

Required fields are shown with yellow backgrounds and asterisks.

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
Form 19b-4

File No. * SR 2023 - * 801

Amendment No. (req. for Amendments *)

Filing by Options Clearing Corporation

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

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

<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)

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010
Section 806(e)(1) *

Section 806(e)(2) *

Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934
Section 3C(b)(2) *

Exhibit 2 Sent As Paper Document

Exhibit 3 Sent As Paper Document

Description

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

Advance Notice Concerning Modifications to the Amended and Restated Stock Options and Futures Settlement Agreement Between The Options Clearing Corporation and the National Securities Clearing Corporation

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 * Last Name *

Title *

E-mail * rulefilings@theocc.com

Telephone * (312) 322-6200 Fax

Signature

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

Date 08/10/2023

(Title *)

By

(Name *)

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

Required fields are shown with yellow backgrounds and astericks.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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

Form 19b-4 Information *

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SR-OCC-2023-801 (Accord) 19b-4 AM

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 Advanced Notice by Clearing Agencies *

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SR-OCC-2023-801 (Accord) Exhibit 1A

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 2- Notices, Written Comments, Transcripts, Other Communications

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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

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SR-OCC-2023-801 (Accord) Exhibit 3
SR-OCC-2023-801 (Accord) Exhibit 3
SR-OCC-2023-801 (Accord) Exhibit 3

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

Add Remove View

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

SR-OCC-2023-801 (Accord) Exhibit 5
SR-OCC-2023-801 (Accord) Exhibit 5
SR-OCC-2023-801 (Accord) Exhibit 5

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item 1 and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change

Partial Amendment

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

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Advance Notice
by

THE OPTIONS CLEARING CORPORATION

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

Item 1. Text of the Advance Notice

In accordance with Section 806I(1) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 (“Payment, Clearing and Settlement Supervision Act”)¹ and Rule 19b-4(n)(i)² of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),³ and Rule 19b-4 thereunder,⁴ The Options Clearing Corporation (“OCC”) is filing this advance notice with the Securities and Exchange Commission (“SEC” or “Commission”) to (1) modify the Amended and Restated Stock Options and Futures Settlement Agreement dated August 5, 2017 between OCC and National Securities Clearing Corporation (“NSCC,” and together with OCC, the “Clearing Agencies”) (“Existing Accord”)⁵ and (2) make certain revisions to OCC By-Laws, OCC Rules,⁶ OCC’s Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC’s Liquidity Risk Management Framework in connection with the proposed modifications to the Existing Accord, as described in greater detail below.⁷

The proposed changes would permit OCC to elect to make a cash payment to NSCC following the default of a common clearing participant that would cause NSCC’s central

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(i).

³ 15 U.S.C. 78a *et seq.*

⁴ 17 CFR 240.19b-4.

⁵ The Existing Accord was previously approved by the Commission. See Securities Exchange Act Release Nos. 81266, 81260 (July 31, 2017) (File Nos. SR-NSCC-2017-007; SR-OCC-2017-013), 82 FR 36484 (Aug. 4, 2017).

⁶ OCC By-Laws are available at https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf and OCC Rules are available at https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf.

⁷ NSCC also has filed a proposed rule change with the Commission in connection with this proposal. See SR-NSCC-2023-007.

counterparty trade guaranty to attach to certain obligations of that participant, as described in greater detail below.

The proposed changes are included in Exhibits 5A and 5B and confidential Exhibits 5C, 5D, and 5E to File No. SR-OCC-2023-801. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text.

Item 2. Procedures of the Self-Regulatory Organization

The proposal was approved by OCC's Board of Directors at a meeting held on December 11, 2019 and on March 24, 2023.

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

Not applicable.

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

Not applicable.

Item 5. Self-Regulatory Organization's Statement on Comments on the Advance Notice Received from Members, Participants, or Others

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

Item 6. Extension of Time Period for Commission Action

Not applicable.

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

Not applicable.

Item 8. Advance Notice 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**Description of Proposed Change****Background**

OCC is filing this advance notice to (1) modify the Existing Accord between OCC and NSCC and (2) make certain revisions to OCC By-Laws, OCC Rules, OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC's Liquidity Risk Management Framework in connection with the proposed modifications to the Existing Accord, as described in greater detail below. The proposed changes would permit OCC to elect to make a cash payment to NSCC following the default of a common clearing participant that would cause NSCC's central counterparty trade guaranty to attach to certain obligations of that participant, as described in greater detail below.

i. Executive Summary

NSCC is a clearing agency that provides clearing, settlement, risk management, and central counterparty services for trades involving equity securities. OCC is the sole clearing agency for standardized equity options listed on national securities exchanges registered with the Commission, including options that contemplate the physical delivery of equities cleared by NSCC in exchange for cash ("physically settled" options).⁸ OCC also clears certain futures

⁸ The term "physically-settled" as used throughout the OCC Rulebook refers to cleared contracts that settle into their underlying interest (i.e., options or futures contracts that are not cash-settled). When a contract settles into its underlying interest, shares of stock are sent, i.e., delivered, to contract holders who have the right to receive the shares from contract holders who are obligated to deliver the shares at the time of exercise/assignment in the case of an option and maturity in the case of a future.

contracts that, at maturity, require the delivery of equity securities cleared by NSCC in exchange for cash. As a result, the exercise/assignment of certain options or maturation of certain futures cleared by OCC effectively results in stock settlement obligations. NSCC and OCC maintain a legal agreement, generally referred to by the parties as the “Accord” agreement, that governs the processing of such physically settled options and futures cleared by OCC that result in transactions in underlying equity securities to be cleared by NSCC (i.e., the Existing Accord). The Existing Accord establishes terms under which NSCC accepts for clearing certain securities transactions that result from the exercise and assignment of relevant options contracts and the maturity of futures contracts that are cleared and settled by OCC.⁹ It also establishes the time when OCC’s settlement guaranty in respect of those transactions ends and NSCC’s settlement guaranty begins.

The Existing Accord allows for a scenario in which NSCC could choose not to guarantee the settlement of such securities arising out of transactions. Specifically, NSCC is not obligated to guarantee settlement until its member has met its collateral requirements at NSCC. If NSCC chooses not to guarantee settlement, OCC would engage in an alternate method of settlement outside of NSCC. This scenario presents two primary problems. First, the cash required for OCC and its Clearing Members in certain market conditions to facilitate settlement outside of NSCC could be significantly more than the amount required if NSCC were to guarantee the relevant transactions. This is because settlement of the transactions in the underlying equity securities outside of NSCC would mean that they would no longer receive the benefit of netting through the facilities of NSCC. In such a scenario, the additional collateral required from Clearing Members to support OCC’s continuing settlement guarantee would also have to be

⁹ Under the Existing Accord, such options and futures are defined as “E&A/Delivery

sufficiently liquid to properly manage the risks associated with those transactions being due on the second business day following the option exercise or the relevant futures contract maturity date.

Based on an analysis of scenarios using historical data where it was assumed that OCC could not settle transactions through the facilities of NSCC, the worst-case outcome resulted in extreme liquidity demands of over \$300 billion for OCC to effect settlement via an alternative method, e.g., by way of gross broker-to-broker settlement, as discussed in more detail below. OCC Clearing Members, by way of their contributions to the OCC Clearing Fund, would bear the brunt of this demand. Furthermore, there is no guarantee that OCC Clearing Members could fund the entire amount of any similar real-life scenarios. By contrast, projected GSPs, defined below, identified during the study ranged from approximately \$419 million to over \$6 billion, also as discussed in more detail below.

The second primary problem relates to the significant operational complexities if settlement occurs outside of NSCC. More specifically, netting through NSCC reduces the volume and value of settlement obligations. For example, in 2022 it is estimated that netting through NSCC's continuous net settlement ("CNS") accounting system¹⁰ reduced the value of CNS settlement obligations by approximately 98% or \$510 trillion from \$519 trillion to \$9 trillion. If settlement occurred outside of NSCC, on a broker-to-broker basis between OCC Clearing Members, for example, shares would not be netted and Clearing Members would have to coordinate directly with each other to settle the relevant transactions. The operational

Transactions", which refers to "Exercise & Assignment Delivery Transactions."

¹⁰ See Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules. See NSCC's Rules, available at https://www.dtcc.com/-/media/Files/Downloads/legal/rules/nscc_rules.pdf.

complexities and uncertainty associated with alternate means of settlement would impact every market participant involved in a settlement of OCC-related transactions.

To address these problems, the Clearing Agencies are proposing to amend and restate the Existing Accord and make related changes to their respective rules that would allow OCC to elect to make a cash payment to NSCC following the default of a Common Member¹¹ that would cause NSCC to guarantee settlement of that Common Member's transactions and, therefore, cause those transactions to be settled through processing by NSCC. As part of this proposal, OCC also will enhance its daily liquidity stress testing processes and procedures to account for the possibility of OCC making such a payment to NSCC in the event of a Common Member default. By making these enhancements to its stress testing, OCC could include the liquid resources necessary to make the payment in its resource planning. The Clearing Agencies believe that by NSCC accepting such a payment from OCC, the operational efficiencies and reduced costs related to the settlement of transactions through NSCC would limit market disruption following a Common Member default because settlement through NSCC following such a default would be less operationally complex and would be expected to require less liquidity and other collateral from market participants than the processes available to OCC for closing out positions. Additionally, proposed enhancements by OCC to its liquidity stress testing would add assurances that OCC could make such a payment in the event of a Common Member default. The Clearing Agencies believe that their respective clearing members and all other participants in the markets for which OCC provides clearance and settlement will benefit from

¹¹ A firm that is both an OCC Clearing Member and an NSCC Member or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a "Common Member." The term "Clearing Member" as used herein has the meaning provided in OCC's By-Laws. See OCC's By-Laws, supra, note 6. The term

OCC's ability to choose to make a cash payment to effect settlement through the facilities of NSCC. This change will provide more certainty around certain default scenarios and would blunt the financial and operational burdens market participants could experience in the case of most clearing member defaults.¹²

ii. Background

OCC acts as a central counterparty clearing agency for U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. In connection with these services, OCC provides the OCC Guaranty pursuant to its By-Laws and Rules. NSCC acts as a central counterparty clearing agency for certain equity securities, corporate and municipal debt, exchange traded funds and unit investment trusts that are eligible for its services. Eligible trading activity may be processed through NSCC's CNS system¹³ or through its Balance Order Account system,¹⁴ where all eligible compared and recorded transactions for a particular settlement date are netted by issue into one net long (buy), net short (sell) or flat position. As a result, for each day with activity, each Member has a single deliver or receive obligation for each issue in which it has activity. In connection with these services, NSCC also provides the NSCC Guaranty pursuant to Addendum K of the NSCC Rules.

OCC's Rules provide that delivery of, and payment for, securities underlying certain exercised stock options and matured single stock futures that are physically settled are generally

"Member" as used herein has the meaning provided in NSCC's Rules. See NSCC's Rules, supra note 10.

¹² OCC provided its analysis of the financial impact of alternate means of settlement as Exhibit 3A to File No. SR-OCC-2023-801.

¹³ See Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules, supra note 10.

¹⁴ See Rule 8 (Balance Order and Foreign Security Systems) and Procedure V (Balance Order Accounting Operation) of the NSCC Rules, supra note 10.

effected through the facilities of NSCC and are not settled through OCC's facilities.¹⁵ OCC and NSCC executed the Existing Accord to facilitate, via NSCC's systems, the physical settlement of securities arising out of options and futures cleared by OCC. OCC Clearing Members that clear and settle physically settled options and futures transactions through OCC also are required under OCC's Rules¹⁶ to be Members of NSCC or to have appointed or nominated a Member of NSCC to act on its behalf. As noted above, these firms are referred to as "Common Members" in the Existing Accord.

iii. Summary of the Existing Accord

The Existing Accord governs the transfer between OCC and NSCC of responsibility for settlement obligations that involve a delivery and receipt of stock in the settlement of physically settled options and futures that are cleared and settled by OCC and for which the underlying securities are eligible for clearing through the facilities of NSCC ("E&A/Delivery Transactions"). It also establishes the time when OCC's settlement guarantee (the "OCC Guaranty") ends and NSCC's settlement guarantee (the "NSCC Guaranty")¹⁷ begins with respect to E&A/Delivery Transactions. However, in the case of a Common Member default¹⁸ NSCC can reject these settlement obligations, in which case the settlement guaranty will not transfer from OCC to NSCC and OCC would not have a right to settle the transactions through the facilities of NSCC. Instead, OCC would have to engage in alternative methods of settlement that have the potential to create significant liquidity and collateral requirements for both OCC and its non-

¹⁵ See Chapter IX of OCC's Rules (Delivery of Underlying Securities and Payment), supra note 6.

¹⁶ See OCC Rule 901, supra note 6.

¹⁷ See Addendum K and Procedure III of the NSCC Rules, supra note 10.

¹⁸ A Common Member that has been suspended by OCC or for which NSCC has ceased to act is referred to as a "Mutually Suspended Member."

defaulting Clearing Members.¹⁹ More specifically, this could involve broker-to-broker settlement between OCC Clearing Members.²⁰ This settlement method is operationally complex because it requires bilateral coordination directly between numerous Clearing Members rather than relying on NSCC to facilitate multilateral netting to settle the relevant settlement obligations. As described above, it also potentially could result in significant liquidity and collateral requirements for both OCC and its non-defaulting Clearing Members because the transactions will not be netted through the facilities of NSCC. Alternatively, where NSCC accepts the E&A/Delivery Transactions from OCC, the OCC Guaranty ends and the NSCC Guaranty takes effect. The transactions are then netted through NSCC's systems, which allows settlement obligations for the same settlement date to be netted into a single deliver or receive obligation. This netting reduces the costs associated with securities transfers by reducing the number of securities movements required for settlement and further reduces operational and market risk. The benefits of such netting by NSCC may be significant with respect to the large volumes of E&A/Delivery Transactions processed during monthly options expiry periods.

¹⁹ For example, OCC evaluated certain Clearing Member default scenarios in which OCC assumed that NSCC would not accept the settlement obligations under the Existing Accord, including the default of a large Clearing Member coinciding with a monthly options expiration. OCC has estimated that in such a Clearing Member default scenario, the aggregate liquidity burden on OCC in connection with obligations having to be settled on a gross broker-to-broker basis could reach a significantly high level. For example, in January 2022, the largest gross broker-to-broker settlement amount in the case of a larger Clearing Member default would have resulted in liquidity needs of approximately \$384,635,833,942. OCC provided the data and analysis as Exhibit 3A to File No. SR-OCC-2023-801.

²⁰ In broker-to-broker settlement, Clearing Member parties are responsible for coordinating settlement – delivery and payment – among themselves on a transaction-by-transaction basis. Once transactions settle, the parties also have an obligation to affirmatively notify OCC so that OCC can close out the transactions. If either one of or both of the parties do not notify OCC, the transaction will remain open on OCC's books indefinitely until the time both parties have provided notice of settlement to OCC.

Pursuant to the Existing Accord, on each trading day NSCC delivers to OCC a file that identifies the securities, including stocks, exchange-traded funds and exchange-traded notes, that are eligible (1) to settle through NSCC and (2) to be delivered in settlement of (i) exercises and assignments of stock options cleared and settled by OCC or (ii) delivery obligations from maturing stock futures cleared and settled by OCC. OCC, in turn, delivers to NSCC a file identifying securities to be delivered, or received, for physical settlement in connection with OCC transactions.²¹

After NSCC, receives the list of eligible transactions from OCC, and NSCC has received all required deposits to the NSCC Clearing Fund from all Common Members taking into consideration amounts required to physically settle the OCC transactions, the OCC Guaranty would end and the NSCC Guaranty would begin with respect to physical settlement of the eligible OCC-related transactions. At this point, NSCC is solely responsible for settling the transactions.^{22 23}

Each day, NSCC is required to promptly notify OCC at the time the NSCC Guaranty takes effect. If NSCC rejects OCC's transactions due to an improper submission²⁴ or if NSCC

²¹ Each day that both OCC and NSCC are open for accepting trades for clearing is referred to as an "Activity Date" in the Existing Accord. Securities eligible for settlement at NSCC are referred to collectively as "Eligible Securities" in the Existing Accord. Eligible securities are settled at NSCC through NSCC's CNS Accounting Operation or NSCC's Balance Order Accounting Operation.

²² The term "NSCC Clearing Fund" as used herein has the same meaning as the term "Clearing Fund" as provided in the NSCC Rules. Procedure XV of the NSCC Rules provides that all NSCC Clearing Fund requirements and other deposits must be made within one hour of demand, unless NSCC determines otherwise, supra note 10.

²³ This is referred to in the Existing Accord as the "Guaranty Substitution Time," and the process of the substitution of the NSCC Guaranty for the OCC Guaranty in respect of E&A/Delivery Transactions is referred to as "Guaranty Substitution."

²⁴ Guaranty Substitution by NSCC (discussed further below) does not occur with respect to an E&A/Delivery Transaction that is not submitted to NSCC in the proper format or that

“ceases to act” for a Common Member,²⁵ NSCC’s Guaranty will not take effect for the affected transactions pursuant to the NSCC Rules.

NSCC is required to promptly notify OCC if it ceases to act for a Common Member. Upon receiving such a notice, OCC would not continue to submit to NSCC any further unsettled transactions that involve such Common Member, unless authorized representatives of both OCC and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all transactions that have already been submitted to NSCC and that involve such Common Member. The NSCC Guaranty ordinarily would not take effect with respect to transactions for a Common Member for which NSCC has ceased to act, unless both Clearing Agencies agree otherwise. As such, NSCC does not have any existing contractual obligation to guarantee such Common Member’s transactions. To the extent the NSCC Guaranty does not take effect, OCC’s Guaranty would continue to apply, and, as described above, OCC would remain responsible for effecting the settlement of such Common Member’s transactions pursuant to OCC’s By-Laws and Rules.

As noted above, the Existing Accord does provide that the Clearing Agencies may agree to permit additional transactions for a Common Member default (“Defaulted NSCC Member Transactions”) to be processed by NSCC while subject to the NSCC Guaranty. This optional feature, however, creates uncertainty for the Clearing Agencies and market participants about how Defaulted NSCC Member Transactions may be processed following a Common Member

involves a security that is not identified as an Eligible Security on the then-current NSCC Eligibility Master File.

²⁵ Under NSCC’s Rules, a default would generally be referred to as a “cease to act” and could encompass a number of circumstances, such as an NSCC Member’s failure to make a Required Fund Deposit in a timely fashion. See NSCC Rule 46 (Restrictions on Access to Services), supra note 10. An NSCC Member for which it has ceased to act is referred to in the Existing Accord as a “Defaulting NSCC Member.” Transactions associated with a Defaulting NSCC Member are referred to as “Defaulted NSCC Member Transactions” in the Existing Accord.

default and also does not provide NSCC with the ability to collect collateral from OCC that it may need to close out these additional transactions. While the optional feature would remain in the agreement as part of this proposal, the proposed changes to the Existing Accord, as described below, could significantly reduce the likelihood that it would be utilized.

Proposed Change

i. Proposed Changes to the Existing Accord

The proposed changes to the Existing Accord would permit OCC to make a cash payment, referred to as the “Guaranty Substitution Payment” or “GSP,” to NSCC. This cash payment could occur on either or both of the day that the Common Clearing Member becomes a Mutually Suspended Member and on the next business day. Upon NSCC’s receipt of the Guaranty Substitution Payment from OCC, the NSCC Guaranty would take effect for the Common Member’s transactions, and they would be accepted by NSCC for clearance and settlement.²⁶ OCC could use all Clearing Member contributions to the OCC Clearing Fund²⁷ and certain Margin Assets²⁸ of a defaulted Clearing Member to pay the GSP, as described in more detail below.

NSCC would calculate the Guaranty Substitution Payment as the sum of the Mutually Suspended Member’s unpaid required deposit to the NSCC Clearing Fund (“Required Fund

²⁶ Acceptance of such transactions by NSCC would be subject to NSCC’s standard validation criteria for incoming trades. See NSCC Rule 7, *supra* note 10.

²⁷ The term “OCC Clearing Fund” as used herein has the same meaning as the term “Clearing Fund” in OCC’s By-Laws, supra note 6.

²⁸ The term “Margin Assets” as used herein has the same meaning as provided in OCC’s By-Laws, supra note 6.

Deposit”)²⁹ and the unpaid Supplemental Liquidity Deposit³⁰ obligation that is attributable to E&A/Delivery Transactions. The proposed changes to the Existing Accord define how NSCC would calculate the Guaranty Substitution Payment.

More specifically, NSCC would first determine how much of the member’s unpaid Clearing Fund requirement would be included in the GSP. NSCC would look at the day-over-day change in gross market value of the Mutually Suspended Member’s positions as well as day-over-day change in the member’s NSCC Clearing Fund requirements. Based on such changes, NSCC would identify how much of the change in the Clearing Fund requirement was attributable to E&A/Delivery Transactions coming from OCC. If 100 percent of the day-over-day change in the NSCC Clearing Fund requirement is attributable to activity coming from OCC, then the GSP would include 100 percent of the member’s NSCC Clearing Fund requirement. If less than 100 percent of the change is attributable to activity coming from OCC, then the GSP would include that percent of the member’s unpaid NSCC Clearing Fund requirement attributable to activity coming from OCC. NSCC would then determine the portion of the member’s unpaid SLD obligation that is attributable to E&A/Delivery Transactions. As noted above, the GSP would be the sum of these two amounts. A member’s NSCC Clearing Fund requirement and SLD obligation at NSCC are designed to address the credit and liquidity risks that a member poses to NSCC. The GSP calculation is intended to assess how much of a member’s obligations arise out of activity coming from OCC so that the amount paid by OCC is commensurate with the risk to

²⁹ The Required Fund Deposit is calculated pursuant to Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the NSCC Rules, see supra note 10.

