Required fields are shown with yellow backgrounds and asterisks.

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

File No. * SR 2023 - * 007
Amendment No. (req. for Amendments *) 2

Filing by Options Clearing Corporation

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

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
☐	☑	☐	☑	☐	☐

Pilot	Extension of Time Period for Commission Action *	Date Expires *
☐	☐	

Rule

☐ 19b-4(f)(1) ☐ 19b-4(f)(4)
☐ 19b-4(f)(2) ☐ 19b-4(f)(5)
☐ 19b-4(f)(3) ☐ 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 *).

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 * [redacted] Last Name * [redacted]

Title * [redacted]

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 01/23/2024

By [redacted]
(Name *)

(Title *)
[redacted]

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.

[redacted]

Required fields are shown with yellow backgrounds and astericks.

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

Form 19b-4 Information * Add Remove View SR-OCC-2023-007 (Accord) 19b-4 (0	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 SR-OCC-2023-007 (Accord) Exhibit 1	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 * 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 2- Notices, Written Comments, Transcripts, Other Communications Add Remove View	Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G. ☐ Exhibit Sent As Paper Document
Exhibit 3 - Form, Report, or Questionnaire Add Remove View SR-OCC-2023-007 (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 SR-OCC-2023-007 (Accord) Exhibit 4 SR-OCC-2023-007 (Accord) Exhibit 4	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-2023-007 (Accord) Exhibit 5 SR-OCC-2023-007 (Accord) Exhibit 5 SR-OCC-2023-007 (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 I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change
Partial Amendment Add Remove View	If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change
by

THE OPTIONS CLEARING CORPORATION

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

Item 1. <u>Text of the Proposed Rule Change</u>

Pursuant to the provisions of Section 19(b) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),[1] and Rule 19b-4 thereunder,[2] The Options Clearing Corporation ("OCC") is filing this amendment ("Amendment No. 2") to the proposed rule change SR-OCC-2023-007 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")[3] to 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 and to make certain related revisions to OCC By-Laws, OCC Rules,[4] OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC's Liquidity Risk Management Framework ("Phase 1") and (2) to improve information sharing between the Clearing Agencies to facilitate the upcoming transition to a T+1 standard securities settlement cycle and allow OCC, after the compliance date under amended Exchange Act Rule 15c6-1(a), to provide certain assurances to NSCC prior to the default of a common clearing participant that would enable NSCC to begin processing E&A/Delivery

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 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).

4 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*.

Transactions (defined below) before the central counterparty trade guaranty attaches to certain obligations of that participant ("Phase 2").[5] This Amendment No. 2 would amend and replace the Initial Filing and Amendment No. 1 in their entirety.

The proposed changes are included in Exhibits 5A and 5B and confidential Exhibits 5C, 5D, and 5E of Amendment No. 2 to File No. SR-OCC-2023-007. 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 meetings held on December 11, 2019, March 24, 2023, and December 14, 2023.

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

A. Purpose

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

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5 OCC initially filed a proposed rule change concerning the proposed Phase 1 changes on August 10, 2023. *See* Securities Exchange Act Release No. 98215 (Aug. 24, 2023), 88 FR 59976 (Aug. 30, 2023) (File No. SR–OCC–2023–007) ("Initial Filing"). OCC subsequently submitted a partial amendment to clarify the proposed implementation plan for the Initial Filing. *See* Securities Exchange Act Release No. 98932 (Nov. 14, 2023), 88 FR 80781 (Nov. 20, 2023) (File No. SR–OCC–2023–007) ("Amendment No. 1"). NSCC also has filed a proposed rule change with the Commission in connection with this proposal. *See* Securities Exchange Act Release No. 98213 (Aug. 24, 2023), 88 FR 59968 (Aug. 30, 2023) (File No. SR–NSCC–2023–007); Securities Exchange Act Release No. 98930 (Nov. 14, 2023), 88 FR 80790 (Nov. 20, 2023) (Partial Amendment No. 1 to File No. SR–NSCC–2023–007).

NSCC in exchange for cash ("physically settled" options).[6] 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 settlement obligations 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.[7] 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 E&A/Delivery 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

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6 The term "physically-settled" as used throughout the OCC Rules 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.

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

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 Guaranty Substitution Payments, 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 system[8] reduced the value of CNS settlement obligations by approximately 98% or $510 trillion from $519 trillion to $9

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8 *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*.

