OCC THE FOUNDATION FOR SECURE MARKETS®

Options Clearing Corporation
125. S. Franklin Street, Suite 1200
Chicago, IL 60606
312 322 6200 | theocc.com

July 21, 2023

VIA CFTC PORTAL
Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Rule Certification Concerning Updates to OCC's Capital Management Policy and Cash and Investment Management Policy

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, The Options Clearing Corporation ("OCC") hereby certifies a rule change concerning updates to OCC's Capital Management Policy and Cash and Investment Management Policy. The date of implementation of the rule is at least 10 business days following receipt of the certification by the CFTC. The proposal has also been submitted to the Securities and Exchange Commission ("SEC") under Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder (File No. SR-OCC-2023-006). The change will not be implemented until OCC has obtained all necessary regulatory approvals.

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

Explanation and Analysis

This proposed rule certification would: (1) amend the Capital Management policy to provide that Management will, at a minimum, review OCC's fee schedule at each regularly scheduled Compensation and Performance Committee ("CPC") meeting, consistent with recent updates to the OCC's Board of Director ("Board") and Board-level committee ("Committee") charters, which require each Committee meet at least four times per year, rather than quarterly as the Capital Management Policy currently provides; (2) make certain other edits and additions to the Capital Management Policy for clarity and consistency with OCC's other policies, and (3) amend the Cash and Investment Management Policy to better align the text of that policy to OCC Rules 604(a) and 1002(c), which provide separate treatment for cash deposited by Clearing Members in respect of margin requirements and Clearing Fund deposits, respectively.

The proposed changes to the Capital Management Policy and the Cash and Investment Management Policy are included in confidential Exhibits A and B, respectively. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in OCC's By-Laws and Rules.[1]

Overview

OCC is proposing to make certain administrative and clarifying amendments to OCC's Capital Management Policy, and Cash and Investment Management Policy identified and approved by the Board as part of the annual review of such policies. Specifically, as discussed in more detail below, the proposed changes to the Capital Management Policy would: (1) provide that Management will, at a minimum, review the fee schedule at each regularly scheduled CPC meeting, rather than quarterly, which would align the frequency of such reviews with recent updates to the Board and Committee charters that require each Committee to meet at least four times per year, not necessarily quarterly;[2] and (2) make certain other administrative edits and additions for clarity and consistency with OCC's other policies, including to (i) clarify the ways in which OCC may hold additional financial resources for capital needs, (ii) modify verbiage to avoid confusion with concepts addressed by other OCC rules, and (iii) conform the Capital Management Policy to OCC's current template[3] for its rule-filed policies. The proposed changes to the Cash and Investment Management Policy would clarify that interest earned on Clearing Fund cash, as opposed to margin cash, held at a Federal Reserve Bank would accrue to the benefit of Clearing Members, less a cash management fee, consistent with OCC Rule 1002(c) and the intended meaning of the Cash and Investment Management Policy as expressed in the rule filing that established that policy.[4] Interest or gain on

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1 OCC's current 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.

2 See Exchange Act Release No. 94988 (May 26, 2022), 87 FR 33535, 33537-8 (June 2, 2022) (SR-OCC-2022-002); see also CPC Charter, Section II.B, available at https://www.theocc.com/company-information/documents-and-archives/board-charters ("The Committee shall meet at least four times a year.").

3 "Template" here refers to the format and organizational structure for OCC's internal policies. Previous OCC filings have made similar changes across other policies to conform them to OCC's standard template. See, e.g., Exchange Act Release No. 96566 (Dec. 22, 2022), 87 FR 80207, 80210 (Dec. 29, 2022) (SR-OCC-2022-010) (approving conforming changes across risk policies to remove policy-specific sections concerning policy exceptions and violations in connection with adoption of a section in OCC's Risk Management Framework that uniformly covered those processes); Exchange Act Release No. 93436 (Oct. 27, 2021), 86 FR 60499, 60500 (Nov. 2, 2021) (SR-OCC-2021-010) (removing non-substantive items from OCC's rule-filed policies, including repeated document titles, certain introductory information, related policies and standards, related procedures, and revision history).

4 See infra note 16 and accompanying text.

investment of margin cash would continue to accrue to OCC in accordance with existing OCC Rule 604(a).