³⁰ Under the NSCC Rules, NSCC collects additional cash deposits from those Members who would generate the largest settlement debits in stressed market conditions, referred to as “Supplemental Liquidity Deposits” or “SLD”. See Rule 4A of the NSCC Rules, supra note 10.

NSCC of guarantying such activity.

To permit OCC to anticipate the potential resources it would need to pay the GSP for a Mutually Suspended Member, each business day, NSCC would provide OCC with (1) Required Fund Deposit and Supplemental Liquidity Deposit obligations, as calculated pursuant to the NSCC Rules, and (2) the gross market value of the E&A/Delivery Transactions and the gross market value of total Net Unsettled Positions (as such term is defined in the NSCC Rules). On options expiry days that fall on a Friday, NSCC would also provide OCC with information regarding liquidity needs and resources, and any intraday SLD requirements of Common Members. Such information would be delivered pursuant to the ongoing information sharing obligations under the Existing Accord (as proposed to be amended) and the Service Level Agreement (“SLA”) to which both NSCC and OCC are a party pursuant to Section 2 of the Existing Accord.³¹ The SLA addresses specifics regarding the time, form, and manner of various required notifications and actions described in the Accord and also includes information applicable under the Accord.

NSCC and OCC believe the proposed calculation of the Required Fund Deposit portion of the GSP is appropriate because it is designed to provide a reasonable proxy for the impact of the Mutually Suspended Member’s E&A/Delivery Transactions on its Required Fund Deposit. While impact study data did show that the proposed calculation could result in a GSP that overestimates or underestimates the Required Fund Deposit attributable to the Mutually Suspended Member’s E&A/Delivery Transactions,³² current technology constraints prohibit

³¹ OCC provided the revised SLA to the Commission as Exhibit 3C to File No. SR-OCC-2023-801.

³² The impact study was conducted at the Commission’s request to cover a three-day period and reviewed the ten Common Members with the largest Required Fund Deposits attributable to the Mutually Suspended Member’s E&A/Delivery Transactions. Over the

NSCC from performing a precise calculation of the GSP on a daily basis for every Common Member.³³

Implementing the ability for OCC to make the GSP and cause the E&A/Delivery Transactions to be cleared and settled through NSCC would promote the ability of OCC and NSCC to be efficient and effective in meeting the requirements of the markets they serve. This is because data demonstrates that the expected size of the GSP would be smaller than the amount of cash that would otherwise be needed by OCC and its Clearing Members to facilitate settlement outside of NSCC. More specifically, based on a historical study of alternate means of settlement available to OCC from September 2021 through September 2022, in the event that NSCC did not accept E&A/Delivery Transactions, the worst-case scenario peak liquidity need OCC identified was \$384,635,833,942 for settlement to occur on a gross broker-to-broker basis. OCC estimates that the corresponding GSP in this scenario would have been \$863,619,056. OCC also analyzed several other large liquidity demand amounts that were identified during the study if OCC effected settlement on a gross broker-to-broker basis.³⁴ These liquidity demand amounts and the largest liquidity demand amount OCC observed of \$384,635,833,942

30 instances in the study, approximately 15 instances resulted in an underestimate of the Required Fund Deposit by an average of approximately \$112,900,926, four instances where the proxy calculation was the same as the Required Fund Deposit, and eleven instances of an overestimate of the Required Fund Deposit by an average of approximately \$59,654,583. See Exhibit 3D to File No. SR-OCC-2023-801 for additional detail related to the referenced study.

³³ OCC and NSCC have agreed that performing the necessary technology build at this time would delay the implementation of this proposal. Therefore, NSCC would consider incorporating those technology updates into future revisions to the Accord, for example in connection with a move to a shorter settlement cycle in the U.S. equities markets.

³⁴ See Exhibit 3A to File No. SR-OCC-2023-801 for additional detail related to the referenced study.

substantially exceed the amount of liquid resources currently available to OCC.³⁵ By contrast, projected GSPs identified during the study ranged from \$419,297,734 to \$6,281,228,428. For each of these projected GSP amounts, OCC observed that the Margin Assets and OCC Clearing Fund contributions that would have been required of Clearing Members in these scenarios would have been sufficient to satisfy the amount of the projected GSPs.

To help address the current technology constraint that prohibits NSCC from performing a precise calculation of the GSP on a daily basis for every Common Member, proposed Section 6(b)(i) of the Existing Accord and related Section 7(d) of the SLA would provide that with respect to a Mutually Suspended Member, either NSCC or OCC may require that the Required Fund Deposit portion of the GSP be re-calculated by calculating the Required Fund Deposit for the Mutually Suspended Member both before and after the delivery of the E&A/Delivery Transactions and utilize the precise amount that is attributable to that activity in the final GSP. If such a recalculation is required, the result would replace the Required Fund Deposit component of the GSP that was initially calculated. The SLD component of the GSP would be unchanged by such recalculation.

As the above demonstrates, the GSP is intended to address the significant collateral and liquidity requirements that could be required of OCC Clearing Members in the event of a Common Member default.

Allowing OCC to make a GSP payment also is intended to allow for settlement processing to take place through the facilities of NSCC to retain operational efficiencies associated with the settlement process. Alternative settlement means such as broker-to-broker

³⁵ As of March 31, 2023, OCC held approximately \$10.37 billion in qualifying liquid resources. See OCC Quantitative Disclosure, January – March 2023, available at <https://www.theocc.com/risk-management/pfmi-disclosures>.

settlement add operational burdens, because transactions would need to be settled individually on one-off bases. In contrast, NSCC's netting reduces the volume and value of settlement obligations that would need to be closed out in the market.³⁶ Because the clearance and settlement of obligations through NSCC's facilities following a Common Member default, including netting of E&A/Delivery Transactions with a Common Member's positions at NSCC, would avoid these potentially significant operational burdens for OCC and its Clearing Members, OCC and NSCC believe that the proposed changes would limit market disruption relating to a Common Member default. NSCC netting significantly reduces the total number of obligations that require the exchange of money for settlement. Allowing more activity to be processed through NSCC's netting systems would minimize risk associated with the close out of those transactions following the default of a Common Member.

Amending the Existing Accord to define the terms and conditions under which Guaranty Substitution may occur, at OCC's election, with respect to Defaulted NSCC Member Transactions after a Common Member becomes a Mutually Suspended Member will also provide more certainty to both the Clearing Agencies and market participants generally about how a Mutually Suspended Member's Defaulted NSCC Member Transactions may be processed.

NSCC and OCC have agreed it is appropriate to limit the availability of the proposed provision to the day of the Common Member default and the next business day because, based on historical simulations of cease to act events involving Common Members, most activity of a Mutually Suspended Member is closed out on those days.³⁷ Furthermore, the benefits of netting

³⁶ CNS reduces the value of obligations that require financial settlement by approximately 98%, where, for example \$519 trillion in trades could be netted down to approximately \$9 trillion in net settlements.

³⁷ OCC provided data regarding such events in a Exhibit 3B to File No. SR-OCC-2023-801. The information contained therein includes the assumptions and timelines leading up to

through NSCC's systems would be reduced for any activity submitted to NSCC after that time.

To implement these proposed changes to the Existing Accord, OCC and NSCC propose to make the following changes.

Section 1 – Definitions

First, new definitions would be added, and existing definitions would be amended in Section 1, which is the Definitions section.

The new defined terms would be as follows.

- The term “Close Out Transaction” would be defined to mean “the liquidation, termination or acceleration of one or more exercised or matured Stock Options³⁸ or Stock Futures³⁹ contracts, securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements, master netting agreements or similar agreements of a Mutually Suspended Member pursuant to OCC Rules 901, 1006 and 1101 through 1111 (including but not limited to Rules 1104 and 1107) and/or NSCC Rule 18.” This proposed definition would make it clear that the payment of the Guaranty Substitution Payment and NSCC's subsequent acceptance of Defaulted NSCC Member Transactions for clearance and settlement are intended to fall within the “safe harbors” provided in the Bankruptcy Code,⁴⁰ the Securities Investor Protection Act,⁴¹ and other similar laws.
- The term “Guaranty Substitution Payment” would be defined to mean “an amount calculated by NSCC in accordance with the calculations set forth in Appendix A [to the Existing Accord (as proposed to be amended)], to include two components: (i) a portion of the Mutually Suspended Member's Required Fund Deposit deficit to NSCC at the time of the cease to act; and (ii) a portion of the Mutually Suspended Member's unpaid Supplemental Liquidity Deposit obligation at the time of the cease to act.”

the declaration of a default for a Common Member and the anticipated timing of OCC's payment of the GSP.

³⁸ The term “Stock Options” is defined in the Existing Accord within the definition of “Eligible Securities,” and refers to options issued by OCC.

³⁹ The term “Stock Futures” is defined in the Existing Accord within the definition of “Eligible Securities,” and refers to stock futures contracts cleared by OCC.

⁴⁰ 11 U.S.C. § 101 et seq., including §§362(b)(6), (7), (17), (25) and (27) (exceptions to the automatic stay), §§546(e) – (g) and (j) (limitations on avoiding powers), and §§555 – 556 and 559 – 562 (contractual right to liquidate, terminate or accelerate certain contracts).

⁴¹ 15 U.S.C. §§ 78aaa – III, including §78eee(b)(2)(C) (exceptions to the stay).

- The term “Mutually Suspended Member” would mean “any OCC Participating Member⁴² that has been suspended by OCC that is also an NSCC Participating Member⁴³ for which NSCC has ceased to act.”
- The term “Required Fund Deposit” would have the meaning “provided in Rule 4 of NSCC’s Rules and Procedures (or any replacement or substitute rule), the version of which, with respect to any transaction or obligation incurred that is the subject of this Agreement, is in effect at the time of such transaction or incurrence of obligation.”
- The term “Supplemental Liquidity Deposit” would have the meaning “provided in Rule 4A of NSCC’s Rules and Procedures (or any replacement or substitute rule), the version of which, with respect to any transaction or obligation incurred that is the subject of this Agreement, is in effect at the time of such transaction or incurrence of obligation.”

The defined terms that would be amended in Section 1 of the Existing Accord are as follows.

- The definition for the term “E&A/Delivery Transaction” generally contemplates a transaction that involves a delivery and receipt of stock in the settlement of physically settled options and futures that are cleared and settled by OCC and for which the underlying securities are eligible for clearing through the facilities of NSCC. The definition would be amended to make clear that it would apply in respect of a “Close Out Transaction” of a “Mutually Suspended Member” as those terms are proposed to be defined (described above).
- The definition for the term “Eligible Securities” generally contemplates the securities that are eligible to be used for physical settlement under the Existing Accord. The term would be modified to clarify that this may include, for example, equities, exchange-traded funds and exchange-traded notes that are underlying securities for options issued by OCC.

⁴² The term “OCC Participating Member” is defined in the Existing Accord to mean “(i) a Common Member; (ii) an OCC Clearing Member that is an ‘Appointing Clearing Member’ (as defined in Article I of OCC’s By-Laws) and has appointed an Appointed Clearing Member that is an NSCC Member to effect settlement of E&A/Delivery Transactions through NSCC on the Appointing Clearing Member’s behalf; (iii) an OCC Clearing Member that is an Appointed Clearing Member; or (iv) a Canadian Clearing Member.” No changes are proposed to this definition.

⁴³ The term “NSCC Participating Member” is defined in the Existing Accord to mean “(i) a Common Member; (ii) an NSCC Member that is an ‘Appointed Clearing Member’ (as defined in Article I of OCC’s By-Laws); or (iii) [or Canadian Depository for Securities, or “CDS”]. For the avoidance of doubt, the Clearing Agencies agree that CDS is an NSCC Member for purposes of this Agreement.” No changes are proposed to this definition.

Section 6 – Default by an NSCC Participating Member or OCC Participating Member

Section 6 of the Existing Accord provides that NSCC is required to provide certain notice to OCC in circumstances in which NSCC has ceased to act for a Common Member. Currently, Section 6(A)(ii) of the Existing Accord also requires NSCC to notify OCC if a Common Member has failed to satisfy its Clearing Fund obligations to NSCC, but for which NSCC has not yet ceased to act. In practice, this provision would trigger a number of obligations (described below) when a Common Member fails to satisfy its NSCC Clearing Fund obligations for any reason, including those due to an operational delay. Therefore, OCC and NSCC are proposing to remove the notification requirement under Section 6(A)(ii) from the Existing Accord. Under Section 7(d) of the Existing Accord, NSCC and OCC are required to provide each other with general surveillance information regarding Common Members, which includes information regarding any Common Member that is considered by the other party to be in distress. Therefore, if a Common Member has failed to satisfy its NSCC Clearing Fund obligations and NSCC believes this failure is due to, for example, financial distress and not, for example, due to a known operational delay, and NSCC has not yet ceased to act for that Common Member, such notification to OCC would still occur but would be done pursuant to Section 7(d) of the Existing Accord (as proposed to be amended), and not Section 6(A)(ii). Notifications under Section 6 of the Existing Accord (as proposed to be amended) would be limited to instances when NSCC has actually ceased to act for a Common Member pursuant to the NSCC Rules.⁴⁴

Following notice by NSCC that it has ceased to act for a Common Member, OCC is obligated in turn to deliver to NSCC a list of all E&A/Delivery Transactions (excluding certain

⁴⁴ See Rule 46 (Restrictions on Access to Services) of the NSCC Rules, supra note 10.

transactions for which Guaranty Substitution does not occur) involving the Common Member.⁴⁵

This provision would be amended to clarify that it applies in respect of such E&A/Delivery Transactions for the Common Member for which the NSCC Guaranty has not yet attached – meaning that Guaranty Substitution has not yet occurred.

As described above in the summary of the Existing Accord, where NSCC has ceased to act for a Common Member, the Existing Accord refers to the Common Member as the Defaulting NSCC Member and also refers to the relevant E&A/Delivery Transactions in connection with that Defaulting NSCC Member for which a Guaranty Substitution has not yet occurred as Defaulted NSCC Member Transactions.

If the Defaulting NSCC Member is also suspended by OCC, it would be covered by the proposed definition that is described above for a Mutually Suspended Member. For such a Mutually Suspended Member, the proposed changes in Section 6(b) would provide that NSCC, by a time agreed upon by the parties, would provide OCC with the amount of the Guaranty Substitution Payment as calculated by NSCC and related documentation regarding the calculation. The Guaranty Substitution Payment would be calculated pursuant to NSCC's Rules as that portion of the unmet Required Fund Deposit⁴⁶ and Supplemental Liquidity Deposit⁴⁷ obligations of the Mutually Suspended Member attributable to the Defaulted NSCC Member

⁴⁵ The section of the Existing Accord that addresses circumstances in which NSCC ceases to act and/or an NSCC Member defaults is currently part of Section 6(a). It would be re-designated as Section 6(b) for organizational purposes.

⁴⁶ The Required Fund Deposit is calculated pursuant to Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the NSCC Rules, see supra note 10.

⁴⁷ The Supplemental Liquidity Deposit is calculated pursuant to Rule 4A (Supplemental Liquidity Deposits) of the NSCC Rules, see supra note 10.

Transactions. By a time agreed upon by the parties,⁴⁸ OCC would then be required to either notify NSCC of its intent to make the full amount of the Guaranty Substitution Payment to NSCC or notify NSCC that it will not make the Guaranty Substitution Payment. If OCC makes the full amount of the Guaranty Substitution Payment, NSCC's guaranty would take effect at the time of NSCC's receipt of that payment and the OCC Guaranty would end.

The proposed changes would further provide that if OCC does not suspend the Common Member (such that the Common Member would therefore not meet the proposed definition of a Mutually Suspended Member) or if OCC elects to not make the full amount of the Guaranty Substitution Payment to NSCC, then all of the Defaulted NSCC Member Transactions would be exited from NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation, as applicable, and Guaranty Substitution would not occur in respect thereof. Therefore, NSCC would continue to have no obligation to guarantee or settle the Defaulted NSCC Member Transactions, and the OCC Guaranty would continue to apply to them pursuant to OCC's By-Laws and Rules.⁴⁹

Proposed changes to the Existing Accord would also address the application of any Guaranty Substitution Payment by NSCC. Specifically, new Section 6(d) would provide that any Guaranty Substitution Payment made by OCC may be used by NSCC to satisfy any liability or obligation of the Mutually Suspended Clearing Member to NSCC on account of transactions involving the Mutually Suspended Clearing Member for which the NSCC Guaranty applies and to the extent that any amount of assets otherwise held by NSCC for the account of the Mutually

⁴⁸ The time by which OCC would be required notify NSCC of its intent would be defined in the Service Level Agreement. As of the time of this filing, the parties intend to set that time as one hour after OCC's receipt of the calculated Guaranty Substitution Payment from NSCC.

Suspended Member (including any Required Fund Deposit or Supplemental Liquidity Deposit) are insufficient to satisfy its obligations related to transactions for which the NSCC Guaranty applies. Proposed changes to Section 6(d) would further provide for the return to OCC of any unused portion of the GSP. With regard to the portion of the Guaranty Substitution Payment that corresponds to a member's Supplemental Liquidity Deposit obligation, NSCC must return any unused amount to OCC within fourteen (14) days following the conclusion of NSCC's settlement, close-out and/or liquidation. With regard to the portion of the Guaranty Substitution Payment that corresponds to a Required Fund Deposit, NSCC must return any unused amount to OCC under terms agreed to by the parties.⁵⁰

Other Proposed Changes

Certain other technical changes are also proposed to the Existing Accord to conform it to the proposed changes described above. For example, the preamble and the "whereas" clauses in the Preliminary Statement would be amended to clarify that the agreement is an amended and restated agreement and to summarize that the agreement would be modified to contemplate the Guaranty Substitution Payment structure. Section 1(c), which addresses the terms in the Existing Accord that are defined by reference to NSCC's Rules and Procedures and OCC's By-Laws and Rules would be modified to state that such terms would have the meaning then in effect at the time of any transaction or obligation that is covered by the agreement rather than stating that such terms have the meaning given to them as of the effective date of the agreement. This change is proposed to help ensure that the meaning of such terms in the agreement will not

⁴⁹ Under the current and proposed terms of the Existing Accord, NSCC would be permitted to voluntarily guaranty and settle the Defaulted NSCC Member Transactions.

⁵⁰ Such amounts would be returned to OCC as appropriate and in accordance with a Netting Contract and Limited Cross-Guaranty, by and among the Depository Trust Company,

become inconsistent with the meaning in the NSCC Rules and/or OCC By-Laws and Rules, as they may be modified through proposed rule changes with the Commission.

Technical changes would be made to Sections 3(d) and (e) of the Existing Accord to provide that those provisions would not apply in the event new Section 6(b) described above, is triggered. Section 3(d) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving a suspended OCC Participating Member.⁵¹ Similarly, Section 3(e) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving an NSCC Participating Member⁵² for which NSCC has ceased to act. A proposed change would also be made to Section 5 of the Existing Accord to modify a reference to Section 5 of Article VI of OCC's By-Laws to instead provide that the updated cross-reference should be to Chapter IV of OCC's Rules.

Section 5 would also be amended to clarify that Guaranty Substitution occurs when NSCC has received both the Required Fund Deposit and Supplemental Liquidity Deposit, as calculated by NSCC in its sole discretion, from Common Members. The addition of the collection of the Supplemental Liquidity Deposit to the definition of the Guaranty Substitution Time in this Section 5 would reflect OCC and NSCC's agreement that both amounts are components of the Guaranty Substitution Payment (as described above) and would make this definition consistent with that agreement.

In Section 7 of the Existing Accord, proposed changes would be made to provide that NSCC would provide to OCC information regarding a Common Member's Required Fund

Fixed Income Clearing Corporation, NSCC and OCC, dated as of January 1, 2003, as amended.

⁵¹ See supra note 42 defining OCC Participating Member.

⁵² See supra note 43 defining NSCC Participating Member.

Deposit and Supplemental Liquidity Deposit obligations, to include the Supplemental Liquidity Deposit obligation in this notice requirement, and additionally that NSCC would provide OCC with information regarding the potential Guaranty Substitution Payment for the Common Member. On an options expiration date that is a Friday, NSCC would, by close of business on that day, also provide to OCC information regarding the intra-day liquidity requirement, intra-day liquidity resources and intra-day calls for a Common Member that is subject to a Supplemental Liquidity Deposit at NSCC.

Finally, Section 14 of the Existing Accord would be modernized to provide that notices between the parties would be provided by e-mail rather than by hand, overnight delivery service or first-class mail.

ii. Proposed Changes to OCC By-Laws and Rules

General Description

OCC is also proposing certain changes to its By-Laws and Rules that are designed to complement the proposed changes described above regarding the Existing Accord. These proposed changes to the By-Laws and Rules are described below, and they generally cover the following four areas. First, the proposed changes would define Guaranty Substitution Payment. Second, the proposed changes would describe the circumstances under which OCC could make a Guaranty Substitution Payment to NSCC. Third, the proposed changes would specify what financial resources could be used by OCC to make the Guaranty Substitution Payment.⁵³ Fourth,

⁵³ OCC would be permitted to borrow from the Clearing Fund and margin of a suspended Clearing Member, over which OCC has a general lien, where that Clearing Member is a Mutually Suspended Member. The change would merely expand the circumstances under which OCC's current By-Laws and Rules permit OCC to borrow Clearing Fund and margin. The change would not affect the treatment of such borrowing under OCC's default waterfall that determines how OCC allocates losses against available financial

the proposed changes to OCC's Comprehensive Stress Testing and Clearing Fund Methodology, and Liquidity Risk Management Description would outline enhanced stress testing incorporating the GSP and OCC's ability to call for additional resources from Clearing Members. OCC also is proposing changes to OCC's Liquidity Risk Management Framework to account for OCC's ability to make the GSP.