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 certain changes as part of Phase 1 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 (the "Guaranty Substitution Payment" or "GSP") to NSCC following the default of a Common Member[9] 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. In connection with this proposal, OCC also would 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

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9 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 4. The term "Member" as used herein has the meaning provided in NSCC's Rules. *See* NSCC's Rules, *supra* note 8.

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 would benefit from OCC's ability to choose to make a cash payment to effect settlement through the facilities of NSCC. This change would 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.[10]

Finally, the Clearing Agencies are also proposing certain changes as part of Phase 2 that, if approved, would not be implemented until after the Commission shortens the standardized settlement cycle under Exchange Act Rule 15c6-1(a) from two days after the traded date ("T+2") to one day after the trade date ("T+1"), which currently is set for May 28, 2024. The Phase 2 changes would address the operational realities concerning the Accord that will result from the Commission's adoption and implementation of a new standard settlement cycle of T+1 pursuant to Rule 15c6-1(a) under the Act. The Phase 2 changes generally are designed to allow OCC to provide certain assurances with respect to OCC's ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing Common Members' E&A/Delivery Transactions in a shortened settlement cycle prior to Guaranty Substitution occurring by introducing new or amended terms and setting out the processes associated therewith.

Background

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[10] OCC provided its analysis of the financial impact of alternate means of settlement as confidential Exhibit 3A to this filing.

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 system[11] or through its Balance Order Accounting system,[12] 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 at NSCC. 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.[13] 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 Rules[14] to be Members of NSCC or to have appointed or nominated a Member of

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11 *See* Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules, *supra* note 8.

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

13 *See* Chapter IX of OCC's Rules (Delivery of Underlying Securities and Payment), *supra* note 4.

14 *See* OCC Rule 901, *supra* note 4.

NSCC to act on its behalf. As noted above, these firms are referred to as "Common Members" in the Existing Accord.

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")[15] begins with respect to E&A/Delivery Transactions. However, in the case of a Common Member default[16] NSCC can reject these settlement obligations, in which case the settlement guaranty would 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.[17] More specifically, this could involve broker-to-broker

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15 *See* Addendum K and Procedure III of the NSCC Rules, *supra* note 8.

16 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".

17 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 confidential Exhibit 3A to this filing.

settlement between OCC Clearing Members.[18] 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 would 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

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18 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 would remain open on OCC's books indefinitely until the time both parties have provided notice of settlement to OCC.

identifying securities to be delivered, or received, for physical settlement in connection with OCC transactions.[19]

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.[20] At this point, NSCC is solely responsible for settling the transactions.[21]

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 submission[22] or if NSCC "ceases to act" for a Common Member,[23] NSCC's Guaranty would not take effect for the affected transactions pursuant to the NSCC Rules.

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19 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.

20 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 8.

21 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 with respect to E&A/Delivery Transactions is referred to as "Guaranty Substitution."

22 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.

23 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 8. 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.

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 reversal file containing a list of all transactions that OCC already 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 Phase 1 Changes

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 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.[24] OCC could use all Clearing Member contributions to the OCC Clearing Fund[25] and certain Margin Assets[26] 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")[27] and the unpaid Supplemental Liquidity Deposit[28] 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.

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[24] Acceptance of such transactions by NSCC would be subject to NSCC's standard validation criteria for incoming trades. *See* NSCC Rule 7, *supra* note 8.

[25] The term "OCC Clearing Fund" as used herein has the same meaning as the term "Clearing Fund" in OCC's By-Laws, *supra* note 4.

[26] The term "Margin Assets" as used herein has the same meaning as provided in OCC's By-Laws, *supra* note 4.

[27] 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 8.

[28] 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 8.

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 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.[29] 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,[30] current technology constraints prohibit NSCC from performing a precise calculation of the GSP on a daily basis for every Common Member.[31]

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

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29 OCC provided a draft of the revised SLA to the Commission as confidential Exhibit 3C to this filing.

30 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* confidential Exhibit 3D to this filing for additional detail related to the referenced study.

31 OCC and NSCC agreed that performing the necessary technology build during Phase 1 would delay the implementation of Phase 1 of this proposal. NSCC will incorporate those technology updates in connection with Phase 2 of this proposal.

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.[32] 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.[33] 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

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32 *See* confidential Exhibit 3A to this filing for additional detail related to the referenced study.

33 As of September 30, 2023, OCC held approximately $12.37 billion in qualifying liquid resources. *See OCC Quantitative Disclosure*, July – September 2023, *available at https://www.theocc.com/risk-management/pfmi-disclosures*.