Background

Capital Management Policy

Under the Capital Management Policy, OCC determines its Target Capital Requirement, monitors its levels of shareholders' equity ("Equity") and liquid net assets funded by equity ("LNAFBE") to help ensure adequate financial resources are available for general business obligations, and manages Equity levels, including by adjusting OCC's fee schedule as appropriate and establishing a plan for accessing additional capital should OCC's Equity fall below certain thresholds (the "Replenishment Plan").[5] In addition, OCC's Rules[6] and Capital Management Policy[7] provide for OCC's skin-in-the-game, including a Minimum Corporate Contribution[8] and the use of LNAFBE in excess of 110% of the Target Capital Requirement (i.e., the "Early Warning"[9] threshold under OCC's Replenishment Plan) to cover losses arising from a Clearing Member's default.

Target Capital Requirement

Pursuant to the Capital Management Policy, the Target Capital Requirement is based on two components: (1) the amount of LNAFBE determined by OCC to be necessary to ensure compliance with OCC's regulatory obligations, including Rule 17Ad-22(e)(15) under the Exchange Act[10] and (2) any additional amounts determined to be necessary and appropriate for capital expenditures

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5 See Exchange Act Release No. 88029 (Jan. 24, 2020), 85 FR 5500, 5501-03 (Jan. 30, 2020) (SR-OCC-2019-007).

6 See OCC Rule 1006(e)(i).

7 See Exchange Act Release No. 92038 (May 27, 2021), 86 FR 29861 (June 3, 2021) (SR-OCC-2021-003) (order approving changes to OCC's Capital Management Policy and OCC Rule 1006(e) to establish OCC's persistent minimum skin-in-the-game).

8 OCC Rule 101(M)(1) defines the term "Minimum Corporate Contribution" to mean the minimum level of OCC funds maintained exclusively to cover credit losses or liquidity shortfalls. The Minimum Corporate Contribution is determined by the Board from time to time.

9 The Capital Management Policy defines "Early Warning" as when Equity less the Minimum Corporate Contribution falls below 110% of the Target Capital Requirement. Management reviews the Early Warning threshold on an annual basis. See Exchange Act Release No. 88029, 85 FR at 5502.

10 17 CFR 240.17Ad-22(e)(15).

approved by OCC's Board.[11] With respect to the first component, OCC must set its Target Capital Requirement at a level sufficient to maintain LNAFBE at least equal to the greater of: (1) six months of OCC's current operating expenses, (2) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services ("RWD Amount"),[12] and (3) the amount determined by the Board to be sufficient for OCC to continue operations and services as a going concern if general business losses materialize. With respect to the second component, the Capital Management Policy authorizes the Board to increase the Target Capital Requirement by an amount to be retained for capital expenditures. Alternatively, the Board may determine to fund capital expenditures out of funds in excess of the Target Capital Requirement. In making such a determination, the Board would consider factors including, but not limited to, the amount of funding required, the amount of Equity proposed to be retained, the potential impact of the investment on OCC's operations, and the duration of time over which funds would be accumulated.

On an annual basis, OCC's Chief Financial Officer ("CFO") recommends a Target Capital Requirement for the coming year to OCC management.[13] Management reviews the CFO's recommendation and, as appropriate, recommends the Target Capital Requirement to the CPC. The CPC then reviews and, as appropriate, recommends the proposal to the Board, which reviews and, as appropriate, approves the Target Capital Requirement for the coming year.

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11 In setting the Target Capital Requirement, OCC considers, but is not bound by, its projected rolling twelve-months' operating expenses pursuant to OCC's interpretation of CFTC Regulation 39.11(a)(2). See 17 CFR 39.11(a)(2). Unlike SEC Rule 17Ad-22(e)(15) and CFTC Regulation 39.11(e)(2), which concern the liquidity of the financial resources to meet six-months' of operating expenses, the financial resources OCC may count toward the CFTC's twelve-months' requirement is not limited to LNAFBE or "unencumbered, liquid financial assets." See 17 CFR 39.11(e)(2). OCC may count its "own capital" (i.e., Equity) and "[a]ny other financial resource deemed acceptable by the [CFTC]" toward the twelve-months' requirement. See 17 CFR 39.11(b)(2). Accordingly, the Capital Management Policy does not require OCC to set its Target Capital Requirement—the amount of LNAFBE it must maintain to meet its regulatory obligations—to equal twelve-months' operating expenses.

12 Management recommends an RWD Amount calculated on an annual basis pursuant to the Capital Management Procedure based on the assumptions in OCC's Recovery and Orderly Wind-down Plan. See Exchange Act Release No. 88029, 85 FR at 5509.