Article I – Definitions

OCC proposes to add "Guaranty Substitution Payment" as a new defined term under Article I of OCC's By-Laws, which is the Definitions section. The term "Guaranty Substitution Payment" would be defined to mean: "a payment that may be made by [OCC] to [NSCC] under the terms of an agreement between them, as described in Rule 901, so that [NSCC] will not reject settlement obligations for CCC-eligible⁵⁴ securities that are directed by [OCC] for settlement through the facilities of [NSCC] on account of a Clearing Member that has been suspended, as described in Rule 1102, and for which [NSCC] has ceased to act."

Chapter IX – Delivery of Underlying Securities and Payment

Certain changes are also proposed to Chapter IX of OCC's Rules. OCC proposes to add parenthetical language to the Introduction section of Chapter IX of OCC's Rules. It would specify that a Guaranty Substitution Payment could be made by OCC to NSCC in connection with OCC's general policy that to the extent a security to be delivered and received is CCC-eligible, OCC will direct the delivery and payment obligations to be settled through the facilities of NSCC where the obligations are physically-settled and arise out of the exercise of stock option contracts or the maturity of stock futures contracts.

resources. The Mutually Suspended Member's margin and Clearing Fund collateral would remain first in line to absorb losses.

Next, OCC proposes to delete certain provisions from Rule 901(b) regarding when a Guaranty Substitution occurs. Specifically, Rule 901(b) currently provides that unless otherwise agreed between OCC and NSCC, a Guaranty Substitution with respect to settlement obligations for CCC-eligible securities that settle “regular way” under NSCC’s Rules and Procedures will occur if: (i) the applicable settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it has ceased to act for the relevant Clearing Member or Appointed Clearing Member; and (iii) the NSCC Clearing Fund requirements of the relevant Clearing Member or Appointed Clearing Member owing to NSCC, as determined in accordance with NSCC’s Rules and Procedures, are received by NSCC. These considerations regarding when a Guaranty Substitution occurs are addressed under the terms of the Existing Accord, and they would continue to be relevant considerations regarding when a Guaranty Substitution occurs under the changes that OCC and NSCC are proposing to the Existing Accord. However, because additional considerations would be added to the Guaranty Substitution process in connection with the proposed ability for OCC in certain circumstances to make a Guaranty Substitution Payment to NSCC and also to eliminate the potential for a description of the Guaranty Substitution process in OCC’s Rules to become inconsistent with the process that OCC and NSCC have agreed to in the Existing Accord, as it would be amended, OCC is proposing to delete the discussion of these considerations in Rule 901(b) in favor of instead simply cross referencing the terms of the agreement.⁵⁵

⁵⁴ The term “CCC-Eligible” as used herein has the meaning provided in OCC’s By-Laws, supra note 6.

⁵⁵ For purposes of the proposed rule change process under Exchange Act Section 19(b), the agreement is treated as a rule of a clearing agency under Exchange Act Section 3(a)(27) and therefore any proposed changes to it by OCC are subject to the related rule change process and public notice and comment. OCC therefore believes that addressing the

In addition, OCC proposes to add a new paragraph to the end of Rule 901(b) to provide that pursuant to the proposed changes to the Existing Accord, OCC would be permitted to make a Guaranty Substitution Payment to NSCC. The proposed changes would also describe the circumstances in which OCC may make a Guaranty Substitution Payment in connection with settlement obligations of a suspended Clearing Member, and that the amount of the Guaranty Substitution Payment under the terms of the Existing Accord, as amended, would be the amount required by NSCC to satisfy its deficit(s) regarding such Clearing Member's "Required Fund Deposit" and "Supplemental Liquidity Deposit" as those terms are defined in NSCC's Rules and Procedures.⁵⁶ The changes would provide that any amount of a Guaranty Substitution Payment that NSCC does not use pursuant to its Rules and Procedures would subsequently be returned to OCC under such terms and within such times as are agreed by OCC and NSCC. OCC believes that it is useful to include this description of the proposed process for the Guaranty Substitution Payment and the circumstances in which it may be made so that a user of OCC's publicly available By-Laws and Rules would have sufficient information to understand the existence of the Guaranty Substitution Payment mechanism, the general circumstances in which it may be made and the role that a Guaranty Substitution Payment would play in causing NSCC to accept obligations for CCC-eligible securities for clearance and settlement..

Chapters X and XI – Clearing Fund Contributions and Suspension of a Clearing Member

As generally described above, the proposed changes would also provide that OCC would be permitted to borrow from the OCC Clearing Fund and also against certain Margin Assets of a Clearing Member that has been suspended by OCC where that Clearing Member is a Mutually

terms in the agreement and cross-referencing the agreement in OCC Rule 901 would not deprive the Commission or the public of notice regarding any future proposed changes.

Suspended Member. To implement these changes, OCC is proposing the following amendments to OCC Rule 1006 and Rule 1104.

OCC Rule 1006 addresses the purpose and permitted uses of the OCC Clearing Fund. OCC proposes to make amendments to paragraphs (a) and (f) to permit OCC to utilize assets in the Clearing Fund as a liquidity resource in connection with making a Guaranty Substitution Payment. Currently, OCC Rule 1006(a) states the conditions for use of the OCC Clearing Fund. These provide that the OCC Clearing Fund may be used for borrowings pursuant to OCC Rule 1006(f) or to make good losses or expenses suffered by OCC including: (i) as a result of the failure of any Clearing Member to discharge duly any obligation on or arising from any confirmed trade accepted by OCC, (ii) as a result of the failure of any Clearing Member (including any Appointed Clearing Member) or of CDS (Canada's national securities depository) to perform its obligations under any contract or obligation issued, undertaken, or guaranteed by OCC or in respect of which OCC is otherwise liable, (iii) as a result of the failure of any Clearing Member to perform any of its obligations to OCC in respect of the stock loan and borrow positions of such Clearing Member, (iv) in connection with any liquidation of a Clearing Member's open positions, (v) in connection with protective transactions effected for the account of OCC pursuant to Chapter XI of OCC's Rules (delivery of underlying securities and payment), (vi) as a result of the failure of any Clearing Member to make any other required payment or render any other required performance or (vii) as a result of the failure of any bank, securities or

⁵⁶ See NSCC Rules 4 (defining "Required Fund Deposit") and 4A (defining "Supplemental Liquidity Deposit"), supra note 10.

commodities clearing organization, or investment counterparty, to perform its obligations to OCC for certain specified reasons.⁵⁷

OCC proposes to renumber clauses (iii) through (vii) in paragraph (a) as (iv) through (viii), and to insert as new clause (iii) a provision that the OCC Clearing Fund may be used “regarding any Guaranty Substitution Payment that [OCC] may make to [NSCC] under an agreement between them, as described in [OCC] Rule 901, so that [NSCC] will not reject settlement obligations for CCC-eligible securities involving a Clearing Member for which [NSCC] has ceased to act and that [OCC] directs to [NSCC] for settlement through its facilities.”⁵⁸ OCC also proposes to add parenthetical language to paragraphs (f)(1)(A) and (f)(2)(A)(ii) to further clarify that contributions to the OCC Clearing Fund may be borrowed by OCC for use in connection with making a Guaranty Substitution Payment to NSCC. Any borrowing from the OCC Clearing Fund by OCC to make a Guaranty Substitution Payment to NSCC would be subject to the existing terms of OCC Rule 1006(f)(3) that provide that irrespective of how any such borrowings from the OCC Clearing Fund are applied by OCC, the borrowing for a period not to exceed thirty (30) days will not be deemed to result in charges against the OCC Clearing Fund under OCC’s default waterfall for allocating actual losses. For purposes of determining whether a loss resulting from a Guaranty Substitution Payment has occurred, OCC Rule 1006(f)(3) would be amended to provide that the Guaranty Substitution Payment is deemed to be repaid by OCC at such time as under the Accord that it is NSCC’s obligation to return any portion of the Guaranty Substitution Payment that NSCC does not use

⁵⁷ The terms “Clearing Member” and “Appointed Clearing Member” as used herein have the meanings provided in OCC’s By-Laws, supra note 6.

⁵⁸ In connection with these amendments, the reference in Rule 1006(b) to “clauses (i) through (vi) of paragraph (a)” would be changed to “clauses (i) through (vii) of paragraph (a).”

pursuant to its rules. If, subsequent to the borrowing, OCC determines that the borrowing represents an actual loss or all or any part of the borrowing remains outstanding after thirty (30) days (or on the first Business Day thereafter if the thirtieth calendar day is not a Business Day) then the amount of OCC Clearing Fund assets used in the outstanding borrowing would be an actual loss that OCC would be required to immediately allocate under its By-Laws and Rules.⁵⁹ As noted above, losses resulting from the borrowing of Clearing Fund or Margin Assets as a liquidity resource to facilitate OCC making a Guaranty Substitution Payment would be allocated in the same sequence as any other losses charged to the default waterfall.

Consistent with these changes to permit OCC to use the OCC Clearing Fund as a borrowing resource to make a Guaranty Substitution Payment to NSCC, OCC is also proposing similar changes to OCC Rule 1104 that would permit OCC to borrow certain Margin Assets of a Clearing Member that has been suspended by OCC where that Clearing Member is a Mutually Suspended Member and OCC has a general lien⁶⁰ over the Margin Assets.

Specifically, OCC proposes to add a new paragraph (g) to OCC Rule 1104 that would provide that OCC may use specified Margin Assets of a suspended Clearing Member as a borrowing in order to use such borrowed Margin Assets to make a Guaranty Substitution Payment to NSCC. OCC would be permitted to use Margin Assets from the following accounts of a suspended Common Member: firm lien account and firm non-lien account; separate Market-

⁵⁹ If the defaulting OCC Clearing Member's Margin Assets and OCC Clearing Fund contribution were insufficient to cover the associated losses, OCC would next look to certain OCC financial resources that are available for that purpose (e.g., OCC's corporate contribution and Clearing Fund contributions of non-defaulting OCC Clearing Members).

⁶⁰ Article I, Section 1.G.(1) of OCC's By-Laws states that the "term 'general lien' means a security interest of [OCC] in all or specified assets in a Clearing Member account as security for all of the Clearing Member's obligations to [OCC] regardless of the source or nature of such obligations." See OCC By-Laws, supra note 6.

Maker's account; combined Market-Maker's account; and JBO Participants' account.⁶¹ OCC is not proposing at this time to have authority to borrow Margin Assets from other types of accounts over which OCC has a restricted lien⁶² and for which the Margin Assets are security for the particular restricted lien accounts because of additional complexity that OCC believes would be associated with tracking NSCC's use of Margin Assets associated with those accounts and also due to certain regulatory requirements under Commission Rule 15c3-3 that apply to broker-dealer Clearing Members and prohibit the use of customer property of the broker-dealer to support non-customer activities.⁶³

As with the terms that currently apply to any borrowing from the OCC Clearing Fund pursuant to OCC Rule 1006(f), new paragraph (g) in OCC Rule 1104 would further provide that Margin Assets borrowed by OCC to make a Guaranty Substitution Payment to NSCC would not be deemed to be charges against the margin assets for the relevant account(s) for up to thirty (30) days; however, if all or a part of such borrowing were to be determined by OCC, in its discretion, to represent an actual loss, or if all or a part of the borrowing were to remain outstanding after

⁶¹ The Clearing Member accounts referenced herein are described in subparagraphs (a), (b), (c) and (h) of Article VI, Section 3 of OCC's By-Laws. See OCC's By-Laws, supra note 6.

⁶² Article I, Section 1.R.(8) of OCC's By-Laws states that the "term 'restricted lien' means a security interest of [OCC] in specified assets (including any proceeds thereof) in an account of a Clearing Member with [OCC] as security for the Clearing Member's obligations to [OCC] arising from such account or, to the extent so provided in the By-Laws or Rules, a specified group of accounts that includes such account including, without limitation, obligations in respect of all confirmed trades effected through such account or group of accounts, and exercise notices assigned to such account or group of accounts." See OCC's By-Laws, supra note 6.

⁶³ For example, under the broker-dealer customer reserve account formula to SEC Rule 15c3-3 the broker-dealer takes a debit in the formula under Item 13 for margin that is "required and on deposit with OCC for all option contracts written or purchased in customer accounts." This means that such margin in turn can be used by the broker-dealer Clearing Member as Margin Assets to support the securities customers' account at OCC.

such thirty (30)-day period, OCC would consider the amount of margin assets used to support OCC's obligations under the outstanding borrowing or transaction as an actual loss and immediately allocate the loss in accordance with OCC's By-Laws and Rules.

OCC anticipates that in a scenario in which it would be permitted make a Guaranty Substitution Payment to NSCC under the proposed changes to the Existing Accord and OCC's By-Laws and Rules, OCC would generally expect to borrow from the Clearing Fund as a primary liquidity resource. OCC could also borrow Margin Assets of the suspended Clearing Member that is a Common Member under the proposed terms described above. OCC is not proposing changes that would require a specific borrowing sequence because OCC believes that it is more appropriate to preserve flexibility to borrow from the available OCC Clearing Fund or Margin Assets as OCC determines appropriate under the circumstances.

In addition, OCC proposes to specify in OCC Rule 1107(a)(1) that exercised option contracts and matured, physically-settled stock futures to which the suspended Clearing Member is a party may be settled in accordance with the terms of any agreement between OCC and NSCC governing the settlement of exercised option contracts and matured, physically-settled stock futures of a suspended Clearing Member. In such an event, settlement will be governed by and subject to the agreement between OCC and NSCC and the rules of NSCC.

The purpose of the proposed changes to create the Guaranty Substitution Payment mechanism is to provide OCC and NSCC with an additional default management tool to help manage liquidity and settlement risks that OCC believes would be presented to each covered clearing agency in connection with a Mutually Suspended Member. OCC believes that having the ability to make a Guaranty Substitution Payment to NSCC in regard to any unmet Required Fund Deposit or Supplemental Liquidity Deposit obligations of a Mutually Suspended Member

would promote prompt and accurate clearance and settlement in the national system for the settlement of securities transactions by causing NSCC to guarantee certain securities settlement obligations that result from exercised options and matured futures contracts that are cleared and settled by OCC. In the following ways, OCC believes that this would be beneficial to and protective of OCC, NSCC, their participants, and the markets they serve.

First, OCC's ability to make the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. Second, this outcome would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members pursuant to the applicable provisions in Chapter IX of OCC's Rules. As noted above, OCC believes that such a broker-to-broker settlement scenario could result in substantial collateral and liquidity requirements for OCC Clearing Members. OCC believes that these potential collateral and liquidity consequences would be due to the lost benefit of netting of the settlement obligations through NSCC's facilities and also due to the short time (i.e., the T+2 standard settlement cycle) between a rejection by NSCC of the settlement obligations for clearing and the associated settlement date on which settlement would be otherwise required to be made bilaterally by OCC Clearing Members. This scenario also raises the potential for procyclical liquidity demands on OCC Clearing Members and participants during stressed market conditions. Third, OCC will plan to size its liquidity resource requirements to reasonable expectations with a high probability of making a Guaranty Substitution Payment in order to facilitate the settlement of a Mutually Suspended Member's

obligations through NSCC. Accounting for net liquidity demands from a Mutually Suspended Member's settlement obligations at the central counterparty-level enhances liquidity in the financial system and promotes the efficient use of capital by reducing the demand for liquidity associated with gross settlement of obligations and enabling the application of resources at both clearing agencies to satisfy the Member's obligation. Fourth, OCC believes that the potential for the size of the settlement obligations to be comparatively larger than the Guaranty Substitution Payment coupled with the short time remaining to settlement could also increase the risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. Therefore, OCC believes that the proposed changes to implement the ability for OCC to make a Guaranty Substitution Payment to NSCC would allow OCC to avoid these risks by causing NSCC to accept the relevant obligations arising from exercised options and matured futures cleared and settled by OCC, as it ordinarily would, and guarantee their settlement, upon OCC making a Guaranty Substitution Payment to NSCC in accordance with the revised Accord.

Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description

OCC proposes to revise the OCC Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description to include the GSP in its liquidity risk management practices. Overall, the proposed changes would reflect that the GSP functions as an additional liquidity demand type at the Clearing Member Organization ("CMO") Group level.⁶⁴

OCC would include additional specifics to address the potential increased demand that the inclusion of the GSP may cause in its liquidity risk management practices in the Liquidity

⁶⁴ A Clearing Member Group is composed of a set of affiliated OCC Clearing Members.

Risk Management section of the Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description. Specifically, OCC proposes to amend the Liquidity Demand for Positions Rejected by NSCC subsection, which describes the Existing Accord, including the scenario in which NSCC could choose not to guaranty certain securities settlement obligations arising out of transactions cleared by OCC. This subsection would be retitled as the Liquidity Demand Associated with NSCC Performance of Physical Settlement Activities subsection to more clearly describe its content and incorporate the GSP, as further detailed below. Consistent with the changes to the Existing Accord described above, OCC proposes to clarify that the Accord allows NSCC to reject such obligations if OCC elects to not make a GSP.

OCC proposes a new subsection, titled the Liquidity Demand GSP, to describe the GSP, which NSCC would calculate as defined in the proposed amendments to the Existing Accord. OCC would describe a GSP as a firm specific liquidity demand (i.e., the amount of cash OCC needs to pay NSCC on behalf of the defaulting Common Member). OCC would describe the components of the GSP under the Accord. OCC would explain how it accounts for the liquidity demand associated with a potential GSP. Specifically, OCC would apply an amount to account for a potential GSP obligation for every day on which option expirations occur. This amount would be based on peak GSP amounts from the prior 12 months in a given expiration category for the specific CMO Group for each forecasted liquidity demand calculation. OCC will use a one-year lookback time period to determine the appropriate GSP amount to apply. The one-year lookback allows for the best like-to-like application of a historical GSP as there is a cyclical nature to option standard expirations with quarterly (i.e., March, June, September, and December) and January generally being more impactful than non-quarterly expirations. The

one-year lookback also allows behavior changes of a Clearing Member to be recognized within an annual cycle. OCC proposes to utilize a historical GSP based on current system capabilities and data that will be supplied by NSCC.

OCC would use the total amount of Clearing Fund and SLD deficits at NSCC in its calculation to account for its obligation. However, in the event of a default, OCC would be responsible for a proportionate share of both NSCC Clearing Fund deficits (which are analogous to OCC margin deficits) and SLDs that are attributable to OCC E&A activity transmitted to NSCC for settlement, whereas NSCC will be responsible for the portion of the Clearing Fund and SLD deficits associated with activity that NSCC clears that is not transmitted by OCC.

The amount of notional activity sent by OCC to NSCC informs the likelihood of a GSP. Namely, the potential amount of NSCC Clearing Fund and SLD deficits that are allocable to OCC increases as the amount of activity OCC sends to NSCC increases. Since not all types of expirations are the same with respect to the notional amount of activity sent by OCC to NSCC, OCC proposes to use five separate categories of expirations with potentially different GSP amounts to apply. Each day on which expirations occur would fall into one of five categories as follows:

- Standard Monthly Expiration: typically the third Friday of each month from the previous twelve months;
- Non-Standard Monthly Expiration Fridays (“End of Week Expirations”): the last business day of every week, typically a Friday, excluding the third Friday of each month from the previous twelve months;
- End of Month Expirations: the last trading day of every month from the previous twelve months;

- Expirations falling on Bank Holidays where Markets Are Open (“Bank Holiday Expirations”): days where banks are closed but the markets are open from the previous twelve months;⁶⁵
- Remaining Expiration Days (“Daily Expirations”): All other days with an expiration from the previous twelve months that do not fall into any of the categories above (typically most Mondays through Thursdays) from the previous twelve months.

OCC believes these five categories are appropriate after an analysis of notional activity sent to NSCC by OCC.⁶⁶ More specifically, the standard Friday monthly expiration far exceeds the needs associated with any other category.⁶⁷ The remaining categories are intended to capture like time periods that will appropriately account for the GSP.

OCC would apply the peak GSP amounts from the prior twelve months in a given expiration category for the specific CMO Group for each forecasted liquidity demand calculation by adding the GSP amounts to the CMO Group’s other forecasted liquidity demands for the

⁶⁵ The Bank Holiday category recognizes that for Veterans Day and Columbus Day, the equity and equity derivative markets are open for trading, but the banking system is closed for the day. Since the banking system is closed while the aforementioned markets are open, settlement at NSCC encompasses two days of equity trading and equity derivative E&A activity. As OCC is using NSCC deficit numbers without regard for allocation, there is a possibility of a significant outlying GSP requirement due to the settlement of two days of activity simultaneously. Prudence dictates retaining the capability to risk manage a day with such disparate characteristics differently. Additional supporting data in support of the creation of the Bank Holiday Expiration category is included as Exhibit 3E to File No. SR-OCC-2023-801.