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.[34] 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

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[34] 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.

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 would 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.[35] Furthermore, the benefits of netting through NSCC's systems would be reduced for any activity submitted to NSCC after that time.

To implement the proposed Phase 1 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 Options[36]

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35 OCC provided data regarding such events in confidential Exhibit 3B to this filing. 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.

36 The term "Stock Options" is defined in the Existing Accord within the definition of "Eligible Securities" and refers to options issued by OCC.

or Stock Futures[37] 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,[38] the Securities Investor Protection Act,[39] 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 term "Mutually Suspended Member" would mean "any OCC Participating Member[40] that has been suspended by OCC that is also an NSCC Participating Member[41] 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

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37 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.

38 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).

39 15 U.S.C. §§ 78aaa – lll, including §78eee(b)(2)(C) (exceptions to the stay).

40 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.

41 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) [Canadian Depository for Securities Limited 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.

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.

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.[42]

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.[43] 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.

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42 *See* Rule 46 (Restrictions on Access to Services) of the NSCC Rules, *supra* note 8.

43 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.

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 Deposit[44] and Supplemental Liquidity Deposit[45] obligations of the Mutually Suspended Member attributable to the Defaulted NSCC Member Transactions. By a time agreed upon by the parties,[46] 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

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44 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 8.

45 The Supplemental Liquidity Deposit is calculated pursuant to Rule 4A (Supplemental Liquidity Deposits) of the NSCC Rules, *see supra* note 8.

46 The time by which OCC would be required to 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.

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.[47]

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.[48]

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

[48] 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.

Other Proposed Changes as Part of Phase 1

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 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.[49] Similarly, Section 3(e) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving an NSCC Participating Member[50] 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

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[49] *See supra* note 40 defining OCC Participating Member.

[50] *See supra* note 41 defining NSCC Participating Member.

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 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.

Proposed Changes to OCC By-Laws and Rules as Part of Phase 1

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.[51] 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 901, so that [NSCC] will not

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[51] 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.

reject settlement obligations for CCC-eligible[52] 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 Procedures, are received by NSCC. These considerations regarding when a Guaranty Substitution occurs are addressed under the terms of the Existing Accord, and

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52 The term "CCC-Eligible" as used herein has the meaning provided in OCC's By-Laws, *supra* note 4.

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.[53]

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.[54] The changes would provide that any amount of a Guaranty Substitution Payment

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[53] 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.

[54] *See* NSCC Rules 4 (defining "Required Fund Deposit") and 4A (defining "Supplemental Liquidity Deposit"), *supra* note 8.

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 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.[55]

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."[56] 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

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55 The terms "Clearing Member" and "Appointed Clearing Member" as used herein have the meanings provided in OCC's By-Laws, *supra* note 4.

56 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)."

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.[57] 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

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[57] 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).

Clearing Member that has been suspended by OCC where that Clearing Member is a Mutually Suspended Member and OCC has a general lien[58] 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.[59] 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 lien[60] 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-

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[58] 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 4.

[59] 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 4.

[60] 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 4.

dealer Clearing Members and prohibit the use of customer property of the broker-dealer to support non-customer activities.[61]

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 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.

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61 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.

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.

Proposed Changes to Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and Liquidity Risk Management Framework as Part of Phase 1

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.[62]

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

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

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;[63]

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[63] 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

- 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.[64] More specifically, the standard Friday monthly expiration far exceeds the needs associated with any other category.[65] 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.[66] 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

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disparate characteristics differently. Additional supporting data in support of the creation of the Bank Holiday Expiration category is included as confidential Exhibit 3E to this filing.

64 OCC provided its analysis of notional activity sent to NSCC by OCC in support of the creation of the five categories as confidential Exhibit 3E to this filing. 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.

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

66 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.

default management process. As described above, this GSP amount may serve to only increase liquidity demands.[67]

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.[68]

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

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67 OCC provided its analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands as confidential Exhibit 3E to this filing.

68 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.

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."

