever arising from the other obligations of the defaulting Clearing Member. However, if one clearinghouse's net loss is less than 50% of the remaining surplus and the other's is greater, the former is only entitled to the surplus up to the amount of its loss, and the latter is entitled to receive the balance up to the amount of its loss. After all of this, if any amounts remain in the liquidating accounts, such funds are returned to the Joint Clearing Member or pair of Affiliated Clearing Members or their respective representatives.

#### The Proposed X-M Agreement

The Proposed X-M Agreement retains the same basic framework described above regarding the Existing X-M Agreement, and it would not fundamentally alter the scope of the X-M Program or the rights and responsibilities of OCC and CME. The primary purposes for proposing to update the Existing X-M Agreement with the Proposed X-M Agreement are to: (1) bring the Existing X-M Agreement into conformity with current operational procedures; (2) eliminate provisions in the Existing X-M Agreement that are out-of-date; and (3) improve the clarity and readability of the agreement by consolidating redundant provisions. The Proposed X-M Agreement would also move several of the operational details regarding the X-M Accounts to the OCC-CME Cross-Margining

Service Level Agreement (“SLA”). OCC and CME believe that having such operational details in a separate document produces a more streamlined Proposed X-M Agreement that would be easier to comprehend and that would therefore allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement. OCC believes that these changes would make the Proposed X-M Agreement and SLA easier to read and comprehend and would promote consistency with the requirement in Rule 17Ad-22(e)(1)<sup>19</sup> that OCC must establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable, provide for a well-founded, clear and transparent legal basis for each aspect of its activities.

Key changes from the Existing X-M Agreement to the Proposed X-M Agreement are described in detail below.

#### Eligible Contracts and Accepted Transactions

The Proposed X-M Agreement would not change the scope of products eligible for participation in the X-M Program. However, it would include a definition of “Eligible Contracts” in Section 1 that conforms with the substance of the definition that was adopted in 2009 as part of Amendment No. 2 to the Existing X-M Agreement.<sup>20</sup>

Consistent with these changes, the definition of “Eligible Contracts” in the Proposed X-M Agreement would include any contracts that have been “jointly designated” by OCC and CME as eligible for inclusion in the list of eligible contracts jointly maintained by OCC and CME. Prior to designating a new set of contracts as Eligible Contracts, OCC

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<sup>19</sup> 17 CFR 240.17Ad-22(e)(1).

<sup>20</sup> See supra note 13.

and CME would be required to evaluate and approve the additional contracts through internal processes that consider each clearing organization's risk policies.

Section 1 of the Proposed X-M Agreement would also be amended to introduce the new defined term "Accepted Transaction" and to provide a mechanism for confirming what specific transactions are subject to the Proposed X-M Agreement. The purpose of this change is not to change the scope of the X-M Program but rather to provide certainty and clarity regarding the specific transactions – the "Accepted Transactions" – for which OCC and CME would be jointly responsible. "Accepted Transactions" would be defined to include all positions that are Eligible Contracts and have been included on the "daily margin detail report" generated by OCC and transmitted to CME. Positions included in the "daily margin detail report" would be deemed to be the final record of positions in which OCC and CME are obligated under the Proposed X-M Agreement.

#### The Service Level Agreement

As part of the update to the Proposed X-M Agreement, certain operational terms previously covered in the Existing X-M Agreement would be addressed in the SLA. For example, this includes provisions from the Existing X-M Agreement in Section 6 regarding acceptable forms of collateral, Section 7 regarding the timing, methods and forms of daily settlement procedures, and Section 15 regarding OCC and CME's commitment to share information regarding Joint and Affiliated Clearing Members, banks, and their own financial status. The Proposed X-M Agreement would address the existence of this SLA in a proposed Section 2, stating that all "times, methods and forms of deliveries, notification and consents" pertaining to the X-M Program and X-M

Accounts are provided for in the SLA. CME and OCC would also agree to review the SLA at least annually.