⁶⁶ OCC provided its analysis of notional activity sent to NSCC by OCC in support of the creation of the five categories as Exhibit 3E to File No. SR-OCC-2023-801. This Exhibit 3E sets forth data related to OCC’s liquidity stress testing, including Available Liquidity Resources, Minimum Cash Requirement thresholds, and/or liquidity breaches, for Sufficiency and Adequacy scenarios with and without the inclusion of the GSP.

⁶⁷ For example, the average notional transfer for Remaining Expiration Days is approximately 10% the size of Standard Expiration.

relevant expiration day.⁶⁸ If a Clearing Member defaults, OCC may have to pay a GSP to NSCC on two successive days to facilitate the close-out of the defaulted Clearing Member's positions. To account for this possibility in its liquidity risk management process, OCC contemplates the payment of a GSP on expirations that result in settlements on the first and second days of the default management process. As described above, this GSP amount may serve to only increase liquidity demands.⁶⁹

Furthermore, as stated in the new Liquidity Demand GSP subsection, OCC would apply a floor to certain expirations. At a minimum, the GSPs applied to the End of Week, End of Month, and Bank Holiday Expirations will be no lower than the peak of the Daily Expirations category. If a GSP pertaining to the End of Week, End of Month, and Bank Holiday Expiration category is higher than the peak of the Daily Expirations category, then OCC will apply that higher GSP. Standard Monthly Expirations will be floored by End of Week, End of Month, and Daily Expirations. If a GSP pertaining to any of these categories is higher than the Standard Monthly Expiration category, then OCC will apply that higher GSP. OCC would set out formulas representing the floors for the Standard Monthly, End of Week, End of Month, and Bank Holiday Expirations. Finally, OCC also proposes a minor change to clarify that it would attempt to effect alternative settlement if OCC elected not to make a GSP.⁷⁰

Liquidity Risk Management Framework

⁶⁸ As an example, if the applicable GSP is \$100 and the (current) stressed liquidity demand is \$150 for a Clearing Member Group, the result after the application of the GSP for that Clearing Member Group would be a combined liquidity requirement of \$250 versus \$150 currently.

⁶⁹ OCC provided its analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands as Exhibit 3E to File No. SR-OCC-2023-801.

⁷⁰ This clarification would maintain OCC's current process for settling transactions not processed through NSCC and does not represent the adoption of a new process or settlement method.

OCC proposes changes to the Liquidity Risk Management Framework to incorporate the GSP. In the Liquidity Risk Identification section, OCC would specify that, in the situation where a member defaults immediately preceding, or during the expiration, of physically-settled E&A activity, OCC may elect to make a GSP to NSCC to compel NSCC to accept and process the E&A activity. If OCC elects to not make a GSP, OCC would complete settlement of the defaulted Clearing Member's E&A transactions through its current process. Relatedly, OCC would include a minor clarification to a footnote in this section to note that NSCC is not acting on behalf of a defaulting Clearing Member "in this situation."

Anticipated Effect on and Management of Risk

OCC believes that the proposed changes would reduce the nature and level of risk presented by OCC because the purpose of the proposed changes to enhance its stress testing processes and create the Guaranty Substitution Payment mechanism is to provide OCC and NSCC with additional default management tools to help manage liquidity and settlement risks that OCC believes would be presented to each covered clearing agency in connection with a Mutually Suspended Member. OCC believes that having the ability to make a Guaranty Substitution Payment to NSCC in regard to any unmet Required Fund Deposit or Supplemental Liquidity Deposit obligations of a Mutually Suspended Member would promote prompt and accurate clearance and settlement in the national system for the settlement of securities transactions by causing NSCC to guarantee certain securities settlement obligations that result from exercised options and matured futures contracts that are cleared and settled by OCC. OCC further believes that enhancing its stress testing processes will help to ensure that it maintains the resources to make such a payment. In the following ways, OCC believes that this would be beneficial to and protective of OCC, NSCC, their participants, and the markets they serve.

First, OCC's ability to make the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. Second, this outcome would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members pursuant to the applicable provisions in Chapter IX of OCC's Rules. As noted above, OCC believes that such a broker-to-broker settlement scenario could result in substantial collateral and liquidity requirements for OCC Clearing Members. OCC believes that these potential collateral and liquidity consequences would be due to the lost benefit of netting of the settlement obligations through NSCC's facilities and also due to the short time (i.e., the T+2 standard settlement cycle) between a rejection by NSCC of the settlement obligations for clearing and the associated settlement date on which settlement would be otherwise required to be made bilaterally by OCC Clearing Members. This scenario also raises the potential for procyclical liquidity demands on OCC Clearing Members and participants during stressed market conditions. Third, OCC will plan to size its liquidity resource requirements to reasonable expectations with a high probability of making a Guaranty Substitution Payment in order to facilitate the settlement of a Mutually Suspended Member's obligations through NSCC. Accounting for net liquidity demands from a Mutually Suspended Member's settlement obligations at the central counterparty-level enhances liquidity in the financial system and promotes the efficient use of capital by reducing the demand for liquidity associated with gross settlement of obligations and enabling the application of resources at both clearing agencies to satisfy the Member's obligation. Fourth, OCC believes that the potential for

the size of the settlement obligations to be comparatively larger than the Guaranty Substitution Payment coupled with the short time remaining to settlement could also increase the risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. Therefore, OCC believes that the proposed changes to implement the ability for OCC to make a Guaranty Substitution Payment to NSCC would allow OCC to avoid these risks by causing NSCC to accept the relevant obligations arising from exercised options and matured futures cleared and settled by OCC, as it ordinarily would, and guarantee their settlement, upon OCC making a Guaranty Substitution Payment to NSCC in accordance with the revised Accord.

Consistency with the Payment, Clearing and Settlement Supervision Act

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.⁷¹ Section 805(a)(2) of the Clearing Supervision Act⁷² also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act⁷³ states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and

⁷¹ 12 U.S.C. 5461(b).

⁷² 12 U.S.C. 5464(a)(2).

- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Exchange Act in furtherance of these objectives and principles.⁷⁴ Rule 17Ad-22 requires registered clearing agencies, like OCC, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.⁷⁵ Therefore, the Commission has stated⁷⁶ that it believes it is appropriate to review changes proposed in advance notices against Rule 17Ad-22 and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.⁷⁷

OCC believes the proposed changes are consistent with Section 805(b)(1) of the Clearing Supervision Act⁷⁸ because they would promote the reduction of risks to OCC, its Clearing Members and the markets OCC serves. As described above, OCC believes that the proposed enhancements to its stress testing processes and having the ability to make a Guaranty Substitution Payment to NSCC with respect to any unmet obligations of a Mutually Suspended Member would promote the reduction of risk because it would ensure that OCC maintains

⁷³ 12 U.S.C. 5464(b).

⁷⁴ 17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7 17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016).

⁷⁵ 17 CFR 240.17Ad-22.

⁷⁶ See, e.g., Exchange Act Release No. 89039, 85 FR at 36446.

⁷⁷ 12 U.S.C. 5464(b).

⁷⁸ 12 U.S.C. 5464(b)(1).

sufficient liquidity resources and that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations for both the Mutually Suspended Member and its assigned delivery counterparties could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. This would also avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members, which OCC believes could result in substantial collateral and liquidity requirements for OCC Clearing Members and that, in turn, could also increase a risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. For these reasons, OCC believes that the proposed changes: (i) are designed to promote robust risk management; (ii) are consistent with promoting safety and soundness; and (iii) are consistent with reducing systemic risks and promoting the stability of the broader financial system.

OCC believes that the proposed changes are also consistent with the SEC rules that apply to OCC as a covered clearing agency.⁷⁹ In particular, SEC Rule 17Ad-22(e)(20) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor and manage risks related to any link that OCC establishes with one or more other clearing agencies, financial market utilities, or trading markets.⁸⁰ As described in OCC's publicly available disclosure framework for financial market infrastructures,⁸¹ the Existing Accord between OCC and NSCC is one such link. As described above, OCC believes

⁷⁹ 17 CFR 240.17Ad-22(a)(5).

⁸⁰ 17 CFR 240.17Ad-22(e)(20).

⁸¹ See The Options Clearing Corporation Disclosure Framework for Financial Market Infrastructures, pg. 108, (2022), available at <https://www.theocc.com/risk-management/pfmi-disclosures>.

(i) the proposed modifications to OCC's stress testing procedures that are designed to enhance its ability to call for additional liquidity resources, and (ii) the implementation of the ability for OCC to make a Guaranty Substitution Payment to NSCC in the relevant circumstances involving a Mutually Suspended Member would help manage the risks presented to OCC and its Clearing Members by the settlement link with NSCC because the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation.

For this same reason, OCC also believes that the proposed changes are consistent with the requirements of SEC Rules 17Ad-22(e)(3) and (7).⁸² SEC Rule 17Ad-22(e)(3) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing, among other things, liquidity, credit and other risks that arise in or are borne by OCC.⁸³ SEC Rule 17Ad-22(e)(7) requires OCC, in relevant part, to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor and manage the liquidity risk that arises in or is borne by OCC and to, among other things, address foreseeable liquidity shortfalls that would not be covered by OCC's liquid resources.⁸⁴ As noted, OCC believes the proposed stress testing enhancements and the ability to make a Guaranty Substitution Payment to NSCC would allow OCC to better manage liquidity and credit risks related to the settlement link with NSCC by ensuring that the relevant securities settlement

⁸² 17 CFR 240.17Ad-22(e)(3), (7).

⁸³ 17 CFR 240.17Ad-22(e)(3).

⁸⁴ 17 CFR 240.17Ad-22(e)(7).

obligations would be accepted by NSCC for clearance and settlement. It would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members, which OCC believes could result in substantial collateral and liquidity requirements for OCC Clearing Members that, in turn, could also increase a risk of default by the affected OCC Clearing Members, particularly in circumstances where the prior suspension of a Mutually Suspended Member relates to broader stress in the financial system. Moreover, the incorporation of the Guarantee Substitution Payment into OCC's liquidity risk management practices would enhance OCC's ability to maintain additional liquidity resources to effect the settlement of exercise and assignment activity in the event of a Common Member default, and therefore, potentially increase the promotion of market stability.

Item 11. Exhibits

- Exhibit 1A. Completed Notice of Advance Notice for publication in the Federal Register.
- Exhibit 3A. OCC Alternative Settlement and GSP Analysis. As stated above, OCC evaluated certain Clearing Member default scenarios in which OCC assumed that NSCC would not accept the settlement obligations under the Existing Accord, including the default of a large Clearing Member coinciding with a monthly options expiration. OCC has estimated that in such a Clearing Member default scenario, the aggregate liquidity burden on OCC in connection with obligations having to be settled on a gross broker-to-broker basis could reach a significantly high level. OCC provided this analysis of the financial impact of alternate means of settlement as Exhibit 3A. Confidential treatment is requested in part for Exhibit 3A pursuant to SEC Rule 24b-2.
- Exhibit 3B. Close-out Timing. As discussed above, OCC proposes to amend the Existing Accord to define the terms and conditions under which Guaranty Substitution may occur. NSCC and OCC have agreed it is appropriate to limit the availability of the proposed provision to the day of the Common Member default and the next business day because, based on historical simulations of cease to act events involving Common Members, most activity of a Mutually Suspended Member is closed out on those days.

This Exhibit 3B contains information regarding such simulated cease to act events involving Common Members. The information contained therein includes the assumptions and timelines leading up to the declaration of a default for a Common Member and the anticipated timing of OCC's payment of the GSP. Confidential treatment is requested in part for Exhibit 3B pursuant to SEC Rule 24b-2.

- Exhibit 3C SLA. OCC and NSCC are both parties to the SLA pursuant to Section 2 of the Existing Accord. The SLA addresses specifics regarding the time, form, and manner of various required notifications and actions described in the Accord. The SLA also includes information applicable under the Accord, such as relevant defined terms and information sharing obligations. Confidential treatment is requested in part for Exhibit 3C pursuant to SEC Rule 24b-2.
- Exhibit 3D GSP Margin of Error. As stated above, the GSP calculation is intended to estimate how much of a member's obligations arise out of activity coming from OCC so that the amount paid by OCC is commensurate with the risk to NSCC of guarantying such activity. This Exhibit 3D shows the GSP margin of error by evaluating OCC and NSCC GSP and deficit allocations. Confidential treatment is requested in part for Exhibit 3D pursuant to SEC Rule 24b-2.
- Exhibit 3E GSP Impact Analysis and Rationale. This Exhibit 3E includes OCC's analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands. The document sets forth data related to OCC's liquidity stress testing, including Available Liquidity Resources, Minimum Cash Requirement thresholds, and/or liquidity breaches, for Sufficiency and Adequacy scenarios with and without the inclusion of the GSP. As described above, the inclusion of the GSP can only serve to increase liquidity demands. This Exhibit 3E also includes data in support of the creation of the five categories of expiration types, including an analysis of notional activity sent to NSCC by OCC. As discussed above and demonstrated in this exhibit, not all types of expirations are the same with respect to the notional amount of activity sent by OCC to NSCC, and, accordingly, OCC proposes to use five separate categories of expirations with potentially different GSP amounts to apply. Confidential treatment is requested in part for Exhibit 3E pursuant to SEC Rule 24b-2.
- Exhibit 5A. Proposed Changes to OCC By-Laws.
- Exhibit 5B. Proposed Changes to OCC Rules.
- Exhibit 5C Proposed Changes to Amended and Restated Stock Options and Futures Settlement Agreement Between OCC and NSCC. Confidential treatment is requested for Exhibit 5C pursuant to SEC Rule 24b-2.

Exhibit 5D Proposed Changes to OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description. Confidential treatment is requested for Exhibit 5D pursuant to SEC Rule 24b-2.

Exhibit 5E Proposed Changes to OCC's Liquidity Risk Management Framework. Confidential treatment is requested for Exhibit 5E pursuant to SEC Rule 24b-2.

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-[_____]; File No. SR-OCC-2023-801)

[August __, 2023]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Advance Notice Relating to The Options Clearing Corporation's Concerning Modifications to the Amended and Restated Stock Options and Futures Settlement Agreement Between The Options Clearing Corporation and the National Securities Clearing Corporation

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, entitled Payment, Clearing and Settlement Supervision Act of 2010 ("Clearing Supervision Act")¹ and Rule 19b-4(n)(1)(i)² of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),³ notice is hereby given that on August 10, 2023, The Options Clearing Corporation ("OCC" or "Corporation") filed with the Securities and Exchange Commission ("SEC" or "Commission") an advance notice as described in Items I, II and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

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

This advance notice is submitted by OCC in connection with a proposed change to its operations to (1) modify the Amended and Restated Stock Options and Futures Settlement Agreement dated August 5, 2017 between OCC and National Securities Clearing Corporation ("NSCC," and together with OCC, the "Clearing Agencies")

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ 15 U.S.C. 78a et seq.

(“Existing Accord”)⁴ and (2) make certain revisions to OCC By-Laws, OCC Rules,⁵ OCC’s Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC’s Liquidity Risk Management Framework in connection with the proposed modifications to the Existing Accord, as described in greater detail below.⁶

The proposed changes would permit OCC to elect to make a cash payment to NSCC following the default of a common clearing participant that would cause NSCC’s central counterparty trade guaranty to attach to certain obligations of that participant, as described in greater detail below.

The proposed changes are included in Exhibits 5A and 5B and confidential Exhibits 5C, 5D, and 5E to File No. SR-OCC-2023-801. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text.

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

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the advance notice and discussed any comments it received on the advance notice. The text of these statements may be examined at the places specified

⁴ The Existing Accord was previously approved by the Commission. See Securities Exchange Act Release Nos. 81266, 81260 (July 31, 2017) (File Nos. SR-NSCC-2017-007; SR-OCC-2017-013), 82 FR 36484 (Aug. 4, 2017).

⁵ OCC By-Laws are available at https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf and OCC Rules are available at https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf.

⁶ NSCC also has filed a proposed rule change with the Commission in connection with this proposal. See SR-NSCC-2023-007.

in Item IV below. OCC has prepared summaries, set forth in sections (A) and (B) below, of the most significant aspects of these statements.

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

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

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

Description of Proposed Change

Background

OCC is filing this advance notice to (1) modify the Existing Accord between OCC and NSCC and (2) make certain revisions to OCC By-Laws, OCC Rules, OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC's Liquidity Risk Management Framework in connection with the proposed modifications to the Existing Accord, as described in greater detail below. The proposed changes would permit OCC to elect to make a cash payment to NSCC following the default of a common clearing participant that would cause NSCC's central counterparty trade guaranty to attach to certain obligations of that participant, as described in greater detail below.

i. Executive Summary

NSCC is a clearing agency that provides clearing, settlement, risk management, and central counterparty services for trades involving equity securities. OCC is the sole clearing agency for standardized equity options listed on national securities exchanges registered with the Commission, including options that contemplate the physical delivery

of equities cleared by NSCC in exchange for cash (“physically settled” options).⁷ OCC also clears certain futures contracts that, at maturity, require the delivery of equity securities cleared by NSCC in exchange for cash. As a result, the exercise/assignment of certain options or maturation of certain futures cleared by OCC effectively results in stock settlement obligations. NSCC and OCC maintain a legal agreement, generally referred to by the parties as the “Accord” agreement, that governs the processing of such physically settled options and futures cleared by OCC that result in transactions in underlying equity securities to be cleared by NSCC (i.e., the Existing Accord). The Existing Accord establishes terms under which NSCC accepts for clearing certain securities transactions that result from the exercise and assignment of relevant options contracts and the maturity of futures contracts that are cleared and settled by OCC.⁸ It also establishes the time when OCC’s settlement guaranty in respect of those transactions ends and NSCC’s settlement guaranty begins.

The Existing Accord allows for a scenario in which NSCC could choose not to guarantee the settlement of such securities arising out of transactions. Specifically, NSCC is not obligated to guarantee settlement until its member has met its collateral requirements at NSCC. If NSCC chooses not to guarantee settlement, OCC would engage in an alternate method of settlement outside of NSCC. This scenario presents two

⁷ The term “physically-settled” as used throughout the OCC Rulebook refers to cleared contracts that settle into their underlying interest (i.e., options or futures contracts that are not cash-settled). When a contract settles into its underlying interest, shares of stock are sent, i.e., delivered, to contract holders who have the right to receive the shares from contract holders who are obligated to deliver the shares at the time of exercise/assignment in the case of an option and maturity in the case of a future.

⁸ Under the Existing Accord, such options and futures are defined as “E&A/Delivery Transactions”, which refers to “Exercise & Assignment Delivery Transactions.”

primary problems. First, the cash required for OCC and its Clearing Members in certain market conditions to facilitate settlement outside of NSCC could be significantly more than the amount required if NSCC were to guarantee the relevant transactions. This is because settlement of the transactions in the underlying equity securities outside of NSCC would mean that they would no longer receive the benefit of netting through the facilities of NSCC. In such a scenario, the additional collateral required from Clearing Members to support OCC's continuing settlement guarantee would also have to be sufficiently liquid to properly manage the risks associated with those transactions being due on the second business day following the option exercise or the relevant futures contract maturity date.

Based on an analysis of scenarios using historical data where it was assumed that OCC could not settle transactions through the facilities of NSCC, the worst-case outcome resulted in extreme liquidity demands of over \$300 billion for OCC to effect settlement via an alternative method, e.g., by way of gross broker-to-broker settlement, as discussed in more detail below. OCC Clearing Members, by way of their contributions to the OCC Clearing Fund, would bear the brunt of this demand. Furthermore, there is no guarantee that OCC Clearing Members could fund the entire amount of any similar real-life scenarios. By contrast, projected GSPs, defined below, identified during the study ranged from approximately \$419 million to over \$6 billion, also as discussed in more detail below.

The second primary problem relates to the significant operational complexities if settlement occurs outside of NSCC. More specifically, netting through NSCC reduces the volume and value of settlement obligations. For example, in 2022 it is estimated that

netting through NSCC's continuous net settlement ("CNS") accounting system⁹ reduced the value of CNS settlement obligations by approximately 98% or \$510 trillion from \$519 trillion to \$9 trillion. If settlement occurred outside of NSCC, on a broker-to-broker basis between OCC Clearing Members, for example, shares would not be netted and Clearing Members would have to coordinate directly with each other to settle the relevant transactions. The operational complexities and uncertainty associated with alternate means of settlement would impact every market participant involved in a settlement of OCC-related transactions.

To address these problems, the Clearing Agencies are proposing to amend and restate the Existing Accord and make related changes to their respective rules that would allow OCC to elect to make a cash payment to NSCC following the default of a Common Member¹⁰ that would cause NSCC to guarantee settlement of that Common Member's transactions and, therefore, cause those transactions to be settled through processing by NSCC. As part of this proposal, OCC also will enhance its daily liquidity stress testing processes and procedures to account for the possibility of OCC making such a payment to NSCC in the event of a Common Member default. By making these enhancements to its stress testing, OCC could include the liquid resources necessary to make the payment in its resource planning. The Clearing Agencies believe that by NSCC accepting such a

⁹ See Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules. See NSCC's Rules, available at https://www.dtcc.com/-/media/Files/Downloads/legal/rules/nscc_rules.pdf.