13 The CFO's recommendation is prepared in accordance with OCC's Capital Management Procedure, which provides additional detail supporting the Capital Management Policy. See Exchange Act Release No. 86725 (Aug. 21, 2019), 84 FR 44944, 44945 (Aug. 27, 2019) (SR-OCC-2019-007).

Fee Schedule

OCC's fee structure is designed by the Board in accordance with Article IX, Section 9 of OCC's By-Laws. The current Capital Management Policy provides that, on a quarterly basis, management will review OCC's fee schedule and, considering factors including, but not limited to, projected operating expenses, projected volumes, anticipated cashflows and capital needs, recommend to the Board, or a Board-level Committee to which the Board has delegated authority,[14] whether a fee increase, decrease or waiver should be made. If OCC's Equity is above, in the aggregate, 110% of its Target Capital Requirement and other approved capital needs, the Board may use such tools as it determines appropriate to lower costs for Clearing Members, including lowering fees, fee holidays or refunds.[15] On an annual basis, management reviews the operating margin level and, considering historical volume variance and other relevant factors (including, but not limited to, variance in revenue other than from clearing fees, such as interest income), recommends to the Board, or a Committee to which the Board has delegated authority, whether any changes should be made to OCC's defined operating margin.

Cash and Investment Management Policy

Among other things, OCC's Cash and Investment Management Policy provides for how OCC may invest its own cash and cash deposited by Clearing Members in respect of margin requirements or Clearing Fund deposits. In recent filings, OCC explained that the policy would provide that "[i]nterest earned on <u>Clearing Fund</u> cash deposits held at a Federal Reserve Bank would accrue to the benefit of Clearing Members, less a cash management fee."[16] However, the proposed text of the policy submitted with the filing inadvertently did not qualify the scope as limited to Clearing Fund cash deposits. OCC Rule 1002(c) provides that interest on Clearing Fund cash deposits held at a Federal Reserve Bank accrue to Clearing Members less a cash management fee, consistent with the text of the policy.[17] In contrast, under OCC Rule 604(a), interest earned on

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14 The Board has delegated such authority to the CPC under the CPC Charter. <u>See</u> <u>supra</u> note 2.

15 When determining which, if any, tools would be appropriate, the Board considers factors including, but not limited to, projecting future volume, expenses, cashflow, capital needs and the possibility and amount of unfunded obligations. During this process, Equity must always remain above the "Early Warning" threshold. <u>See</u> Exchange Act Release No. 87257 (Oct. 8, 2019), 84 FR 55194, 55196 (Oct. 15, 2019) (SR-OCC-2019-805).

16 <u>See</u> Exchange Act Release No. 93916 (Jan. 6, 2022), 87 FR 1819, 1821 (Jan. 12, 2022) (SR-OCC-2021-014); Exchange Act Release No. 93915 (Jan. 6, 2022), 87 FR 1814, 1815 (Jan. 12, 2022) (SR-OCC-2021-803) (emphasis added).

17 <u>See</u> OCC Rule 1002(c) ("Interest earned on cash deposits held at a Federal Reserve Bank shall accrue to the benefit of Clearing Members (calculated daily based on each Clearing Member's pro rata share of Clearing Fund cash deposits), provided that each such Clearing Member has provided OCC with all tax documentation as OCC may from time to time

investments of cash deposited by Clearing Members in respect of margin requirements accrues to the benefit of OCC.[18] No change to Rule 604(a) was intended by the proposed implementation of OCC's Cash and Investment Management Policy.[19]

Proposed Changes

(1) *Fee Schedule Review*

Currently, the Capital Management Policy requires management to review the fee schedule with the CPC "[o]n a quarterly basis." The proposed changes would amend this language to instead require management to review the fee schedule "[a]t regularly scheduled CPC meetings." This change would align the fee schedule review with the cadence of meetings prescribed in the Board and Committee Charters, which OCC recently amended.[20] While regular meetings generally occur on a quarterly basis, the proposed change would avoid the need to call special meetings to address the routine review of the fee schedule if a regularly scheduled meeting happens to fall at the beginning of the next quarter or the end of the last quarter. For this reason, OCC aligned other periodic reviews identified in the Committee Charters to occur at each regularly scheduled meeting, as opposed to quarterly.[21] OCC proposes to do the same with respect to the cadence of fee schedule reviews in the Capital Management Policy.