#### Account Structure

The same basic account structure in Section 2 of the Existing X-M Agreement would still be used in Section 3 of the Proposed X-M Agreement. Proprietary and/or non-proprietary paired clearing accounts would still be established for Joint and Affiliated Clearing Members that participate in the X-M Program, and OCC and CME would continue to have a joint security interest in the contracts, margin, and other property held in the joint accounts. However, as noted above, the Proposed X-M Agreement would remove all references to X-M Pledge Accounts because such accounts are no longer in use. Along with removing all references to such accounts throughout the Proposed X-M Agreement, Section 3 of the Existing X-M Agreement, entitled “Establishment of X-M Pledge Accounts,” would be deleted in its entirety.

The Proposed X-M Agreement would also change some of the defined terms that are used to describe the accounts related to the X-M Program to describe their purpose more accurately. For example, the “Proprietary Joint Settlement Account” and “Segregated Joint Margin Account” would be referred to as the “Proprietary Joint Margin Cash Account” and “Segregated Joint Margin Cash Account,” and the “Proprietary Joint Custody Account” and “Segregated Joint Custody Account” would be referred to as the “Proprietary Joint Margin Custody Account” and “Segregated Joint Margin Custody Account.” The terms “Proprietary Bank Account” and “Segregated Funds Bank Account” would also be added to the defined terms section for readability and consistency, though they were already used in the body of the Existing X-M Agreement. The proposed

addition of such terms to the defined terms section would not change for the purposes of the agreement. The defined term “Liquidating Accounts” would also be added to the agreement to cover the Non-Proprietary and Proprietary Liquidating Accounts created in the event of a Clearing Member suspension and liquidation.

#### Margin and Posted Collateral

The Proposed X-M Agreement would replace the provisions in Section 5 of the Existing X-M Agreement regarding the methodology for determining the initial margin requirements for each X-M Account with a statement that, with respect to each pair of X-M Accounts, the amount of cash, securities or other property required to be deposited as collateral would be determined by using OCC’s approved margin methodology, as in effect as of the date of the Proposed X-M Agreement. As a practical matter, this change would not represent a change from the existing operation of the X-M Program because, consistent with the authority in Section 5, CME already elects to use the margin calculation that is produced by OCC. The Proposed X-M Agreement would also require OCC to provide 30 calendar days prior notice to CME of any proposed changes to OCC’s margin methodology, and any changes to the way collateral requirements are calculated with respect to X-M Accounts would be required to be agreed upon in writing in advance by OCC and CME. The Proposed X-M Agreement would also specify that OCC and CME would each determine the net amount of premiums, exercise settlement amounts, and variation margin due for its respective products because the determination is made based upon the products cleared by OCC and CME, and adopts the defined terms “Net Pay/Collect” to refer to such amount. Each clearinghouse would be required to notify the other of the Net Pay/Collect amount in accordance with the SLA.



Like under the Existing X-M Agreement, OCC and CME would each still have the ability to charge additional margin at any amount as it deems appropriate without the consent of the other and each would be responsible for determining the adequacy of the margin requirement for each cross-margin account.

As discussed above, Section 6 of the Proposed X-M Agreement would no longer specify the eligible forms of initial margin, instead referring to the SLA. The SLA would revise the list of eligible collateral to include cash, treasuries, and letters of credit from pre-approved U.S. depository institutions, and eliminate the eligibility of government sponsored entity debt and money market funds. OCC and CME are proposing to eliminate the eligibility of these instruments because, in practice, OCC no longer accepts them as collateral for the X-M Program. This is because no money market mutual funds currently meet OCC's requirements for such margin assets set forth in OCC Rule 604(b)(3), and OCC's liquidity facilities do not currently accept government sponsored entity debt as collateral. Consequently, all references to government sponsored entity debt and money market funds are removed from the Proposed X-M Agreement. The Proposed X-M Agreement would also clarify that the more conservative limits would apply to the extent OCC and CME's rules with respect to concentration limits for eligible margin differ. Furthermore, if OCC reduces any of its required haircuts for eligible margin below CME's required haircuts, OCC is required to provide prompt notice to CME.

The Proposed X-M Agreement would also provide that OCC and CME would each be permitted to invest any cash deposited as collateral in their joint margin cash accounts overnight in certain eligible investments and with certain custodians,

depositories, and counterparties, as OCC and CME may mutually agree, with each clearinghouse sharing equally in any proceeds received, or losses incurred, from such overnight investments. This formalizes the existing practice of OCC and CME and provides clarity that OCC and CME share equally in any proceeds or losses from overnight investments.