¹⁰ A firm that is both an OCC Clearing Member and an NSCC Member or is an OCC Clearing Member that has designated an NSCC Member to act on its behalf is referred to herein as a "Common Member." The term "Clearing Member" as used herein has the meaning provided in OCC's By-Laws. See OCC's By-Laws, *supra*, note 5. The term "Member" as used herein has the meaning provided in NSCC's Rules. See NSCC's Rules, *supra* note 9.

payment from OCC, the operational efficiencies and reduced costs related to the settlement of transactions through NSCC would limit market disruption following a Common Member default because settlement through NSCC following such a default would be less operationally complex and would be expected to require less liquidity and other collateral from market participants than the processes available to OCC for closing out positions. Additionally, proposed enhancements by OCC to its liquidity stress testing would add assurances that OCC could make such a payment in the event of a Common Member default. The Clearing Agencies believe that their respective clearing members and all other participants in the markets for which OCC provides clearance and settlement will benefit from OCC's ability to choose to make a cash payment to effect settlement through the facilities of NSCC. This change will provide more certainty around certain default scenarios and would blunt the financial and operational burdens market participants could experience in the case of most clearing member defaults.¹¹

ii. Background

OCC acts as a central counterparty clearing agency for U.S.-listed options and futures on a number of underlying financial assets including common stocks, currencies and stock indices. In connection with these services, OCC provides the OCC Guaranty pursuant to its By-Laws and Rules. NSCC acts as a central counterparty clearing agency for certain equity securities, corporate and municipal debt, exchange traded funds and unit investment trusts that are eligible for its services. Eligible trading activity may be

¹¹ OCC provided its analysis of the financial impact of alternate means of settlement as Exhibit 3A to File No. SR-OCC-2023-801.

processed through NSCC's CNS system¹² or through its Balance Order Account system,¹³ where all eligible compared and recorded transactions for a particular settlement date are netted by issue into one net long (buy), net short (sell) or flat position. As a result, for each day with activity, each Member has a single deliver or receive obligation for each issue in which it has activity. In connection with these services, NSCC also provides the NSCC Guaranty pursuant to Addendum K of the NSCC Rules.

OCC's Rules provide that delivery of, and payment for, securities underlying certain exercised stock options and matured single stock futures that are physically settled are generally effected through the facilities of NSCC and are not settled through OCC's facilities.¹⁴ OCC and NSCC executed the Existing Accord to facilitate, via NSCC's systems, the physical settlement of securities arising out of options and futures cleared by OCC. OCC Clearing Members that clear and settle physically settled options and futures transactions through OCC also are required under OCC's Rules¹⁵ to be Members of NSCC or to have appointed or nominated a Member of NSCC to act on its behalf. As noted above, these firms are referred to as "Common Members" in the Existing Accord.

iii. Summary of the Existing Accord

The Existing Accord governs the transfer between OCC and NSCC of responsibility for settlement obligations that involve a delivery and receipt of stock in the settlement of physically settled options and futures that are cleared and settled by OCC

¹² See Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules, supra note 9.

¹³ See Rule 8 (Balance Order and Foreign Security Systems) and Procedure V (Balance Order Accounting Operation) of the NSCC Rules, supra note 9.

¹⁴ See Chapter IX of OCC's Rules (Delivery of Underlying Securities and Payment), supra note 5.

¹⁵ See OCC Rule 901, supra note 5.

and for which the underlying securities are eligible for clearing through the facilities of NSCC (“E&A/Delivery Transactions”). It also establishes the time when OCC’s settlement guarantee (the “OCC Guaranty”) ends and NSCC’s settlement guarantee (the “NSCC Guaranty”)¹⁶ begins with respect to E&A/Delivery Transactions. However, in the case of a Common Member default¹⁷ NSCC can reject these settlement obligations, in which case the settlement guaranty will not transfer from OCC to NSCC and OCC would not have a right to settle the transactions through the facilities of NSCC. Instead, OCC would have to engage in alternative methods of settlement that have the potential to create significant liquidity and collateral requirements for both OCC and its non-defaulting Clearing Members.¹⁸ More specifically, this could involve broker-to-broker settlement between OCC Clearing Members.¹⁹ This settlement method is operationally complex because it requires bilateral coordination directly between numerous Clearing

¹⁶ See Addendum K and Procedure III of the NSCC Rules, *supra* note 9.

¹⁷ A Common Member that has been suspended by OCC or for which NSCC has ceased to act is referred to as a “Mutually Suspended Member.”

¹⁸ For example, OCC evaluated certain Clearing Member default scenarios in which OCC assumed that NSCC would not accept the settlement obligations under the Existing Accord, including the default of a large Clearing Member coinciding with a monthly options expiration. OCC has estimated that in such a Clearing Member default scenario, the aggregate liquidity burden on OCC in connection with obligations having to be settled on a gross broker-to-broker basis could reach a significantly high level. For example, in January 2022, the largest gross broker-to-broker settlement amount in the case of a larger Clearing Member default would have resulted in liquidity needs of approximately \$384,635,833,942. OCC provided the data and analysis as Exhibit 3A to File No. SR-OCC-2023-801.

¹⁹ In broker-to-broker settlement, Clearing Member parties are responsible for coordinating settlement – delivery and payment – among themselves on a transaction-by-transaction basis. Once transactions settle, the parties also have an obligation to affirmatively notify OCC so that OCC can close out the transactions. If either one of or both of the parties do not notify OCC, the transaction will remain open on OCC’s books indefinitely until the time both parties have provided notice of settlement to OCC.

Members rather than relying on NSCC to facilitate multilateral netting to settle the relevant settlement obligations. As described above, it also potentially could result in significant liquidity and collateral requirements for both OCC and its non-defaulting Clearing Members because the transactions will not be netted through the facilities of NSCC. Alternatively, where NSCC accepts the E&A/Delivery Transactions from OCC, the OCC Guaranty ends and the NSCC Guaranty takes effect. The transactions are then netted through NSCC's systems, which allows settlement obligations for the same settlement date to be netted into a single deliver or receive obligation. This netting reduces the costs associated with securities transfers by reducing the number of securities movements required for settlement and further reduces operational and market risk. The benefits of such netting by NSCC may be significant with respect to the large volumes of E&A/Delivery Transactions processed during monthly options expiry periods.

Pursuant to the Existing Accord, on each trading day NSCC delivers to OCC a file that identifies the securities, including stocks, exchange-traded funds and exchange-traded notes, that are eligible (1) to settle through NSCC and (2) to be delivered in settlement of (i) exercises and assignments of stock options cleared and settled by OCC or (ii) delivery obligations from maturing stock futures cleared and settled by OCC. OCC, in turn, delivers to NSCC a file identifying securities to be delivered, or received, for physical settlement in connection with OCC transactions.²⁰

²⁰ Each day that both OCC and NSCC are open for accepting trades for clearing is referred to as an "Activity Date" in the Existing Accord. Securities eligible for settlement at NSCC are referred to collectively as "Eligible Securities" in the Existing Accord. Eligible securities are settled at NSCC through NSCC's CNS Accounting Operation or NSCC's Balance Order Accounting Operation.

After NSCC, receives the list of eligible transactions from OCC, and NSCC has received all required deposits to the NSCC Clearing Fund from all Common Members taking into consideration amounts required to physically settle the OCC transactions, the OCC Guaranty would end and the NSCC Guaranty would begin with respect to physical settlement of the eligible OCC-related transactions. At this point, NSCC is solely responsible for settling the transactions.^{21 22}

Each day, NSCC is required to promptly notify OCC at the time the NSCC Guaranty takes effect. If NSCC rejects OCC's transactions due to an improper submission²³ or if NSCC "ceases to act" for a Common Member,²⁴ NSCC's Guaranty will not take effect for the affected transactions pursuant to the NSCC Rules.

NSCC is required to promptly notify OCC if it ceases to act for a Common Member. Upon receiving such a notice, OCC would not continue to submit to NSCC any

²¹ The term "NSCC Clearing Fund" as used herein has the same meaning as the term "Clearing Fund" as provided in the NSCC Rules. Procedure XV of the NSCC Rules provides that all NSCC Clearing Fund requirements and other deposits must be made within one hour of demand, unless NSCC determines otherwise, supra note 9.

²² This is referred to in the Existing Accord as the "Guaranty Substitution Time," and the process of the substitution of the NSCC Guaranty for the OCC Guaranty in respect of E&A/Delivery Transactions is referred to as "Guaranty Substitution."

²³ Guaranty Substitution by NSCC (discussed further below) does not occur with respect to an E&A/Delivery Transaction that is not submitted to NSCC in the proper format or that involves a security that is not identified as an Eligible Security on the then-current NSCC Eligibility Master File.

²⁴ Under NSCC's Rules, a default would generally be referred to as a "cease to act" and could encompass a number of circumstances, such as an NSCC Member's failure to make a Required Fund Deposit in a timely fashion. See NSCC Rule 46 (Restrictions on Access to Services), supra note 9. An NSCC Member for which it has ceased to act is referred to in the Existing Accord as a "Defaulting NSCC Member." Transactions associated with a Defaulting NSCC Member are referred to as "Defaulted NSCC Member Transactions" in the Existing Accord.

further unsettled transactions that involve such Common Member, unless authorized representatives of both OCC and NSCC otherwise consent. OCC would, however, deliver to NSCC a list of all transactions that have already been submitted to NSCC and that involve such Common Member. The NSCC Guaranty ordinarily would not take effect with respect to transactions for a Common Member for which NSCC has ceased to act, unless both Clearing Agencies agree otherwise. As such, NSCC does not have any existing contractual obligation to guarantee such Common Member's transactions. To the extent the NSCC Guaranty does not take effect, OCC's Guaranty would continue to apply, and, as described above, OCC would remain responsible for effecting the settlement of such Common Member's transactions pursuant to OCC's By-Laws and Rules.

As noted above, the Existing Accord does provide that the Clearing Agencies may agree to permit additional transactions for a Common Member default ("Defaulted NSCC Member Transactions") to be processed by NSCC while subject to the NSCC Guaranty. This optional feature, however, creates uncertainty for the Clearing Agencies and market participants about how Defaulted NSCC Member Transactions may be processed following a Common Member default and also does not provide NSCC with the ability to collect collateral from OCC that it may need to close out these additional transactions. While the optional feature would remain in the agreement as part of this proposal, the proposed changes to the Existing Accord, as described below, could significantly reduce the likelihood that it would be utilized.

Proposed Change

- i. Proposed Changes to the Existing Accord

The proposed changes to the Existing Accord would permit OCC to make a cash payment, referred to as the “Guaranty Substitution Payment” or “GSP,” to NSCC. This cash payment could occur on either or both of the day that the Common Clearing Member becomes a Mutually Suspended Member and on the next business day. Upon NSCC’s receipt of the Guaranty Substitution Payment from OCC, the NSCC Guaranty would take effect for the Common Member’s transactions, and they would be accepted by NSCC for clearance and settlement.²⁵ OCC could use all Clearing Member contributions to the OCC Clearing Fund²⁶ and certain Margin Assets²⁷ of a defaulted Clearing Member to pay the GSP, as described in more detail below.

NSCC would calculate the Guaranty Substitution Payment as the sum of the Mutually Suspended Member’s unpaid required deposit to the NSCC Clearing Fund (“Required Fund Deposit”)²⁸ and the unpaid Supplemental Liquidity Deposit²⁹ obligation that is attributable to E&A/Delivery Transactions. The proposed changes to the Existing Accord define how NSCC would calculate the Guaranty Substitution Payment.

More specifically, NSCC would first determine how much of the member’s

²⁵ Acceptance of such transactions by NSCC would be subject to NSCC’s standard validation criteria for incoming trades. See NSCC Rule 7, *supra* note 9.

²⁶ The term “OCC Clearing Fund” as used herein has the same meaning as the term “Clearing Fund” in OCC’s By-Laws, supra note 5.

²⁷ The term “Margin Assets” as used herein has the same meaning as provided in OCC’s By-Laws, supra note 5.

²⁸ The Required Fund Deposit is calculated pursuant to Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the NSCC Rules, see supra note 9.

²⁹ Under the NSCC Rules, NSCC collects additional cash deposits from those Members who would generate the largest settlement debits in stressed market conditions, referred to as “Supplemental Liquidity Deposits” or “SLD”. See Rule 4A of the NSCC Rules, supra note 9.

unpaid Clearing Fund requirement would be included in the GSP. NSCC would look at the day-over-day change in gross market value of the Mutually Suspended Member's positions as well as day-over-day change in the member's NSCC Clearing Fund requirements. Based on such changes, NSCC would identify how much of the change in the Clearing Fund requirement was attributable to E&A/Delivery Transactions coming from OCC. If 100 percent of the day-over-day change in the NSCC Clearing Fund requirement is attributable to activity coming from OCC, then the GSP would include 100 percent of the member's NSCC Clearing Fund requirement. If less than 100 percent of the change is attributable to activity coming from OCC, then the GSP would include that percent of the member's unpaid NSCC Clearing Fund requirement attributable to activity coming from OCC. NSCC would then determine the portion of the member's unpaid SLD obligation that is attributable to E&A/Delivery Transactions. As noted above, the GSP would be the sum of these two amounts. A member's NSCC Clearing Fund requirement and SLD obligation at NSCC are designed to address the credit and liquidity risks that a member poses to NSCC. The GSP calculation is intended to assess how much of a member's obligations arise out of activity coming from OCC so that the amount paid by OCC is commensurate with the risk to NSCC of guarantying such activity.

To permit OCC to anticipate the potential resources it would need to pay the GSP for a Mutually Suspended Member, each business day, NSCC would provide OCC with (1) Required Fund Deposit and Supplemental Liquidity Deposit obligations, as calculated pursuant to the NSCC Rules, and (2) the gross market value of the E&A/Delivery Transactions and the gross market value of total Net Unsettled Positions (as such term is

defined in the NSCC Rules). On options expiry days that fall on a Friday, NSCC would also provide OCC with information regarding liquidity needs and resources, and any intraday SLD requirements of Common Members. Such information would be delivered pursuant to the ongoing information sharing obligations under the Existing Accord (as proposed to be amended) and the Service Level Agreement (“SLA”) to which both NSCC and OCC are a party pursuant to Section 2 of the Existing Accord.³⁰ The SLA addresses specifics regarding the time, form, and manner of various required notifications and actions described in the Accord and also includes information applicable under the Accord.

NSCC and OCC believe the proposed calculation of the Required Fund Deposit portion of the GSP is appropriate because it is designed to provide a reasonable proxy for the impact of the Mutually Suspended Member’s E&A/Delivery Transactions on its Required Fund Deposit. While impact study data did show that the proposed calculation could result in a GSP that overestimates or underestimates the Required Fund Deposit attributable to the Mutually Suspended Member’s E&A/Delivery Transactions,³¹ current technology constraints prohibit NSCC from performing a precise calculation of the GSP

³⁰ OCC provided the revised SLA to the Commission as Exhibit 3C to File No. SR-OCC-2023-801.

³¹ The impact study was conducted at the Commission’s request to cover a three-day period and reviewed the ten Common Members with the largest Required Fund Deposits attributable to the Mutually Suspended Member’s E&A/Delivery Transactions. Over the 30 instances in the study, approximately 15 instances resulted in an underestimate of the Required Fund Deposit by an average of approximately \$112,900,926, four instances where the proxy calculation was the same as the Required Fund Deposit, and eleven instances of an overestimate of the Required Fund Deposit by an average of approximately \$59,654,583. See Exhibit 3D to File No. SR-OCC-2023-801 for additional detail related to the referenced study.

on a daily basis for every Common Member.³²

Implementing the ability for OCC to make the GSP and cause the E&A/Delivery Transactions to be cleared and settled through NSCC would promote the ability of OCC and NSCC to be efficient and effective in meeting the requirements of the markets they serve. This is because data demonstrates that the expected size of the GSP would be smaller than the amount of cash that would otherwise be needed by OCC and its Clearing Members to facilitate settlement outside of NSCC. More specifically, based on a historical study of alternate means of settlement available to OCC from September 2021 through September 2022, in the event that NSCC did not accept E&A/Delivery Transactions, the worst-case scenario peak liquidity need OCC identified was \$384,635,833,942 for settlement to occur on a gross broker-to-broker basis. OCC estimates that the corresponding GSP in this scenario would have been \$863,619,056. OCC also analyzed several other large liquidity demand amounts that were identified during the study if OCC effected settlement on a gross broker-to-broker basis.³³ These liquidity demand amounts and the largest liquidity demand amount OCC observed of \$384,635,833,942 substantially exceed the amount of liquid resources currently available to OCC.³⁴ By contrast, projected GSPs identified during the study ranged from

³² OCC and NSCC have agreed that performing the necessary technology build at this time would delay the implementation of this proposal. Therefore, NSCC would consider incorporating those technology updates into future revisions to the Accord, for example in connection with a move to a shorter settlement cycle in the U.S. equities markets.

³³ See Exhibit 3A to File No. SR-OCC-2023-801 for additional detail related to the referenced study.

³⁴ As of March 31, 2023, OCC held approximately \$10.37 billion in qualifying liquid resources. See OCC Quantitative Disclosure, January – March 2023, available at <https://www.theocc.com/risk-management/pfmi-disclosures>.

\$419,297,734 to \$6,281,228,428. For each of these projected GSP amounts, OCC observed that the Margin Assets and OCC Clearing Fund contributions that would have been required of Clearing Members in these scenarios would have been sufficient to satisfy the amount of the projected GSPs.

To help address the current technology constraint that prohibits NSCC from performing a precise calculation of the GSP on a daily basis for every Common Member, proposed Section 6(b)(i) of the Existing Accord and related Section 7(d) of the SLA would provide that with respect to a Mutually Suspended Member, either NSCC or OCC may require that the Required Fund Deposit portion of the GSP be re-calculated by calculating the Required Fund Deposit for the Mutually Suspended Member both before and after the delivery of the E&A/Delivery Transactions and utilize the precise amount that is attributable to that activity in the final GSP. If such a recalculation is required, the result would replace the Required Fund Deposit component of the GSP that was initially calculated. The SLD component of the GSP would be unchanged by such recalculation.

As the above demonstrates, the GSP is intended to address the significant collateral and liquidity requirements that could be required of OCC Clearing Members in the event of a Common Member default.

Allowing OCC to make a GSP payment also is intended to allow for settlement processing to take place through the facilities of NSCC to retain operational efficiencies associated with the settlement process. Alternative settlement means such as broker-to-broker settlement add operational burdens, because transactions would need to be settled individually on one-off bases. In contrast, NSCC's netting reduces the volume and value

of settlement obligations that would need to be closed out in the market.³⁵ Because the clearance and settlement of obligations through NSCC's facilities following a Common Member default, including netting of E&A/Delivery Transactions with a Common Member's positions at NSCC, would avoid these potentially significant operational burdens for OCC and its Clearing Members, OCC and NSCC believe that the proposed changes would limit market disruption relating to a Common Member default. NSCC netting significantly reduces the total number of obligations that require the exchange of money for settlement. Allowing more activity to be processed through NSCC's netting systems would minimize risk associated with the close out of those transactions following the default of a Common Member.

Amending the Existing Accord to define the terms and conditions under which Guaranty Substitution may occur, at OCC's election, with respect to Defaulted NSCC Member Transactions after a Common Member becomes a Mutually Suspended Member will also provide more certainty to both the Clearing Agencies and market participants generally about how a Mutually Suspended Member's Defaulted NSCC Member Transactions may be processed.

NSCC and OCC have agreed it is appropriate to limit the availability of the proposed provision to the day of the Common Member default and the next business day because, based on historical simulations of cease to act events involving Common Members, most activity of a Mutually Suspended Member is closed out on those days.³⁶

³⁵ CNS reduces the value of obligations that require financial settlement by approximately 98%, where, for example \$519 trillion in trades could be netted down to approximately \$9 trillion in net settlements.

³⁶ OCC provided data regarding such events in a Exhibit 3B to File No. SR-OCC-2023-801. The information contained therein includes the assumptions and

Furthermore, the benefits of netting through NSCC's systems would be reduced for any activity submitted to NSCC after that time.

To implement these proposed changes to the Existing Accord, OCC and NSCC propose to make the following changes.

Section 1 – Definitions

First, new definitions would be added, and existing definitions would be amended in Section 1, which is the Definitions section.

The new defined terms would be as follows.

- The term “Close Out Transaction” would be defined to mean “the liquidation, termination or acceleration of one or more exercised or matured Stock Options³⁷ or Stock Futures³⁸ contracts, securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements, master netting agreements or similar agreements of a Mutually Suspended Member pursuant to OCC Rules 901, 1006 and 1101 through 1111 (including but not limited to Rules 1104 and 1107) and/or NSCC Rule 18.” This proposed definition would make it clear that the payment of the Guaranty Substitution Payment and NSCC's subsequent acceptance of Defaulted NSCC Member Transactions for clearance and settlement are intended to fall within the “safe harbors” provided in the Bankruptcy Code,³⁹ the Securities Investor Protection Act,⁴⁰ and other similar laws.
- The term “Guaranty Substitution Payment” would be defined to mean “an amount calculated by NSCC in accordance with the calculations set forth in Appendix A [to the Existing Accord (as proposed to be amended)], to include two

timelines leading up to the declaration of a default for a Common Member and the anticipated timing of OCC's payment of the GSP.

³⁷ The term “Stock Options” is defined in the Existing Accord within the definition of “Eligible Securities,” and refers to options issued by OCC.

³⁸ The term “Stock Futures” is defined in the Existing Accord within the definition of “Eligible Securities,” and refers to stock futures contracts cleared by OCC.

³⁹ 11 U.S.C. § 101 et seq., including §§362(b)(6), (7), (17), (25) and (27) (exceptions to the automatic stay), §§546(e) – (g) and (j) (limitations on avoiding powers), and §§555 – 556 and 559 – 562 (contractual right to liquidate, terminate or accelerate certain contracts).