(2) *Additional Textual Changes*

The proposed changes would also make other textual edits and additions to the Capital Management Policy for clarity and consistency with OCC's other policies. For one, OCC would

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require in order to effectuate such payment, and all other interest earned on investments will accrue to the benefit of [OCC]."). See also, Exchange Act Release No. 82657 (Feb. 8, 2018), 83 FR 6651 (Feb. 14, 2018) (SR-OCC-2018-005) (implementing a cash management fee to cover administrative and other operational expenses incurred by OCC in connection with passing through to Clearing Members the interest earned on Clearing Fund cash deposits held at an OCC account at a Federal Reserve Bank).

18 OCC Rule 604(a) ("Clearing Members may deposit U.S. dollars in accordance with procedures acceptable to [OCC]. Funds so deposited may from time to time be partially or wholly invested by [OCC] for its account in Government securities, and any interest or gain received or accrued on the investment of such funds shall belong to [OCC].")

19 See Exchange Act Release No. 93916, 87 FR at 1820 ("OCC does not propose to amend [Rule 604(a)] by this proposed rule change.").

20 See supra note 2.

21 See Exchange Act Release No. 94988, 87 FR at 33537-38 (approving amendments to the Audit Committee, Technology Committee and CPC Charters to align the cadence of periodic reviews to each regular meeting of the Committee, rather than "quarterly").

amend the provision concerning management of OCC's Equity to facilitate capital expenditures to clarify OCC's intent that either of the two options identified for doing so—(1) increasing the Target Capital Requirement or (2) retaining the additional Equity as an amount in excess of the Target Capital Requirement—is available to the Board. The textual edits would state more generally at the outset that OCC may retain additional Equity generated from revenue for capital expenditures following a recommendation by Management and Board approval. Retention of such additional Equity generated from revenue is already implicit in the Capital Management Policy's provisions for setting the fee schedule and determining whether to employ other tools to lower costs for Clearing Members (e.g., a clearing fee refund or holiday), both of which consider OCC's capital needs as a factor. The proposed changes would also more expressly provide that option (2) is available as an alternative to option (1). The principal difference between the two options is that any excess capital retained under option (2) is available as skin-in-the-game in the event of a default loss. In addition, adding that such additional Equity would be "generated from revenue" would also clarify the source of the funds OCC may retain as additional Equity, which under OCC's Capital Management Policy would be generated from fees or interest income—not from capital contributions from OCC's stockholders that were part of the Capital Plan that predated the Capital Management Policy.[22]

The Capital Management Policy also currently provides that in determining whether to retain additional Equity for capital expenditures, the Board will consider the potential impact of the "investment" on OCC's operations. The proposed changes would amend this language to instead provide that the Board will consider the potential impact of the "retention of additional Equity" on OCC's operations, consistent with the terminology that OCC proposes to use throughout that paragraph of the Capital Management Policy. Use of the term "investment" in reference to the retention of Equity may lead to confusion when compared to OCC's Cash and Investment Management Policy, which addresses guidelines for investing OCC's own cash and cash deposited by Clearing Members, as discussed above. "Investment" in that context is a separate concept from OCC's determination whether to retain additional Equity to meet its capital needs, rather than, for example, determining to use tools to decrease the cost of membership through a fee decrease, fee holiday or fee refund.

OCC is also proposing formatting edits to conform the Capital Management Policy to OCC's current template format for its policies and procedures. Specifically, the proposed changes would add a new introductory paragraph at the outset of the Capital Management Policy that addresses the policy's applicability and scope. This new introductory paragraph would clarify that the policy applies to the quantification, monitoring and management of OCC's Equity, as well as identify the OCC departments that have roles in those processes, including, primarily, Accounting and Finance, as well as Member Services, Corporate Risk Management, Legal, and Financial Risk Management business units. Finally, OCC would correct a typo by deleting a duplicative word in one of the

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22 See Exchange Act Release No. 74452 (Mar. 6, 2015), 80 FR 13058 (Mar. 12, 2015) (SR-OCC-2015-02), disapproved on remand by Exchange Act Release No. 85121 (Feb. 13, 2019), 84 FR 5157 (Feb. 20, 2019) (SR-OCC-2015-02).

footnotes to the Capital Management Policy, and such change would have no impact on the meaning of the footnote.[23]

(3) *Cash and Investment Management Policy Correction*

Finally, this proposed change would conform the text of the Cash and Investment Management Policy to the intended meaning by inserting "Clearing Fund" before "cash deposits" when stating that "[i]nterest earned on cash deposits held at a Federal Reserve Bank shall accrue to the benefit of Clearing Members less a cash management fee." The term "Clearing Fund" was inadvertently omitted from the text of the policy, even though that was the intent of the change as described in the associated regulatory filings described above.[24] This change would thereby align the policy statement with OCC Rules 604(a) and 1002(c), which provide different treatment for interest earned on margin cash and Clearing Fund cash deposited at a Federal Reserve Bank.