Additionally, the Proposed X-M Agreement would no longer use the term “Margin” or “Initial Margin” with respect to the collateral deposited in an X-M Account. Instead, it would use the term “Posted Collateral.” OCC proposes the change because it is a more accurate characterization of the margin requirement set by OCC’s System for Theoretical Analysis and Numerical Simulations (“STANS”) – which is the methodology used to determine the collateral requirement for the X-M Program and does not produce a separate Initial Margin requirement. References to margin requirements and deficits or surpluses in respect to such requirements are proposed to be replaced with references to the defined terms “Collateral Requirement,” “Collateral Deficit,” and “Collateral Excess,” respectively.

#### Daily Settlement

Section 7 of the Proposed X-M Agreement would be revised to increase the time OCC and CME would have to provide approval or non-approval of revised Settlement Instructions from 15 minutes to 30 minutes. Based on OCC and CME’s experience operating the X-M Program, OCC believes the change from 15 to 30 minutes would provide additional time which would be useful during the process of performing a full review of any revised Settlement Instructions and making determinations for approval or non-approval of the revised Settlement Instructions. Furthermore, OCC has determined

that the proposed change to add additional time to review revised Settlement Instructions will not negatively impact on the timing of other processes performed under the Proposed X-M Agreement.

As described above, details regarding the timing, methods, and form of daily settlement in the X-M Accounts have been moved to the SLA, and Section 7 of the Proposed X-M Agreement would be amended to reflect that fact. Section 7 would also be amended to conform to existing reporting practices for OCC and CME with respect to settlement. For example, under the Existing X-M Agreement each clearing organization issues a “Margin and Settlement Report” to each Joint Clearing Member or pair of Affiliated Clearing Members for which it is the Designated Clearing Organization. However, in practice, OCC has been the only Designated Clearing Organization. Accordingly, the related provisions would be modified so that the information contained in that report is only provided by OCC to the Clearing Members. The definition of “Margin and Settlement Report” in Section 1 of the Proposed X-M Agreement is correspondingly modified and would refer to the report more specifically as the “Account Summary by Clearing Corporation Report.”

The Proposed X-M Agreement would also update Section 7 to provide for the communication of intra-day instructions to X-M clearing banks with respect to the X-M Accounts, to facilitate the deposit of collateral in response to an intra-day margin call from CME or OCC. A defined term for “Intra-day Instruction” would also be added to Section 1 to accommodate this change.

#### Suspension and Liquidation

Section 8 of the Proposed X-M Agreement essentially retains the Existing X-M Agreement's procedures for the handling of X-M Accounts in the event of the default of a Joint Clearing Member or pair of Affiliated Clearing Members, as described above, with certain modifications. First, paragraphs 8(a) and (b) would be revised to state more generally that each clearinghouse will follow its own rules with respect to the default of a Clearing Member; provided, however, that each clearinghouse would also use its best efforts to coordinate with the other clearinghouse regarding the liquidation or transfer of Accepted Transactions. The proposed changes that expressly provide that each clearinghouse would follow its own rules with respect to the default of a Clearing Member are not intended to substantively change the terms in the Existing X-M Agreement. Instead, they are meant to provide each clearinghouse with greater flexibility to amend their suspension and liquidation procedures pursuant to the normal rule change process without having to also amend the Proposed X-M Agreement. The Proposed X-M Agreement also now expressly contemplates the potential use of a joint liquidating auction with respect to X-M Accounts during a Clearing Member default scenario.

Second, new sections 8(c) and (d) would be added to the Proposed X-M Agreement to provide that upon the suspension of a defaulted Clearing Member, the clearinghouses would establish a plan pursuant to which Accepted Transactions of the Clearing Member would be liquidated or transferred. The plan would be required, at a minimum, to (i) identify the primary point of contact at each clearinghouse responsible for coordinating communications and actions related to the plan; (ii) current-day settlement information related to the suspended Clearing Member; and (iii) whether any transactions in addition to Accepted Transactions would be guaranteed. If by the close of

the markets on the business day that follows the last successful margin collection for the suspended Clearing Member the clearinghouses do not take action under a plan or have not otherwise established a plan, then the clearinghouses would be required to take certain steps to transfer cleared contracts prior to the open of trading on the next business day. Specifically, contracts cleared by each respective clearinghouse would be transferred into an account under its control to allow that clearinghouse to liquidate or transfer the contracts pursuant to its rules. The closing prices for the cleared contracts used to determine final proceeds and any liquidity obligations of the clearinghouses would be the prices as of the business day that immediately follows the last successful margin collection for the suspended Clearing Member.