⁴⁰ 15 U.S.C. §§ 78aaa – III, including §78eee(b)(2)(C) (exceptions to the stay).

components: (i) a portion of the Mutually Suspended Member's Required Fund Deposit deficit to NSCC at the time of the cease to act; and (ii) a portion of the Mutually Suspended Member's unpaid Supplemental Liquidity Deposit obligation at the time of the cease to act."

- The term "Mutually Suspended Member" would mean "any OCC Participating Member⁴¹ that has been suspended by OCC that is also an NSCC Participating Member⁴² for which NSCC has ceased to act."
- The term "Required Fund Deposit" would have the meaning "provided in Rule 4 of NSCC's Rules and Procedures (or any replacement or substitute rule), the version of which, with respect to any transaction or obligation incurred that is the subject of this Agreement, is in effect at the time of such transaction or incurrence of obligation."
- The term "Supplemental Liquidity Deposit" would have the meaning "provided in Rule 4A of NSCC's Rules and Procedures (or any replacement or substitute rule), the version of which, with respect to any transaction or obligation incurred that is the subject of this Agreement, is in effect at the time of such transaction or incurrence of obligation."

The defined terms that would be amended in Section 1 of the Existing Accord are as follows.

- The definition for the term "E&A/Delivery Transaction" generally contemplates a transaction that involves a delivery and receipt of stock in the settlement of physically settled options and futures that are cleared and settled by OCC and for which the underlying securities are eligible for clearing through the facilities of NSCC. The definition would be amended to make clear that it would apply in

⁴¹ The term "OCC Participating Member" is defined in the Existing Accord to mean "(i) a Common Member; (ii) an OCC Clearing Member that is an 'Appointing Clearing Member' (as defined in Article I of OCC's By-Laws) and has appointed an Appointed Clearing Member that is an NSCC Member to effect settlement of E&A/Delivery Transactions through NSCC on the Appointing Clearing Member's behalf; (iii) an OCC Clearing Member that is an Appointed Clearing Member; or (iv) a Canadian Clearing Member." No changes are proposed to this definition.

⁴² The term "NSCC Participating Member" is defined in the Existing Accord to mean "(i) a Common Member; (ii) an NSCC Member that is an 'Appointed Clearing Member' (as defined in Article I of OCC's By-Laws); or (iii) [or Canadian Depository for Securities, or 'CDS']". For the avoidance of doubt, the Clearing Agencies agree that CDS is an NSCC Member for purposes of this Agreement." No changes are proposed to this definition.

respect of a “Close Out Transaction” of a “Mutually Suspended Member” as those terms are proposed to be defined (described above).

- The definition for the term “Eligible Securities” generally contemplates the securities that are eligible to be used for physical settlement under the Existing Accord. The term would be modified to clarify that this may include, for example, equities, exchange-traded funds and exchange-traded notes that are underlying securities for options issued by OCC.

Section 6 – Default by an NSCC Participating Member or OCC Participating Member

Section 6 of the Existing Accord provides that NSCC is required to provide certain notice to OCC in circumstances in which NSCC has ceased to act for a Common Member. Currently, Section 6(A)(ii) of the Existing Accord also requires NSCC to notify OCC if a Common Member has failed to satisfy its Clearing Fund obligations to NSCC, but for which NSCC has not yet ceased to act. In practice, this provision would trigger a number of obligations (described below) when a Common Member fails to satisfy its NSCC Clearing Fund obligations for any reason, including those due to an operational delay. Therefore, OCC and NSCC are proposing to remove the notification requirement under Section 6(A)(ii) from the Existing Accord. Under Section 7(d) of the Existing Accord, NSCC and OCC are required to provide each other with general surveillance information regarding Common Members, which includes information regarding any Common Member that is considered by the other party to be in distress. Therefore, if a Common Member has failed to satisfy its NSCC Clearing Fund obligations and NSCC believes this failure is due to, for example, financial distress and not, for example, due to a known operational delay, and NSCC has not yet ceased to act for that Common Member, such notification to OCC would still occur but would be done pursuant to Section 7(d) of the Existing Accord (as proposed to be amended), and not Section 6(A)(ii). Notifications under Section 6 of the Existing Accord (as proposed to be

amended) would be limited to instances when NSCC has actually ceased to act for a Common Member pursuant to the NSCC Rules.⁴³

Following notice by NSCC that it has ceased to act for a Common Member, OCC is obligated in turn to deliver to NSCC a list of all E&A/Delivery Transactions (excluding certain transactions for which Guaranty Substitution does not occur) involving the Common Member.⁴⁴ This provision would be amended to clarify that it applies in respect of such E&A/Delivery Transactions for the Common Member for which the NSCC Guaranty has not yet attached – meaning that Guaranty Substitution has not yet occurred.

As described above in the summary of the Existing Accord, where NSCC has ceased to act for a Common Member, the Existing Accord refers to the Common Member as the Defaulting NSCC Member and also refers to the relevant E&A/Delivery Transactions in connection with that Defaulting NSCC Member for which a Guaranty Substitution has not yet occurred as Defaulted NSCC Member Transactions.

If the Defaulting NSCC Member is also suspended by OCC, it would be covered by the proposed definition that is described above for a Mutually Suspended Member. For such a Mutually Suspended Member, the proposed changes in Section 6(b) would provide that NSCC, by a time agreed upon by the parties, would provide OCC with the amount of the Guaranty Substitution Payment as calculated by NSCC and related documentation regarding the calculation. The Guaranty Substitution Payment would be

⁴³ See Rule 46 (Restrictions on Access to Services) of the NSCC Rules, supra note 9.

⁴⁴ The section of the Existing Accord that addresses circumstances in which NSCC ceases to act and/or an NSCC Member defaults is currently part of Section 6(a). It would be re-designated as Section 6(b) for organizational purposes.

calculated pursuant to NSCC's Rules as that portion of the unmet Required Fund Deposit⁴⁵ and Supplemental Liquidity Deposit⁴⁶ obligations of the Mutually Suspended Member attributable to the Defaulted NSCC Member Transactions. By a time agreed upon by the parties,⁴⁷ OCC would then be required to either notify NSCC of its intent to make the full amount of the Guaranty Substitution Payment to NSCC or notify NSCC that it will not make the Guaranty Substitution Payment. If OCC makes the full amount of the Guaranty Substitution Payment, NSCC's guaranty would take effect at the time of NSCC's receipt of that payment and the OCC Guaranty would end.

The proposed changes would further provide that if OCC does not suspend the Common Member (such that the Common Member would therefore not meet the proposed definition of a Mutually Suspended Member) or if OCC elects to not make the full amount of the Guaranty Substitution Payment to NSCC, then all of the Defaulted NSCC Member Transactions would be exited from NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation, as applicable, and Guaranty Substitution would not occur in respect thereof. Therefore, NSCC would continue to have no obligation to guarantee or settle the Defaulted NSCC Member Transactions, and the OCC Guaranty would continue to apply to them pursuant to OCC's By-Laws and

⁴⁵ The Required Fund Deposit is calculated pursuant to Rule 4 (Clearing Fund) and Procedure XV (Clearing Fund Formula and Other Matters) of the NSCC Rules, see supra note 9.

⁴⁶ The Supplemental Liquidity Deposit is calculated pursuant to Rule 4A (Supplemental Liquidity Deposits) of the NSCC Rules, see supra note 9.

⁴⁷ The time by which OCC would be required notify NSCC of its intent would be defined in the Service Level Agreement. As of the time of this filing, the parties intend to set that time as one hour after OCC's receipt of the calculated Guaranty Substitution Payment from NSCC.

Rules.⁴⁸

Proposed changes to the Existing Accord would also address the application of any Guaranty Substitution Payment by NSCC. Specifically, new Section 6(d) would provide that any Guaranty Substitution Payment made by OCC may be used by NSCC to satisfy any liability or obligation of the Mutually Suspended Clearing Member to NSCC on account of transactions involving the Mutually Suspended Clearing Member for which the NSCC Guaranty applies and to the extent that any amount of assets otherwise held by NSCC for the account of the Mutually Suspended Member (including any Required Fund Deposit or Supplemental Liquidity Deposit) are insufficient to satisfy its obligations related to transactions for which the NSCC Guaranty applies. Proposed changes to Section 6(d) would further provide for the return to OCC of any unused portion of the GSP. With regard to the portion of the Guaranty Substitution Payment that corresponds to a member's Supplemental Liquidity Deposit obligation, NSCC must return any unused amount to OCC within fourteen (14) days following the conclusion of NSCC's settlement, close-out and/or liquidation. With regard to the portion of the Guaranty Substitution Payment that corresponds to a Required Fund Deposit, NSCC must return any unused amount to OCC under terms agreed to by the parties.⁴⁹

Other Proposed Changes

Certain other technical changes are also proposed to the Existing Accord to

⁴⁸ Under the current and proposed terms of the Existing Accord, NSCC would be permitted to voluntarily guaranty and settle the Defaulted NSCC Member Transactions.

⁴⁹ Such amounts would be returned to OCC as appropriate and in accordance with a Netting Contract and Limited Cross-Guaranty, by and among the Depository Trust Company, Fixed Income Clearing Corporation, NSCC and OCC, dated as of January 1, 2003, as amended.

conform it to the proposed changes described above. For example, the preamble and the “whereas” clauses in the Preliminary Statement would be amended to clarify that the agreement is an amended and restated agreement and to summarize that the agreement would be modified to contemplate the Guaranty Substitution Payment structure. Section 1(c), which addresses the terms in the Existing Accord that are defined by reference to NSCC’s Rules and Procedures and OCC’s By-Laws and Rules would be modified to state that such terms would have the meaning then in effect at the time of any transaction or obligation that is covered by the agreement rather than stating that such terms have the meaning given to them as of the effective date of the agreement. This change is proposed to help ensure that the meaning of such terms in the agreement will not become inconsistent with the meaning in the NSCC Rules and/or OCC By-Laws and Rules, as they may be modified through proposed rule changes with the Commission.

Technical changes would be made to Sections 3(d) and (e) of the Existing Accord to provide that those provisions would not apply in the event new Section 6(b) described above, is triggered. Section 3(d) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving a suspended OCC Participating Member.⁵⁰ Similarly, Section 3(e) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving an NSCC Participating Member⁵¹ for which NSCC has ceased to act. A proposed change would also be made to Section 5 of the Existing Accord to modify a reference to Section 5 of Article VI of OCC’s By-Laws to instead provide that the updated cross-reference should be to Chapter IV of OCC’s Rules.

⁵⁰ See supra note 41 defining OCC Participating Member.

⁵¹ See supra note 42 defining NSCC Participating Member.

Section 5 would also be amended to clarify that Guaranty Substitution occurs when NSCC has received both the Required Fund Deposit and Supplemental Liquidity Deposit, as calculated by NSCC in its sole discretion, from Common Members. The addition of the collection of the Supplemental Liquidity Deposit to the definition of the Guaranty Substitution Time in this Section 5 would reflect OCC and NSCC's agreement that both amounts are components of the Guaranty Substitution Payment (as described above) and would make this definition consistent with that agreement.

In Section 7 of the Existing Accord, proposed changes would be made to provide that NSCC would provide to OCC information regarding a Common Member's Required Fund Deposit and Supplemental Liquidity Deposit obligations, to include the Supplemental Liquidity Deposit obligation in this notice requirement, and additionally that NSCC would provide OCC with information regarding the potential Guaranty Substitution Payment for the Common Member. On an options expiration date that is a Friday, NSCC would, by close of business on that day, also provide to OCC information regarding the intra-day liquidity requirement, intra-day liquidity resources and intra-day calls for a Common Member that is subject to a Supplemental Liquidity Deposit at NSCC.

Finally, Section 14 of the Existing Accord would be modernized to provide that notices between the parties would be provided by e-mail rather than by hand, overnight delivery service or first-class mail.

ii. Proposed Changes to OCC By-Laws and Rules

General Description

OCC is also proposing certain changes to its By-Laws and Rules that are designed to complement the proposed changes described above regarding the Existing Accord. These proposed changes to the By-Laws and Rules are described below, and they generally cover the following four areas. First, the proposed changes would define Guaranty Substitution Payment. Second, the proposed changes would describe the circumstances under which OCC could make a Guaranty Substitution Payment to NSCC. Third, the proposed changes would specify what financial resources could be used by OCC to make the Guaranty Substitution Payment.⁵² Fourth, the proposed changes to OCC's Comprehensive Stress Testing and Clearing Fund Methodology, and Liquidity Risk Management Description would outline enhanced stress testing incorporating the GSP and OCC's ability to call for additional resources from Clearing Members. OCC also is proposing changes to OCC's Liquidity Risk Management Framework to account for OCC's ability to make the GSP.

Article I – Definitions

OCC proposes to add “Guaranty Substitution Payment” as a new defined term under Article I of OCC's By-Laws, which is the Definitions section. The term “Guaranty Substitution Payment” would be defined to mean: “a payment that may be made by [OCC] to [NSCC] under the terms of an agreement between them, as described in Rule

⁵² OCC would be permitted to borrow from the Clearing Fund and margin of a suspended Clearing Member, over which OCC has a general lien, where that Clearing Member is a Mutually Suspended Member. The change would merely expand the circumstances under which OCC's current By-Laws and Rules permit OCC to borrow Clearing Fund and margin. The change would not affect the treatment of such borrowing under OCC's default waterfall that determines how OCC allocates losses against available financial resources. The Mutually Suspended Member's margin and Clearing Fund collateral would remain first in line to absorb losses.

901, so that [NSCC] will not reject settlement obligations for CCC-eligible⁵³ securities that are directed by [OCC] for settlement through the facilities of [NSCC] on account of a Clearing Member that has been suspended, as described in Rule 1102, and for which [NSCC] has ceased to act.”

Chapter IX – Delivery of Underlying Securities and Payment

Certain changes are also proposed to Chapter IX of OCC’s Rules. OCC proposes to add parenthetical language to the Introduction section of Chapter IX of OCC’s Rules. It would specify that a Guaranty Substitution Payment could be made by OCC to NSCC in connection with OCC’s general policy that to the extent a security to be delivered and received is CCC-eligible, OCC will direct the delivery and payment obligations to be settled through the facilities of NSCC where the obligations are physically-settled and arise out of the exercise of stock option contracts or the maturity of stock futures contracts.

Next, OCC proposes to delete certain provisions from Rule 901(b) regarding when a Guaranty Substitution occurs. Specifically, Rule 901(b) currently provides that unless otherwise agreed between OCC and NSCC, a Guaranty Substitution with respect to settlement obligations for CCC-eligible securities that settle “regular way” under NSCC’s Rules and Procedures will occur if: (i) the applicable settlement obligations are reported to and are not rejected by NSCC; (ii) NSCC has not notified OCC that it has ceased to act for the relevant Clearing Member or Appointed Clearing Member; and (iii) the NSCC Clearing Fund requirements of the relevant Clearing Member or Appointed Clearing Member owing to NSCC, as determined in accordance with NSCC’s Rules and

⁵³ The term “CCC-Eligible” as used herein has the meaning provided in OCC’s By-Laws, supra note 5.

Procedures, are received by NSCC. These considerations regarding when a Guaranty Substitution occurs are addressed under the terms of the Existing Accord, and they would continue to be relevant considerations regarding when a Guaranty Substitution occurs under the changes that OCC and NSCC are proposing to the Existing Accord. However, because additional considerations would be added to the Guaranty Substitution process in connection with the proposed ability for OCC in certain circumstances to make a Guaranty Substitution Payment to NSCC and also to eliminate the potential for a description of the Guaranty Substitution process in OCC's Rules to become inconsistent with the process that OCC and NSCC have agreed to in the Existing Accord, as it would be amended, OCC is proposing to delete the discussion of these considerations in Rule 901(b) in favor of instead simply cross referencing the terms of the agreement.⁵⁴

In addition, OCC proposes to add a new paragraph to the end of Rule 901(b) to provide that pursuant to the proposed changes to the Existing Accord, OCC would be permitted to make a Guaranty Substitution Payment to NSCC. The proposed changes would also describe the circumstances in which OCC may make a Guaranty Substitution Payment in connection with settlement obligations of a suspended Clearing Member, and that the amount of the Guaranty Substitution Payment under the terms of the Existing Accord, as amended, would be the amount required by NSCC to satisfy its deficit(s) regarding such Clearing Member's "Required Fund Deposit" and "Supplemental

⁵⁴ For purposes of the proposed rule change process under Exchange Act Section 19(b), the agreement is treated as a rule of a clearing agency under Exchange Act Section 3(a)(27) and therefore any proposed changes to it by OCC are subject to the related rule change process and public notice and comment. OCC therefore believes that addressing the terms in the agreement and cross-referencing the agreement in OCC Rule 901 would not deprive the Commission or the public of notice regarding any future proposed changes.

Liquidity Deposit” as those terms are defined in NSCC’s Rules and Procedures.⁵⁵ The changes would provide that any amount of a Guaranty Substitution Payment that NSCC does not use pursuant to its Rules and Procedures would subsequently be returned to OCC under such terms and within such times as are agreed by OCC and NSCC. OCC believes that it is useful to include this description of the proposed process for the Guaranty Substitution Payment and the circumstances in which it may be made so that a user of OCC’s publicly available By-Laws and Rules would have sufficient information to understand the existence of the Guaranty Substitution Payment mechanism, the general circumstances in which it may be made and the role that a Guaranty Substitution Payment would play in causing NSCC to accept obligations for CCC-eligible securities for clearance and settlement..

Chapters X and XI – Clearing Fund Contributions and Suspension of a Clearing Member

As generally described above, the proposed changes would also provide that OCC would be permitted to borrow from the OCC Clearing Fund and also against certain Margin Assets of a Clearing Member that has been suspended by OCC where that Clearing Member is a Mutually Suspended Member. To implement these changes, OCC is proposing the following amendments to OCC Rule 1006 and Rule 1104.

OCC Rule 1006 addresses the purpose and permitted uses of the OCC Clearing Fund. OCC proposes to make amendments to paragraphs (a) and (f) to permit OCC to utilize assets in the Clearing Fund as a liquidity resource in connection with making a Guaranty Substitution Payment. Currently, OCC Rule 1006(a) states the conditions for

⁵⁵ See NSCC Rules 4 (defining “Required Fund Deposit”) and 4A (defining “Supplemental Liquidity Deposit”), supra note 9.

use of the OCC Clearing Fund. These provide that the OCC Clearing Fund may be used for borrowings pursuant to OCC Rule 1006(f) or to make good losses or expenses suffered by OCC including: (i) as a result of the failure of any Clearing Member to discharge duly any obligation on or arising from any confirmed trade accepted by OCC, (ii) as a result of the failure of any Clearing Member (including any Appointed Clearing Member) or of CDS (Canada's national securities depository) to perform its obligations under any contract or obligation issued, undertaken, or guaranteed by OCC or in respect of which OCC is otherwise liable, (iii) as a result of the failure of any Clearing Member to perform any of its obligations to OCC in respect of the stock loan and borrow positions of such Clearing Member, (iv) in connection with any liquidation of a Clearing Member's open positions, (v) in connection with protective transactions effected for the account of OCC pursuant to Chapter XI of OCC's Rules (delivery of underlying securities and payment), (vi) as a result of the failure of any Clearing Member to make any other required payment or render any other required performance or (vii) as a result of the failure of any bank, securities or commodities clearing organization, or investment counterparty, to perform its obligations to OCC for certain specified reasons.⁵⁶

OCC proposes to renumber clauses (iii) through (vii) in paragraph (a) as (iv) through (viii), and to insert as new clause (iii) a provision that the OCC Clearing Fund may be used "regarding any Guaranty Substitution Payment that [OCC] may make to [NSCC] under an agreement between them, as described in [OCC] Rule 901, so that [NSCC] will not reject settlement obligations for CCC-eligible securities involving a Clearing Member for which [NSCC] has ceased to act and that [OCC] directs to [NSCC]

⁵⁶ The terms "Clearing Member" and "Appointed Clearing Member" as used herein have the meanings provided in OCC's By-Laws, supra note 5.

for settlement through its facilities.”⁵⁷ OCC also proposes to add parenthetical language to paragraphs (f)(1)(A) and (f)(2)(A)(ii) to further clarify that contributions to the OCC Clearing Fund may be borrowed by OCC for use in connection with making a Guaranty Substitution Payment to NSCC. Any borrowing from the OCC Clearing Fund by OCC to make a Guaranty Substitution Payment to NSCC would be subject to the existing terms of OCC Rule 1006(f)(3) that provide that irrespective of how any such borrowings from the OCC Clearing Fund are applied by OCC, the borrowing for a period not to exceed thirty (30) days will not be deemed to result in charges against the OCC Clearing Fund under OCC’s default waterfall for allocating actual losses. For purposes of determining whether a loss resulting from a Guaranty Substitution Payment has occurred, OCC Rule 1006(f)(3) would be amended to provide that the Guaranty Substitution Payment is deemed to be repaid by OCC at such time as under the Accord that it is NSCC’s obligation to return any portion of the Guaranty Substitution Payment that NSCC does not use pursuant to its rules. If, subsequent to the borrowing, OCC determines that the borrowing represents an actual loss or all or any part of the borrowing remains outstanding after thirty (30) days (or on the first Business Day thereafter if the thirtieth calendar day is not a Business Day) then the amount of OCC Clearing Fund assets used in the outstanding borrowing would be an actual loss that OCC would be required to immediately allocate under its By-Laws and Rules.⁵⁸ As noted above, losses resulting

⁵⁷ In connection with these amendments, the reference in Rule 1006(b) to “clauses (i) through (vi) of paragraph (a)” would be changed to “clauses (i) through (vii) of paragraph (a).”