Consistency with DCO Core Principles

OCC reviewed the DCO core principles ("Core Principles") as set forth in the Act, the regulations thereunder, and the provisions applicable to a DCO that elects to be subject to the provisions of 17 CFR Subpart C ("Subpart C DCO"). During this review, OCC identified the following as potentially being impacted:

Legal Risk Considerations. OCC believes that the proposed changes to the Cash and Investment Management Policy are consistent with Core Principle R[25] and CFTC Regulations thereunder, which require a DCO to have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the DCO. Specifically, CFTC Regulation 39.27 requires, among other things, that a DCO's legal framework must provide for the DCO's interest in collateral.[26] The proposed changes to OCC's Cash and Investment Management Policy are designed to conform the text of the policy with OCC's Rules,[27] thereby improving the clarity and transparency of OCC rules and helping to support OCC's legal basis for its cash management and investment activities, including OCC's interest in various types of collateral that it collects from its members. Accordingly, OCC believes that proposed changes to the Cash and Investment Management Policy are consistent with Core Principle R and the CFTC Regulations thereunder.

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[23] Currently, the relevant footnote states that OCC management makes a recommendation that is "based calculated on an annual basis" pursuant to an underlying procedure. OCC proposes to remove the extraneous word "based" from the footnote.

[24] See supra note 16 and accompanying text.

[25] 7 U.S.C. 7a-1(c)(2)(R).

[26] 17 CFR 39.27(b)(3).

[27] See supra notes 16 and accompanying text.

Governance. OCC believes that the proposed changes to the Capital Management Policy are consistent with Core Principle O[28] and CFTC Regulations thereunder, including CFTC Regulation 39.24, which, among other things, requires that a DCO have governance arrangements that include clear and direct lines of responsibility.[29] As noted above, the proposed changes to the Capital Management Policy would align the cadence of the fee schedule review to the CPC Charter, which provides for at least four regularly scheduled meetings each year, but does not require those meetings be scheduled in each fiscal quarter. For that reason, OCC previously amended its Committee Charters to align the cadence of other periodic reviews to occur at each "regularly scheduled" meeting, rather than quarterly.[30] In addition, the proposed change to conform OCC's Capital Management Policy to the latest Board-approved format would add an Applicability and Scope section that would identify the OCC business units with responsibilities under that policy, thereby helping to delineate clear and direct lines of responsibility with respect to the processes set forth therein.

Risk Management. OCC also believes that the proposed changes to the Capital Management Policy and Cash and Investment Management Policy are consistent with Core Principle D[31] and CFTC Regulations thereunder, including CFTC Regulation 39.13, which, among other things, requires that a DCO implement written policies, procedures, and controls approved by its board of directors, that establish an appropriate risk management framework that is reviewed regularly and updated as necessary.[32] The proposed changes to the Capital Management Policy and the Cash and Investment Management Policy arose from the Board's annual reviews of policies designed to address general business risk and investment risk, respectively. By helping to maintain consistency across OCC's rules and conform those policies to the versions last approved by the Board, the proposed changes support the maintenance of OCC's risk management policies consistent with regulatory expectations.

For these reasons, OCC believes that the proposed changes are consistent with the requirements of the DCO Core Principles and the CFTC Regulations thereunder.

Opposing Views

No substantive opposing views were expressed related to the rule amendments by OCC's Board members, Clearing Members or market participants.

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28 7 U.S.C. 7a-1(c)(2)(O).

29 17 CFR 39.24(b)(4).

30 See supra note 21 and accompanying text.

31 7 U.S.C. 7a-1(c)(2)(D).

32 17 CFR 39.13(b).

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 this certification on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rules set forth in Exhibits A and B of the enclosed filing comply with the Act and the CFTC Regulations thereunder.

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

Sincerely,

/s/ Mark C. Brown
Mark C. Brown
Associate General Counsel

Enclosure: Exhibits A and B