Third, Section 8 would also be revised to provide that each of OCC and CME agree to enter into any agreements reasonably necessary to ensure that the other can obtain liquidity during a default scenario and will be jointly and equally responsible for providing liquidity to ensure all obligations of a non-defaulting Clearing Member with respect to the X-M Accounts on a timely basis. OCC believes this change would help ensure OCC and CME have sufficient access to liquidity and thereby provide for efficient and effective default management in the event of a Clearing Member default.

Finally, OCC and CME also would agree to conduct joint default management drills for the cross-margin accounts at least annually. OCC believes that this change would promote consistency with the requirement in Rule 17Ad-22(e)(13) that OCC as a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to “[e]nsure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity

demands and continue to meet its obligations by, at a minimum, requiring [its] participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedure, at least annually and following material changes thereto.”<sup>21</sup>

#### Miscellaneous Changes

Regarding other changes, first the “Recitals” to the Proposed X-M Agreement would be updated to reflect OCC and CME’s respective SEC and CFTC registration statuses and designations as systemically important by the Financial Stability Oversight Council. Related to this, defined terms would be added for “FSOC,” “Dodd Frank Act,” “DCO,” “Exchange Act,” and “SEC.”

Second, Section 9 of the Proposed X-M Agreement would be amended to clarify that the requirement that one clearinghouse notify the other when it becomes subject to a court order to disclose “confidential information” is only required if it is permitted by law.

Third, Section 10 of the Proposed X-M Agreement would rephrase the section to only reference Losses because the definition of Losses under the Proposed X-M Agreement would be revised to include claims and other potential loss events.

Fourth, Section 13 of the proposed agreement would change the process and timing related to termination of the agreement because OCC and CME believe the revised language would reduce risk in the event of a termination.

Fifth, the Proposed X-M Agreement would also revise Section 14, to clarify that while OCC and CME are not permitted to reject any transaction effected in an X-M

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<sup>21</sup> 17 CFR 240.17Ad-22(e)(13).

Account without the other's express consent, this condition would not interfere with their respective abilities to implement recovery and orderly wind-down plans under their own rules, as required under Rule 17Ad-22(e)(3)(ii)<sup>22</sup> and CFTC Rule 39.39(b).<sup>23</sup>

Sixth, as discussed above in the description of the SLA, Section 15 of the Existing X-M Agreement regarding information sharing between OCC and CME would be deleted from the Proposed X-M Agreement and moved to the SLA. OCC believes the more succinctly drafted language in the SLA maintains consistent rights and/or obligations for OCC and CME to share information which will continue to allow OCC and CME to efficiently manage the risks presented by Joint and Affiliated Clearing Members.

Seventh, Section 15 of the Proposed X-M Agreement regarding notifications differs from the corresponding provisions in Section 16 of the Existing X-M Agreement, in that it would allow for the use of electronic mail to satisfy notice requirements, except with respect to notifications relating to the termination of the Proposed X-M Agreement. It would also eliminate facsimile as an appropriate method of communication. OCC believes this change conforms to current communication procedures and standards and ensures notices will be received in a timely manner through a communication method that is monitored regularly.

Finally, the Proposed X-M Agreement would also add Section 17 to clarify that each of OCC and CME would be responsible for obtaining their own regulatory approvals in connection with the implementation of the Proposed X-M Agreement.

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<sup>22</sup> 17 CFR 240.17Ad-22(e)(3)(ii).

<sup>23</sup> 17 CFR 39.39(b).