⁵⁸ If the defaulting OCC Clearing Member’s Margin Assets and OCC Clearing Fund contribution were insufficient to cover the associated losses, OCC would next look to certain OCC financial resources that are available for that purpose (e.g.,

from the borrowing of Clearing Fund or Margin Assets as a liquidity resource to facilitate OCC making a Guaranty Substitution Payment would be allocated in the same sequence as any other losses charged to the default waterfall.

Consistent with these changes to permit OCC to use the OCC Clearing Fund as a borrowing resource to make a Guaranty Substitution Payment to NSCC, OCC is also proposing similar changes to OCC Rule 1104 that would permit OCC to borrow certain Margin Assets of a Clearing Member that has been suspended by OCC where that Clearing Member is a Mutually Suspended Member and OCC has a general lien⁵⁹ over the Margin Assets.

Specifically, OCC proposes to add a new paragraph (g) to OCC Rule 1104 that would provide that OCC may use specified Margin Assets of a suspended Clearing Member as a borrowing in order to use such borrowed Margin Assets to make a Guaranty Substitution Payment to NSCC. OCC would be permitted to use Margin Assets from the following accounts of a suspended Common Member: firm lien account and firm non-lien account; separate Market-Maker's account; combined Market-Maker's account; and JBO Participants' account.⁶⁰ OCC is not proposing at this time to have authority to borrow Margin Assets from other types of accounts over which OCC has a restricted

OCC's corporate contribution and Clearing Fund contributions of non-defaulting OCC Clearing Members).

⁵⁹ Article I, Section 1.G.(1) of OCC's By-Laws states that the "term 'general lien' means a security interest of [OCC] in all or specified assets in a Clearing Member account as security for all of the Clearing Member's obligations to [OCC] regardless of the source or nature of such obligations." See OCC By-Laws, supra note 5.

⁶⁰ The Clearing Member accounts referenced herein are described in subparagraphs (a), (b), (c) and (h) of Article VI, Section 3 of OCC's By-Laws. See OCC's By-Laws, supra note 5.

lien⁶¹ and for which the Margin Assets are security for the particular restricted lien accounts because of additional complexity that OCC believes would be associated with tracking NSCC's use of Margin Assets associated with those accounts and also due to certain regulatory requirements under Commission Rule 15c3-3 that apply to broker-dealer Clearing Members and prohibit the use of customer property of the broker-dealer to support non-customer activities.⁶²

As with the terms that currently apply to any borrowing from the OCC Clearing Fund pursuant to OCC Rule 1006(f), new paragraph (g) in OCC Rule 1104 would further provide that Margin Assets borrowed by OCC to make a Guaranty Substitution Payment to NSCC would not be deemed to be charges against the margin assets for the relevant account(s) for up to thirty (30) days; however, if all or a part of such borrowing were to be determined by OCC, in its discretion, to represent an actual loss, or if all or a part of the borrowing were to remain outstanding after such thirty (30)-day period, OCC would consider the amount of margin assets used to support OCC's obligations under the

⁶¹ Article I, Section 1.R.(8) of OCC's By-Laws states that the "term 'restricted lien' means a security interest of [OCC] in specified assets (including any proceeds thereof) in an account of a Clearing Member with [OCC] as security for the Clearing Member's obligations to [OCC] arising from such account or, to the extent so provided in the By-Laws or Rules, a specified group of accounts that includes such account including, without limitation, obligations in respect of all confirmed trades effected through such account or group of accounts, and exercise notices assigned to such account or group of accounts." See OCC's By-Laws, supra note 5.

⁶² For example, under the broker-dealer customer reserve account formula to SEC Rule 15c3-3 the broker-dealer takes a debit in the formula under Item 13 for margin that is "required and on deposit with OCC for all option contracts written or purchased in customer accounts." This means that such margin in turn can be used by the broker-dealer Clearing Member as Margin Assets to support the securities customers' account at OCC.

outstanding borrowing or transaction as an actual loss and immediately allocate the loss in accordance with OCC's By-Laws and Rules.

OCC anticipates that in a scenario in which it would be permitted make a Guaranty Substitution Payment to NSCC under the proposed changes to the Existing Accord and OCC's By-Laws and Rules, OCC would generally expect to borrow from the Clearing Fund as a primary liquidity resource. OCC could also borrow Margin Assets of the suspended Clearing Member that is a Common Member under the proposed terms described above. OCC is not proposing changes that would require a specific borrowing sequence because OCC believes that it is more appropriate to preserve flexibility to borrow from the available OCC Clearing Fund or Margin Assets as OCC determines appropriate under the circumstances.

In addition, OCC proposes to specify in OCC Rule 1107(a)(1) that exercised option contracts and matured, physically-settled stock futures to which the suspended Clearing Member is a party may be settled in accordance with the terms of any agreement between OCC and NSCC governing the settlement of exercised option contracts and matured, physically-settled stock futures of a suspended Clearing Member. In such an event, settlement will be governed by and subject to the agreement between OCC and NSCC and the rules of NSCC.

The purpose of the proposed changes to create the Guaranty Substitution Payment mechanism is to provide OCC and NSCC with an additional default management tool to help manage liquidity and settlement risks that OCC believes would be presented to each covered clearing agency in connection with a Mutually Suspended Member. OCC believes that having the ability to make a Guaranty Substitution Payment to NSCC in

regard to any unmet Required Fund Deposit or Supplemental Liquidity Deposit obligations of a Mutually Suspended Member would promote prompt and accurate clearance and settlement in the national system for the settlement of securities transactions by causing NSCC to guarantee certain securities settlement obligations that result from exercised options and matured futures contracts that are cleared and settled by OCC. In the following ways, OCC believes that this would be beneficial to and protective of OCC, NSCC, their participants, and the markets they serve.

First, OCC's ability to make the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. Second, this outcome would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members pursuant to the applicable provisions in Chapter IX of OCC's Rules. As noted above, OCC believes that such a broker-to-broker settlement scenario could result in substantial collateral and liquidity requirements for OCC Clearing Members. OCC believes that these potential collateral and liquidity consequences would be due to the lost benefit of netting of the settlement obligations through NSCC's facilities and also due to the short time (i.e., the T+2 standard settlement cycle) between a rejection by NSCC of the settlement obligations for clearing and the associated settlement date on which settlement would be otherwise required to be made bilaterally by OCC Clearing Members. This scenario also raises the potential for procyclical liquidity demands on OCC Clearing Members and

participants during stressed market conditions. Third, OCC will plan to size its liquidity resource requirements to reasonable expectations with a high probability of making a Guaranty Substitution Payment in order to facilitate the settlement of a Mutually Suspended Member's obligations through NSCC. Accounting for net liquidity demands from a Mutually Suspended Member's settlement obligations at the central counterparty-level enhances liquidity in the financial system and promotes the efficient use of capital by reducing the demand for liquidity associated with gross settlement of obligations and enabling the application of resources at both clearing agencies to satisfy the Member's obligation. Fourth, OCC believes that the potential for the size of the settlement obligations to be comparatively larger than the Guaranty Substitution Payment coupled with the short time remaining to settlement could also increase the risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. Therefore, OCC believes that the proposed changes to implement the ability for OCC to make a Guaranty Substitution Payment to NSCC would allow OCC to avoid these risks by causing NSCC to accept the relevant obligations arising from exercised options and matured futures cleared and settled by OCC, as it ordinarily would, and guarantee their settlement, upon OCC making a Guaranty Substitution Payment to NSCC in accordance with the revised Accord.

Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description

OCC proposes to revise the OCC Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description to include the GSP in its liquidity risk management practices. Overall, the proposed changes would reflect that the

GSP functions as an additional liquidity demand type at the Clearing Member Organization (“CMO”) Group level.⁶³

OCC would include additional specifics to address the potential increased demand that the inclusion of the GSP may cause in its liquidity risk management practices in the Liquidity Risk Management section of the Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description. Specifically, OCC proposes to amend the Liquidity Demand for Positions Rejected by NSCC subsection, which describes the Existing Accord, including the scenario in which NSCC could choose not to guaranty certain securities settlement obligations arising out of transactions cleared by OCC. This subsection would be retitled as the Liquidity Demand Associated with NSCC Performance of Physical Settlement Activities subsection to more clearly describe its content and incorporate the GSP, as further detailed below. Consistent with the changes to the Existing Accord described above, OCC proposes to clarify that the Accord allows NSCC to reject such obligations if OCC elects to not make a GSP.

OCC proposes a new subsection, titled the Liquidity Demand GSP, to describe the GSP, which NSCC would calculate as defined in the proposed amendments to the Existing Accord. OCC would describe a GSP as a firm specific liquidity demand (i.e., the amount of cash OCC needs to pay NSCC on behalf of the defaulting Common Member). OCC would describe the components of the GSP under the Accord. OCC would explain how it accounts for the liquidity demand associated with a potential GSP. Specifically, OCC would apply an amount to account for a potential GSP obligation for every day on which option expirations occur. This amount would be based on peak GSP

⁶³ A Clearing Member Group is composed of a set of affiliated OCC Clearing Members.

amounts from the prior 12 months in a given expiration category for the specific CMO Group for each forecasted liquidity demand calculation. OCC will use a one-year lookback time period to determine the appropriate GSP amount to apply. The one-year lookback allows for the best like-to-like application of a historical GSP as there is a cyclical nature to option standard expirations with quarterly (i.e., March, June, September, and December) and January generally being more impactful than non-quarterly expirations. The one-year lookback also allows behavior changes of a Clearing Member to be recognized within an annual cycle. OCC proposes to utilize a historical GSP based on current system capabilities and data that will be supplied by NSCC.

OCC would use the total amount of Clearing Fund and SLD deficits at NSCC in its calculation to account for its obligation. However, in the event of a default, OCC would be responsible for a proportionate share of both NSCC Clearing Fund deficits (which are analogous to OCC margin deficits) and SLDs that are attributable to OCC E&A activity transmitted to NSCC for settlement, whereas NSCC will be responsible for the portion of the Clearing Fund and SLD deficits associated with activity that NSCC clears that is not transmitted by OCC.

The amount of notional activity sent by OCC to NSCC informs the likelihood of a GSP. Namely, the potential amount of NSCC Clearing Fund and SLD deficits that are allocable to OCC increases as the amount of activity OCC sends to NSCC increases. Since not all types of expirations are the same with respect to the notional amount of activity sent by OCC to NSCC, OCC proposes to use five separate categories of expirations with potentially different GSP amounts to apply. Each day on which expirations occur would fall into one of five categories as follows:

- Standard Monthly Expiration: typically the third Friday of each month from the previous twelve months;
- Non-Standard Monthly Expiration Fridays (“End of Week Expirations”): the last business day of every week, typically a Friday, excluding the third Friday of each month from the previous twelve months;
- End of Month Expirations: the last trading day of every month from the previous twelve months;
- Expirations falling on Bank Holidays where Markets Are Open (“Bank Holiday Expirations”): days where banks are closed but the markets are open from the previous twelve months;⁶⁴
- Remaining Expiration Days (“Daily Expirations”): All other days with an expiration from the previous twelve months that do not fall into any of the categories above (typically most Mondays through Thursdays) from the previous twelve months.

OCC believes these five categories are appropriate after an analysis of notional activity sent to NSCC by OCC.⁶⁵ More specifically, the standard Friday monthly

⁶⁴ The Bank Holiday category recognizes that for Veterans Day and Columbus Day, the equity and equity derivative markets are open for trading, but the banking system is closed for the day. Since the banking system is closed while the aforementioned markets are open, settlement at NSCC encompasses two days of equity trading and equity derivative E&A activity. As OCC is using NSCC deficit numbers without regard for allocation, there is a possibility of a significant outlying GSP requirement due to the settlement of two days of activity simultaneously. Prudence dictates retaining the capability to risk manage a day with such disparate characteristics differently. Additional supporting data in support of the creation of the Bank Holiday Expiration category is included as Exhibit 3E to File No. SR-OCC-2023-801.

⁶⁵ OCC provided its analysis of notional activity sent to NSCC by OCC in support of the creation of the five categories as Exhibit 3E to File No. SR-OCC-2023-801.

expiration far exceeds the needs associated with any other category.⁶⁶ The remaining categories are intended to capture like time periods that will appropriately account for the GSP.

OCC would apply the peak GSP amounts from the prior twelve months in a given expiration category for the specific CMO Group for each forecasted liquidity demand calculation by adding the GSP amounts to the CMO Group's other forecasted liquidity demands for the relevant expiration day.⁶⁷ If a Clearing Member defaults, OCC may have to pay a GSP to NSCC on two successive days to facilitate the close-out of the defaulted Clearing Member's positions. To account for this possibility in its liquidity risk management process, OCC contemplates the payment of a GSP on expirations that result in settlements on the first and second days of the default management process. As described above, this GSP amount may serve to only increase liquidity demands.⁶⁸

Furthermore, as stated in the new Liquidity Demand GSP subsection, OCC would apply a floor to certain expirations. At a minimum, the GSPs applied to the End of Week, End of Month, and Bank Holiday Expirations will be no lower than the peak of the Daily Expirations category. If a GSP pertaining to the End of Week, End of Month, and

This Exhibit 3E sets forth data related to OCC's liquidity stress testing, including Available Liquidity Resources, Minimum Cash Requirement thresholds, and/or liquidity breaches, for Sufficiency and Adequacy scenarios with and without the inclusion of the GSP.

⁶⁶ For example, the average notional transfer for Remaining Expiration Days is approximately 10% the size of Standard Expiration.

⁶⁷ As an example, if the applicable GSP is \$100 and the (current) stressed liquidity demand is \$150 for a Clearing Member Group, the result after the application of the GSP for that Clearing Member Group would be a combined liquidity requirement of \$250 versus \$150 currently.

⁶⁸ OCC provided its analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands as Exhibit 3E to File No. SR-OCC-2023-801.

Bank Holiday Expiration category is higher than the peak of the Daily Expirations category, then OCC will apply that higher GSP. Standard Monthly Expirations will be floored by End of Week, End of Month, and Daily Expirations. If a GSP pertaining to any of these categories is higher than the Standard Monthly Expiration category, then OCC will apply that higher GSP. OCC would set out formulas representing the floors for the Standard Monthly, End of Week, End of Month, and Bank Holiday Expirations. Finally, OCC also proposes a minor change to clarify that it would attempt to effect alternative settlement if OCC elected not to make a GSP.⁶⁹

Liquidity Risk Management Framework

OCC proposes changes to the Liquidity Risk Management Framework to incorporate the GSP. In the Liquidity Risk Identification section, OCC would specify that, in the situation where a member defaults immediately preceding, or during the expiration, of physically-settled E&A activity, OCC may elect to make a GSP to NSCC to compel NSCC to accept and process the E&A activity. If OCC elects to not make a GSP, OCC would complete settlement of the defaulted Clearing Member's E&A transactions through its current process. Relatedly, OCC would include a minor clarification to a footnote in this section to note that NSCC is not acting on behalf of a defaulting Clearing Member "in this situation."

Anticipated Effect on and Management of Risk

OCC believes that the proposed changes would reduce the nature and level of risk presented by OCC because the purpose of the proposed changes to enhance its stress

⁶⁹ This clarification would maintain OCC's current process for settling transactions not processed through NSCC and does not represent the adoption of a new process or settlement method.

testing processes and create the Guaranty Substitution Payment mechanism is to provide OCC and NSCC with additional default management tools to help manage liquidity and settlement risks that OCC believes would be presented to each covered clearing agency in connection with a Mutually Suspended Member. OCC believes that having the ability to make a Guaranty Substitution Payment to NSCC in regard to any unmet Required Fund Deposit or Supplemental Liquidity Deposit obligations of a Mutually Suspended Member would promote prompt and accurate clearance and settlement in the national system for the settlement of securities transactions by causing NSCC to guarantee certain securities settlement obligations that result from exercised options and matured futures contracts that are cleared and settled by OCC. OCC further believes that enhancing its stress testing processes will help to ensure that it maintains the resources to make such a payment. In the following ways, OCC believes that this would be beneficial to and protective of OCC, NSCC, their participants, and the markets they serve.

First, OCC's ability to make the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. Second, this outcome would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members pursuant to the applicable provisions in Chapter IX of OCC's Rules. As noted above, OCC believes that such a broker-to-broker settlement scenario could result in substantial collateral and liquidity requirements for OCC Clearing Members. OCC believes that these potential

collateral and liquidity consequences would be due to the lost benefit of netting of the settlement obligations through NSCC's facilities and also due to the short time (i.e., the T+2 standard settlement cycle) between a rejection by NSCC of the settlement obligations for clearing and the associated settlement date on which settlement would be otherwise required to be made bilaterally by OCC Clearing Members. This scenario also raises the potential for procyclical liquidity demands on OCC Clearing Members and participants during stressed market conditions. Third, OCC will plan to size its liquidity resource requirements to reasonable expectations with a high probability of making a Guaranty Substitution Payment in order to facilitate the settlement of a Mutually Suspended Member's obligations through NSCC. Accounting for net liquidity demands from a Mutually Suspended Member's settlement obligations at the central counterparty-level enhances liquidity in the financial system and promotes the efficient use of capital by reducing the demand for liquidity associated with gross settlement of obligations and enabling the application of resources at both clearing agencies to satisfy the Member's obligation. Fourth, OCC believes that the potential for the size of the settlement obligations to be comparatively larger than the Guaranty Substitution Payment coupled with the short time remaining to settlement could also increase the risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. Therefore, OCC believes that the proposed changes to implement the ability for OCC to make a Guaranty Substitution Payment to NSCC would allow OCC to avoid these risks by causing NSCC to accept the relevant obligations arising from exercised options and matured futures cleared and settled by OCC, as it ordinarily would, and

guarantee their settlement, upon OCC making a Guaranty Substitution Payment to NSCC in accordance with the revised Accord.

Consistency with the Payment, Clearing and Settlement Supervision Act

The stated purpose of the Clearing Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.⁷⁰

Section 805(a)(2) of the Clearing Supervision Act⁷¹ also authorizes the Commission to prescribe risk management standards for the payment, clearing and settlement activities of designated clearing entities, like OCC, for which the Commission is the supervisory agency. Section 805(b) of the Clearing Supervision Act⁷² states that the objectives and principles for risk management standards prescribed under Section 805(a) shall be to:

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

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act and the Exchange Act in furtherance of these objectives and principles.⁷³ Rule 17Ad-22 requires registered clearing agencies, like OCC, to

⁷⁰ 12 U.S.C. 5461(b).

⁷¹ 12 U.S.C. 5464(a)(2).

⁷² 12 U.S.C. 5464(b).

⁷³ 17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) (“Clearing Agency Standards”); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7

establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.⁷⁴ Therefore, the Commission has stated⁷⁵ that it believes it is appropriate to review changes proposed in advance notices against Rule 17Ad-22 and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.⁷⁶

OCC believes the proposed changes are consistent with Section 805(b)(1) of the Clearing Supervision Act⁷⁷ because they would promote the reduction of risks to OCC, its Clearing Members and the markets OCC serves. As described above, OCC believes that the proposed enhancements to its stress testing processes and having the ability to make a Guaranty Substitution Payment to NSCC with respect to any unmet obligations of a Mutually Suspended Member would promote the reduction of risk because it would ensure that OCC maintains sufficient liquidity resources and that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations for both the Mutually Suspended Member and its assigned delivery counterparties could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation. This would also avoid a scenario in which OCC's Guaranty would continue

17 CFR 240.17Ad-22. See Securities Exchange Act Release Nos. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11) ("Clearing Agency Standards"); 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016).

⁷⁴ 17 CFR 240.17Ad-22.

⁷⁵ See, e.g., Exchange Act Release No. 89039, 85 FR at 36446.

⁷⁶ 12 U.S.C. 5464(b).

⁷⁷ 12 U.S.C. 5464(b)(1).

to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members, which OCC believes could result in substantial collateral and liquidity requirements for OCC Clearing Members and that, in turn, could also increase a risk of default by the affected OCC Clearing Members at a time when a Common Member has already been suspended. For these reasons, OCC believes that the proposed changes: (i) are designed to promote robust risk management; (ii) are consistent with promoting safety and soundness; and (iii) are consistent with reducing systemic risks and promoting the stability of the broader financial system.

OCC believes that the proposed changes are also consistent with the SEC rules that apply to OCC as a covered clearing agency.⁷⁸ In particular, SEC Rule 17Ad-22(e)(20) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor and manage risks related to any link that OCC establishes with one or more other clearing agencies, financial market utilities, or trading markets.⁷⁹ As described in OCC's publicly available disclosure framework for financial market infrastructures,⁸⁰ the Existing Accord between OCC and NSCC is one such link. As described above, OCC believes (i) the proposed modifications to OCC's stress testing procedures that are designed to enhance its ability to call for additional liquidity resources, and (ii) the implementation of the ability for OCC to make a Guaranty Substitution Payment to NSCC in the relevant circumstances involving a Mutually Suspended Member would help manage the risks presented to OCC

⁷⁸ 17 CFR 240.17Ad-22(a)(5).

⁷⁹ 17 CFR 240.17Ad-22(e)(20).