### Additional Changes to Defined Terms

In addition to the proposed and modified defined terms described above, the Proposed X-M Agreement would make certain additional modifications to Section 1 of the Existing X-M Agreement. Many of these are non-substantive, including adding defined terms that are already used and defined elsewhere in the Existing X-M Agreement but that are not currently listed in Section 1 – e.g., the defined terms “AAA,” “Affiliated Clearing Member,” “CME Clearing Member,” “CME Rules,” “Confidential Information,” “Indemnitor,” “Indemnified Party,” “Losses,” “OCC Clearing Member,” and “OCC Rules.” The Proposed X-M Agreement would also modify the definition of “Affiliate” to remove the statement that 10% ownership of common stock will be deemed *prima facie* control of that entity for purposes of determining whether an entity is under direct or indirect control of a Clearing Member, to instead reflect that OCC and CME believe that a facts-and-circumstances approach is more appropriate. The definition of “Business Day” would be modified to provide that when one or more markets on which cleared contracts trade are closed but banks are open, OCC and CME would each make their own determination regarding whether and to what extent to treat any such day as a Business Day for purposes of Section 7 of the Proposed X-M Agreement regarding daily settlements.

### Clearing Member Agreements

In conjunction with the streamlining efforts at the heart of the Proposed X-M Agreement, OCC is proposing to consolidate certain of the template Clearing Member agreements that it maintains for the X-M Program. As noted above, a Clearing Member that intends to participate in the X-M Program must execute the appropriate Clearing



Member agreement. Currently, there are six such template agreements, and the appropriate agreement for the participating Clearing Member depends on the type of account it will be using as its X-M Account (i.e., proprietary, non-proprietary, or market professional) and whether the Clearing Member will be participating in the X-M Program as a Joint Clearing Member or with an Affiliated Clearing Member. To maintain fewer templates and streamline the Clearing Member documentation, the six template agreements would be consolidated into three. Specifically, Joint Clearing Members and Affiliated Clearing Members would use the same template agreement for the appropriate account type (i.e., proprietary, non-proprietary, or market professional). The revised Clearing Member agreements include language providing for OCC and CME's ability to move positions between Clearing Member accounts, as necessary, based upon Clearing Member instruction, to maintain positions in the appropriate account type. The substance of the agreements is not otherwise being altered.

(2) Statutory Basis

OCC believes the proposed rule change is consistent with Section 17A of the Act<sup>24</sup> and the rules thereunder applicable to OCC. Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.<sup>25</sup> OCC believes that the proposal is consistent with this requirement for the following reasons. The proposed change would improve the clarity and transparency of the Existing X-M Agreement by

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<sup>24</sup> 15 U.S.C. 78q-1.

<sup>25</sup> 15 U.S.C. 78q-1(b)(3)(F).

moving several of the operational details to an SLA to produce a more streamlined Proposed X-M Agreement that would be easier to comprehend. Maintaining a separate SLA would also allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement – improving the ease with which the parties would be able to keep the legal requirements of X-M Program consistent with evolving operational needs. Further, as described above, certain aspects of the Existing X-M Agreement would be clarified to reflect current practice. For example, the Proposed X-M Agreement would remove provisions related to the X-M Pledge Accounts to reflect the fact that they are no longer used. Also, the Proposed X-M Agreement would modify provisions related to the calculation of the margin requirements for X-M Accounts to reflect the fact that OCC’s margin methodology has historically been and will continue to be the margin methodology that is used.

Section 17A(b)(3)(F) of the Act also requires that the rules of a clearing agency be designed, in general, to protect investors and the public interest.<sup>26</sup> OCC believes the proposal is consistent with this requirement because, under the Proposed X-M Agreement, the X-M Program would continue to benefit dual participants with hedged positions at the respective clearing organizations by permitting them to meet margin requirements that are based on the risk of the combined positions.

Rule 17Ad-22(e)(20)<sup>27</sup> requires that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to

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<sup>26</sup> Id.

<sup>27</sup> 17 CFR 240.17Ad-22(e)(20).

“identify, monitor, and manage risks related to any link<sup>28</sup> the covered clearing agency establishes with one or more other clearing agencies, financial market utilities, or trading markets.” OCC and CME have each been designated as systemically important financial market utilities and OCC believes that the X-M Program meets the definition of a “link” for this purpose. Replacing the Existing X-M Agreement with a Proposed X-M Agreement that better reflects OCC and CME’s current operational procedures, and which relocates several of the operational details to an SLA that allows them to be reviewed and updated on a more regular basis, furthers the purpose of identifying and managing risks arising from the OCC-CME linkage and therefore promotes robust risk management and reducing systemic risk. Accordingly, OCC believes that adopting the Proposed X-M Agreement is consistent with Rule 17Ad-22(e)(20).<sup>29</sup>