⁸⁰ See The Options Clearing Corporation Disclosure Framework for Financial Market Infrastructures, pg. 108, (2022), available at <https://www.theocc.com/risk-management/pfmi-disclosures>.

and its Clearing Members by the settlement link with NSCC because the Guaranty Substitution Payment would ensure that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement and therefore the size of the related settlement obligations could be decreased from netting through NSCC's CNS Accounting Operation and/or NSCC's Balance Order Accounting Operation.

For this same reason, OCC also believes that the proposed changes are consistent with the requirements of SEC Rules 17Ad-22(e)(3) and (7).⁸¹ SEC Rule 17Ad-22(e)(3) requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing, among other things, liquidity, credit and other risks that arise in or are borne by OCC.⁸² SEC Rule 17Ad-22(e)(7) requires OCC, in relevant part, to establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively measure, monitor and manage the liquidity risk that arises in or is borne by OCC and to, among other things, address foreseeable liquidity shortfalls that would not be covered by OCC's liquid resources.⁸³ As noted, OCC believes the proposed stress testing enhancements and the ability to make a Guaranty Substitution Payment to NSCC would allow OCC to better manage liquidity and credit risks related to the settlement link with NSCC by ensuring that the relevant securities settlement obligations would be accepted by NSCC for clearance and settlement. It would avoid a scenario in which OCC's Guaranty would continue to apply and the settlement obligations would be settled on a broker-to-broker basis between OCC Clearing Members, which OCC

⁸¹ 17 CFR 240.17Ad-22(e)(3), (7).

⁸² 17 CFR 240.17Ad-22(e)(3).

⁸³ 17 CFR 240.17Ad-22(e)(7).

believes could result in substantial collateral and liquidity requirements for OCC Clearing Members that, in turn, could also increase a risk of default by the affected OCC Clearing Members, particularly in circumstances where the prior suspension of a Mutually Suspended Member relates to broader stress in the financial system. Moreover, the incorporation of the Guarantee Substitution Payment into OCC's liquidity risk management practices would enhance OCC's ability to maintain additional liquidity resources to effect the settlement of exercise and assignment activity in the event of a Common Member default, and therefore, potentially increase the promotion of market stability.

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

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

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

the Commission. The clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the advance notice is consistent with the

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. Please include File Number SR-OCC-2023-801 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2023-801. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in

accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of 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>.

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-2023-801 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.⁸⁴

Secretary

⁸⁴ 17 CFR 200.30-3(a)(12).

Exhibit 3A

OCC Alternative Settlement and GSP Analysis

OCC evaluated certain Clearing Member default scenarios in which OCC assumed that NSCC would not accept the settlement obligations under the Existing Accord, including the default of a large Clearing Member coinciding with a monthly options expiration. OCC has estimated that in such a Clearing Member default scenario, the aggregate liquidity burden on OCC in connection with obligations having to be settled on a gross broker-to-broker basis could reach a significantly high level. OCC provided this analysis of the financial impact of alternate means of settlement as Exhibit 3A, the remainder of which has been redacted.

[Redacted Pursuant to Rule 24b-2]

Exhibit 3B

Close-out Timing

OCC proposes to amend the Existing Accord to define the terms and conditions under which Guaranty Substitution may occur. NSCC and OCC have agreed it is appropriate to limit the availability of the proposed provision to the day of the Common Member default and the next business day because, based on historical simulations of cease to act events involving Common Members, most activity of a Mutually Suspended Member is closed out on those days. This Exhibit 3B contains information regarding such simulated cease to act events involving Common Members. The information contained herein includes the assumptions and timelines leading up to the declaration of a default for a Common Member and the anticipated timing of OCC's payment of the GSP. The remainder of Exhibit 3B has been redacted.

[Redacted Pursuant to Rule 24b-2]

[Redacted Pursuant to Rule 24b-2]

[Redacted Pursuant to Rule 24b-2]

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[Redacted Pursuant to Rule 24b-2]

Exhibit 3C

SLA

OCC and NSCC are both parties to the SLA pursuant to Section 2 of the Existing Accord. The SLA addresses specifics regarding the time, form, and manner of various required notifications and actions described in the Accord. The SLA also includes information applicable under the Accord, such as relevant defined terms and information sharing obligations. The remainder of Exhibit 3C, which contains the SLA, has been redacted.

[Redacted Pursuant to Rule 24b-2]

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Exhibit 3D

GSP Margin of Error

The GSP calculation is intended to estimate how much of a member's obligations arise out of activity coming from OCC so that the amount paid by OCC is commensurate with the risk to NSCC of guarantying such activity. This Exhibit 3D shows the GSP margin of error by evaluating OCC and NSCC GSP and deficit allocations. The remainder of Exhibit 3D has been redacted.

[Redacted Pursuant to Rule 24b-2]

Exhibit 3E

GSP Impact Analysis and Rationale

This Exhibit 3E includes OCC's analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands. The document sets forth data related to OCC's liquidity stress testing, including Available Liquidity Resources, Minimum Cash Requirement thresholds, and/or liquidity breaches, for Sufficiency and Adequacy scenarios with and without the inclusion of the GSP. The inclusion of the GSP can only serve to increase liquidity demands. This Exhibit 3E also includes data in support of the creation of the five categories of expiration types, including an analysis of notional activity sent to NSCC by OCC. Not all types of expirations are the same with respect to the notional amount of activity sent by OCC to NSCC, and, accordingly, OCC proposes to use five separate categories of expirations with potentially different GSP amounts to apply. The remainder of Exhibit 3E has been redacted.

[Redacted Pursuant to Rule 24b-2]

EXHIBIT 5A



By-Laws

Underlined text indicates new text

~~Strikethrough~~ text indicates deleted text

ARTICLE I – DEFINITIONS

Definitions

SECTION 1. Unless the context requires otherwise (or except as otherwise specified in the By-Laws or Rules) the terms defined herein shall, for purposes of these By-Laws and the Rules of the Corporation, have the meanings herein specified.

* * *

G.

(1) – (6) [No change.]

(7) The term “Guaranty Substitution Payment” means a payment that may be made by the Corporation to the correspondent clearing corporation under the terms of an agreement between them, as described in Rule 901, so that the correspondent clearing corporation will not reject settlement obligations for CCC-eligible securities that are directed by the Corporation for settlement through the facilities of the correspondent clearing corporation on account of a Clearing Member that has been suspended, as described in Rule 1102, and for which the correspondent clearing corporation has ceased to act.

EXHIBIT 5B



OCC Rules

Underlined text indicates new text

~~Strikethrough~~ text indicates deleted text

CHAPTER IX – DELIVERY OF UNDERLYING SECURITIES AND PAYMENT

Introduction

The Rules in this Chapter are applicable to the discharge of delivery and payment obligations arising out of the exercise of physically settled stock option contracts and the maturity of physically settled stock futures contracts. As a general policy, the Corporation will direct that such obligations be settled through the facilities of the correspondent clearing corporation as specified in Rule 901 (including in connection with any Guaranty Substitution Payment as may be made by the Corporation to the Correspondent Clearing Corporation) to the extent that the security to be delivered and received is CCC-eligible, and will direct that such obligations be settled on a broker-to-broker basis as specified in Rules 903 through 912 to the extent that the security to be delivered and received is not CCC-eligible. However, the Corporation may in its discretion make exceptions to this policy, either to direct that the delivery of CCC-eligible securities be made on a broker-to-broker basis as specified in Rules 903 through 912, utilizing services of the correspondent clearing corporation or otherwise, or (with the agreement of the correspondent clearing corporation) to direct that the delivery of non-CCC-eligible securities be made through the facilities of the correspondent clearing corporation as specified in Rule 901. The Corporation may alter a previous designation of a settlement method at any time (i) prior to the obligation time (as defined in Rule 901(b)) for any settlement to be made through the facilities of the correspondent clearing corporation pursuant to Rule 901 or (ii) prior to the designated delivery date for any settlement to be made on a broker-to-broker basis pursuant to Rules 903 through 912 by giving the affected Clearing Members such notice thereof as is practicable under the circumstances.

RULE 901 – Settlement Through Correspondent Clearing Corporations

(a) [No change.]

(b) Settlement obligations for CCC-eligible securities that settle “regular way,” as defined in the rules and procedures of the correspondent clearing corporation, will ordinarily be directed for settlement through the facilities of the correspondent clearing corporation. ~~Unless otherwise agreed between the correspondent clearing corporation and the Corporation, if (i) If~~ such settlement obligations are reported to and are not rejected by the correspondent clearing corporation under the terms of an agreement between the correspondent clearing corporation and the Corporation then; ~~(ii) the correspondent clearing corporation has not notified the Corporation that it has ceased to act for the relevant Clearing Member or Appointed Clearing Member; and (iii) the clearing fund requirements of the relevant Clearing Member or Appointed Clearing Member owing to such correspondent clearing corporation, as determined in accordance with its rules and procedures, are received by the correspondent clearing corporation;~~ the Corporation

shall have no further obligation in respect of such settlement obligations, other than such obligations as the Corporation may have pursuant to its agreement with the correspondent clearing corporation, and full settlement shall be deemed to have been made by the Corporation in respect of such settlement obligations, from and after the time when the correspondent clearing corporation becomes unconditionally obligated, in accordance with its rules, to effect settlement in respect thereof or to close out the securities contract arising therefrom (the “obligation time”). If an obligation to make delivery is netted by the Corporation against an obligation to receive in accordance with subparagraph (a) hereof, full settlement shall be deemed to have been made in respect thereof at the opening of business of the Corporation on the delivery date. If the Corporation takes action pursuant to subparagraph (d) hereof, settlement shall be made in accordance with the provisions of subparagraph (d). From and after the time when settlement is deemed to have been made pursuant to the second sentence of this subparagraph (b), the obligations of the Delivering and the Receiving Clearing Member in respect of the contracts deemed to have been settled, and any other obligations resulting from settlement in respect thereof, shall be determined by the rules and procedures of the correspondent clearing corporation.

Each Clearing Member understands and agrees with the Corporation that the Corporation maintains an agreement with the correspondent clearing corporation that addresses the terms under which settlement obligations for CCC-eligible securities may be settled through the facilities of the correspondent clearing corporation and that pursuant to that agreement the parties agree that in certain circumstances in which the correspondent clearing corporation has ceased to act and the Corporation has suspended a Clearing Member, the Corporation may make a Guaranty Substitution Payment to the correspondent clearing corporation so that the correspondent clearing corporation will not reject settlement obligations involving such Clearing Member for CCC-eligible securities that the Corporation directs to the correspondent clearing corporation for settlement through its facilities. The Corporation agrees to make available to each Clearing Member upon request a copy of the agreement between the Corporation and the correspondent clearing corporation.

The circumstances in which the Corporation may make such a Guaranty Substitution Payment under the agreement with the correspondent clearing corporation are as follows:

- (i) the Clearing Member that is suspended by the Corporation is also a member of the correspondent clearing corporation and the correspondent clearing corporation has ceased to act for that member under its rules and procedures;
- (ii) the Clearing Member that is suspended by the Corporation is also an Appointed Member for which the correspondent clearing corporation has ceased to act; or
- (iii) the Clearing Member that is suspended by the Corporation is a Canadian Clearing Member for which CDS has been appointed to make settlement of obligations of the Canadian Clearing Member and the correspondent clearing corporation has ceased to act

for CDS.

Under the terms of the agreement between the Corporation and the correspondent clearing corporation, a Guaranty Substitution Payment will be in an amount as is required by the correspondent clearing corporation to satisfy any deficit(s) of the relevant Clearing Member, Appointed Clearing Member, or CDS as applicable, to the correspondent clearing corporation regarding the Clearing Member's portion of the "required fund deposit" and "supplemental liquidity deposit", as those terms are defined in the correspondent clearing corporation's rules and procedures, attributable to exercise and assignment transactions. Any amount of a Guaranty Substitution Payment that the correspondent clearing corporation does not use pursuant to its rules and procedures will be returned by the correspondent clearing corporation to the Corporation under such terms and within such times as agreed between the Corporation and the correspondent clearing corporation.

(c) – (h) [No change.]

* * *

CHAPTER X – CLEARING FUND CONTRIBUTIONS

* * *

RULE 1006 – Purpose and Use of Clearing Fund

(a) Conditions for Clearing Fund Use. The Clearing Fund may be used for borrowings pursuant to the authority in Rule 1006(f). The Clearing Fund may also be used to make good losses or expenses suffered by the Corporation or losses suffered by the Clearing Fund resulting from borrowings pursuant to the authority in Rule 1006(f): (i) as a result of the failure of any Clearing Member to discharge duly any obligation on or arising from any confirmed trade accepted by the Corporation, (ii) as a result of the failure of any Clearing Member (including any Appointed Clearing Member) or of CDS to perform its obligations (including its obligations to the correspondent clearing corporation) under or arising from any exercised or assigned option contract or matured future or any other contract or obligation issued, undertaken, or guaranteed by the Corporation or in respect of which the Corporation is otherwise liable, (iii) regarding any Guaranty Substitution Payment that that the Corporation may make to the correspondent clearing corporation under an agreement between them, as described in Rule 901, so that the correspondent clearing corporation will not reject settlement obligations for CCC-eligible securities involving a Clearing Member that the Corportion has suspended, as described in Rule 1102, and for which the correspondent clearing corporation has ceased to act, and that the Corporation directs to the correspondent clearing corporation for settlement through its facilities, (iv) as a result of the failure of any Clearing Member to perform any of its obligations to the Corporation in respect of the stock loan and borrow positions of such Clearing Member, (v) in connection with any liquidation of a Clearing Member's open positions, (vi) in connection with

protective transactions effected for the account of the Corporation pursuant to Chapter XI of the Rules, (vi) as a result of the failure of any Clearing Member to make any other required payment or render any other required performance, or (viii) as a result of the failure of any bank, securities or commodities clearing organization, or investment counterparty to perform its obligations to the Corporation for reasons specified in paragraph (c) of this Rule 1006. Notwithstanding the foregoing, in the event that the Corporation performs a Voluntary Tear-Up or a Partial Tear-Up pursuant to Rule 1111, the Clearing Fund may be used to provide compensation to non-defaulting Clearing Members and their customers as a means of re-allocating the losses, costs and fees imposed upon them as a result of such Voluntary Tear-Up or Partial Tear-Up, but only to the extent that such losses, costs and fees can be reasonably determined by the Corporation.

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

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

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

Balance amount, as applicable, and the denominator of which shall be the sum of the EDCP Unvested Balance and fixed amounts, variable amounts and any initial contributions across all Clearing Members (other than suspended Clearing Member(s)).

(c) – (e) [No change.]

(f) *Borrowings.* (1) *Conditions.* The Corporation may take possession of cash or securities deposited by Clearing Members as contributions to the Clearing Fund and securities in which the Corporation has invested Clearing Fund cash contributions if:

(A) the Corporation deems it necessary or advisable to borrow or otherwise obtain funds in order to meet obligations arising out of the default or suspension, or in anticipation of the potential default or suspension, of a Clearing Member or any action taken by the Corporation to address such an actual or potential default or suspension (including in connection with making any Guaranty Substitution Payment to the correspondent clearing corporation related to such circumstances);

(B) the Corporation sustains a loss reimbursable out of the Clearing Fund pursuant to paragraph (c) but elects to borrow or otherwise obtain funds in lieu of immediately charging such loss to the Clearing Fund; or

(C) the Corporation reasonably believes it necessary to borrow to meet its liquidity needs for daily settlement as a result of the failure of any bank, securities or commodities clearing organization, or investment counterparty to perform any obligation to the Corporation when due. Failure of an investment counterparty under this paragraph shall be limited to a failure with respect to cash invested under Rule 604(a) or Rule 1002(c).

(2) *Use of Funds.* (A) The Corporation may use funds it takes possession of under Rule 1006(f) to:

(i) meet obligations, losses or liquidity needs; ~~or~~

(ii) make any Guaranty Substitution Payment to the correspondent clearing corporation; or

(iii) borrow or otherwise obtain funds through any means determined to be reasonable at the discretion of the Chairman, Chief Executive Officer or the Chief Operating Officer (including, without limitation, pledging such assets as security for loans and/or using such assets to effect repurchase, securities lending or other transactions

(B) In the case of a borrowing under conditions (1)(A) or (1)(C), the funds obtained will be used solely for the purposes described in conditions (1)(A) or (1)(C), as applicable.

(3) *Term; Clearing Fund Charge.* (A) The funds obtained by the Corporation under paragraph (f), irrespective of how such funds are applied (including if they are used by the Corporation in connection with making a Guaranty Substitution Payment to the correspondent clearing corporation), shall not be deemed to be charges against the Clearing Fund for a period not to exceed 30 days, and, during said period, shall not affect the amount or timing of any charges otherwise required to be made against the Clearing Fund pursuant to this Chapter X. Each Clearing Member agrees that a borrowing by the Corporation from the Clearing Fund for the purpose of making a Guaranty Substitution Payment shall be deemed to be repaid by the Corporation at such time as under the agreement between the Corporation and the correspondent clearing corporation it is the obligation of the correspondent clearing corporation after accepting a Guaranty Substitution Payment to return to the Corporation any portion of the Guaranty Substitution Payment that the correspondent clearing corporation does not use pursuant to its rules.

(B) At the close of business on a Business Day, the Corporation shall consider the amount of Clearing Fund assets used to support the Corporation's obligations under the outstanding borrowing or transaction as an actual loss to the Clearing Fund and immediately allocate such loss in accordance with this Chapter X if:

(i) on any Business Day, the Corporation determines, in its discretion, all or part of any borrowing or transaction under paragraph (f) represents an actual loss to the Clearing Fund, a loss to the Corporation reimbursable out of the Clearing Fund; or

(ii) all or a part of any borrowing or transaction under Rule 1006(f) remains outstanding after 30 days (or on the first Business Day thereafter if the thirtieth calendar day is not a Business Day).

(4) Substitution Requests. The Corporation may refuse any Clearing Member substitution request regarding securities contributed to the Clearing Fund that the Corporation has taken possession of under Rule 1006(f).

* * *

CHAPTER XI – SUSPENSION OF A CLEARING MEMBER

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RULE 1104 – Creation of Liquidating Settlement Account

(a) – (f) [No change.]

(g) The Corporation may take possession of specified margin assets of a suspended Clearing Member as a borrowing to use such borrowed margin assets to make a Guaranty Substitution

Payment to the correspondent clearing corporation. For the avoidance of doubt, the margin assets may include the proceeds from any borrowing by the Corporation pursuant to paragraph (b) of this Rule 1104. Specifically, the margin assets that may be borrowed by the Corporation to make a Guaranty Substitution Payment are margin assets in the Clearing Member accounts described in the following subparagraphs of Article VI, Sec 3 of the By-Laws: subparagraph (a) (firm lien account and firm non-lien account); (b) (separate Market-Maker's account); (c) (combined Market-Maker's account); and (h) (JBO Participants' account). Each Clearing Member agrees that any such borrowing of margin assets by the Corporation to make a Guaranty Substitution Payment shall be deemed to be repaid by the Corporation to the Clearing Member at such time as under the agreement between the Corporation and the correspondent clearing corporation it is the obligation of the correspondent clearing corporation after accepting the Guaranty Substitution Payment to return to the Corporation any portion that the correspondent clearing corporation does not use pursuant to its rules. Margin assets borrowed by the Corporation to make a Guaranty Substitution Payment to the correspondent clearing corporation shall not be deemed to be charged against the margin assets for the relevant account(s) for a period not to exceed thirty days. If all or a part of any borrowing of margin assets pursuant to this paragraph (g) is determined by the Corporation, in its discretion, on any Business Day, to represent an actual loss or all or a part of any such borrowing remains outstanding after thirty days (or on the first Business Day thereafter if the thirtieth calendar day is not a Business Day), the Corporation, at the close of business on such Business Day shall consider the amount of margin assets used to support the Corporation's obligations under the outstanding borrowing or transaction as an actual loss and immediately allocate such loss in accordance with the By-Laws and Rules.

RULE 1107 – Exercised or Matured Contracts

(a) Unless the Corporation stipulates otherwise in a particular case, exercised option contracts to which a suspended Clearing Member is party (either as the exercising Clearing Member or as the assigned Clearing Member) and matured, physically-settled futures to which such Clearing Member is a party shall be disposed of as follows:

(1) Exercised option contracts and matured, physically-settled stock futures ~~for which the correspondent clearing corporation is obligated to effect settlement shall to which the suspended Clearing Member is a party~~ may be settled in ~~the ordinary course~~ accordance with the terms of any agreement between the Corporation and the correspondent clearing corporation governing the settlement of exercised option contracts and matured, physically-settled stock futures of a suspended Clearing Member. In such an event, the settlement of any such exercised option contracts or matured, physically-settled stock futures shall be governed by and subject to the agreement between the Corporation and correspondent clearing corporation and the rules of the correspondent clearing corporation. If the suspended Clearing Member was the assigned Clearing Member in respect of any such exercised option contract, and the exercise notice was allocated by the suspended Clearing Member, or is allocated by the Corporation pursuant to the

following provisions of this Rule, to a short position for which a specific deposit or an escrow deposit has been made, then (i) in the case of a call option contract, the Corporation shall obtain delivery of the underlying securities deposited in respect thereof from the depository and shall promptly liquidate such underlying securities, or (ii) in the case of a put option contract, the Corporation shall make a demand on the depository for payment out of the deposited property of the aggregate exercise price plus all applicable commissions and other charges.

(2) – (5) [no change]

(b) – (c) [no change]

Exhibit 5C

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