OCC also believes that the proposed change would promote compliance with Rule 17Ad-22(e)(1),<sup>30</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “provide for a well-founded, clear, transparent, and enforceable legal basis for each aspect of its activities in all relevant jurisdictions.” The Proposed X-M Agreement would move several of the operational details regarding the X-M Accounts to a standalone SLA,

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<sup>28</sup> A “link” for purposes of Rule 17Ad-22(e)(20) means “a set of contractual and operational arrangements between two or more clearing agencies, *financial market utilities*, or trading markets that connect them directly or indirectly for the purposes of participating in settlement, *cross margining*, expanding their services to additional instruments or participants, or for any other purposes material to their business.” [emphasis added.] See 17 CFR 240.17Ad-22(a)(8).

<sup>29</sup> 17 CFR 240.17Ad-22(e)(20).

<sup>30</sup> 17 CFR 240.17Ad-22(e)(1).

which OCC believes would produce a more streamlined Proposed X-M Agreement that would be easier to comprehend. The proposed change would also allow OCC and CME to more easily review the service levels and modify them as appropriate without having to amend the entire Proposed X-M Agreement – thereby promoting the ability of the parties to keep the agreements that are the legal basis for the X-M Program consistent with evolving operational needs. Accordingly, OCC believes that the proposed change is consistent with Rule 17Ad-22(e)(1).

OCC further believes that the proposed change would promote compliance with Rule 17Ad-22(e)(13),<sup>31</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “ensure [it] has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring [its] participants and, when practicable, other stakeholders to participate in the testing and review of its default procedures, including any close-out procedures, at least annually and following material changes thereto.” The Proposed X-M Agreement specifically requires OCC and CME to conduct joint default management drills with respect to the X-M Account at least annually. It also includes new language providing that each of OCC and CME will enter into any agreements reasonably necessary to ensure that the other can obtain liquidity during a default scenario and that they will be jointly and equally responsible for providing liquidity to ensure all obligations of non-defaulting Clearing Members with respect to the X-M Accounts on a timely basis. These changes are specifically designed to ensure OCC and CME retain operational capacity

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<sup>31</sup> 17 CFR 240.17Ad-22(e)(13).

with respect to the X-M Program during a Clearing Member default, and OCC accordingly believes they are consistent with Rule 17Ad-22(e)(13).

OCC also believes that the proposed change would promote compliance with Rule 17Ad-22(e)(17),<sup>32</sup> which requires OCC as a covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to “manage the covered clearing agency’s operational risks by,” among other things, “identifying the plausible sources of operational risk . . . and mitigating their impact through the use of appropriate systems, policies, procedures, and controls [and] ensuring that systems have a high degree of security, resiliency, operational reliability, and adequate, scalable capacity.” As described above, certain aspects of the Existing X-M Agreement do not reflect current operational realities with respect to the X-M Program, which potentially could be a source of operational risk to OCC. OCC believes that the Proposed X-M Agreement would reduce this potential source of operational risk by removing and updating provisions and requirements that are out of date, like those related to determining the margin requirements for an X-M Account or various required methods of communication and notification. Accordingly, OCC believes that the proposed change is consistent with Rule 17Ad-22(e)(17). In these ways, OCC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act<sup>33</sup> and Rules 17Ad-22(e)(1), (13), (17), and (20).<sup>34</sup>

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<sup>32</sup> 17 CFR 240.17Ad-22(e)(17).

<sup>33</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(1), (13), (17), and (20).

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act<sup>35</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposal would impose any burden on competition.<sup>36</sup> The primary purpose of the proposed rule change is to update and clarify the existing X-M Agreement to reflect current practices and also streamline Clearing Member agreements. The proposed rule change would not affect any individual Clearing Member's current rights or ability to access OCC services or disadvantage or favor any particular user in relationship to another. As such, OCC believes that the proposed changes would not have any impact or impose any burden on competition.

(C) Clearing Agency'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 proposed change and none have been received. OCC will notify the Commission of any written comments received by OCC.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

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<sup>35</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>36</sup> Id.

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the 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-2020-011 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2020-011. 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 such 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#rule-filings>.

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-2020-011 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Secretary

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<sup>37</sup> 17 CFR 200.30-3(a)(12).