Proposed Phase 2 Changes

On February 15, 2023, the Commission adopted amendments to Rule 15c6-1(a) under the Act[69] to shorten the standard settlement cycle for most broker-dealer transactions in securities from T+2 to T+1. In doing so, the Commission stated that a shorter settlement cycle "can promote investor protection, reduce risk, and increase operational and capital efficiency."[70] Moreover, the Commission stated that delaying the move to a shorter settlement cycle would "allow undue risk to continue to exist in the U.S. clearance and settlement system"[71] and that it "believes that the May 28, 2024, compliance date will help ensure that market participants have sufficient time to implement the changes necessary to reduce risk, such as risks associated with the potential for increases in settlement fails."[72] The Phase 2 changes proposed herein serve those risk reduction objectives related to securities settlements by endeavoring to limit market disruption following a Common Member default. The proposed changes would allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC in a shortened settlement cycle, which would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring. This, in turn, would promote settlement through NSCC that is less operationally complex and would be

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69 17 CFR 240.15c6-1.

70 Securities Exchange Act Release No. 96930 (Feb. 15, 2023), 88 FR 13872, 13873 (Mar. 6, 2023).

71 *Id.* at 13881.

72 *Id.* at 13917.

expected to require less collateral and liquidity from market participants than if OCC engaged in the alternative settlement processes discussed above.

To address the operational realities concerning the Accord that will result from the Commission's adoption and implementation of a new standard settlement cycle of T+1 pursuant to Rule 15c6-1(a) under the Act, OCC and NSCC are proposing Phase 2 changes to further modify the Accord after the T+1 settlement cycle becomes effective. As described in greater detail below, the Phase 2 changes would allow the GSP and other changes that are part of the Phase 1 changes to continue to function appropriately and efficiently in the new T+1 settlement environment. Because of the phased approach, a separate mark-up is provided in confidential Exhibit 5C to this filing of the Phase 2 changes against the Accord as modified through the Phase 1 changes.

As described in more detail below, shortening the settlement cycle to T+1 will require NSCC to process stock settlement obligations arising from E&A Delivery Transactions one day earlier, i.e., on the day after the trade date, than is currently the case. Moving processing times ahead by a full day will require processing to occur before the guaranty transfers from OCC to NSCC.[73] In this new T+1 processing environment, the Phase 2 changes would limit market disruption following a Common Member default because the Phase 2 changes would allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing the defaulting Common Member's E&A/Delivery Transactions prior to Guaranty Substitution occurring. This, in turn,

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[73] Given the reduction in the settlement cycle and existing processes that must be completed for settlement, it is OCC's understanding that the NSCC would not be able to safely compress its processing times further to allow processing to occur after the guaranty transfers from OCC to NSCC. OCC provided proposed processing timelines in confidential Exhibit 3G to this filing.

will promote settlement through NSCC that is less operationally complex and would be expected to require less collateral and liquidity from market participants than if OCC engaged in alternative settlement processes. The specific changes included in Phase 2 are described below. The changes would facilitate the continued ability of the GSP to function in an environment with a shorter settlement cycle. These changes are generally designed to allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring by introducing new or amended terms and setting out the processes associated therewith. All of the descriptions below explain the changes to the Accord as they would be made after the Accord has already been modified through prior implementation of the proposed Phase 1 changes.

Section 1 – Definitions

First, new definitions would be added, and existing definitions would be amended or removed in Section 1.

The new defined terms would be as follows.

- The term "GSP Monitoring Data" would be defined to mean a set of margin and liquidity-related data points provided by NSCC on each Activity Date prior to the submission of E&A/Delivery Transactions by OCC to be used for informational purposes at OCC and NSCC.

- The term "Final Guaranty Substitution Payment" would be defined to mean an amount calculated by NSCC for each Settlement Date in accordance with Appendix A to the Accord, to include two components: (i) a portion of the NSCC Participating Member's[74] Required Fund Deposit deficit to NSCC calculated as a difference between the Required Fund Deposit deficit calculated on the NSCC Participating Member's entire portfolio and the Required Fund Deposit deficit calculated on the NSCC Participating Member's portfolio prior to submission of

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74 *See supra* note 41.

the E&A/Delivery Transactions; and (ii) the portion of the NSCC Participating Member's unpaid Supplemental Liquidity Deposit obligation attributable to the additional activity to be guaranteed.

- The term "Historical Peak Guaranty Substitution Payment" would be defined to mean the largest Final Guaranty Substitution Payment for an NSCC Participating Member and its affiliates that are also NSCC Participating Members over the 12 months immediately preceding the Activity Date, to include two components: (i) the Required Fund Deposit deficits associated with E&A/Delivery Transactions based on peak historical observations of the largest NSCC Participating Member and its affiliates that are also NSCC Participating Members; and (ii) the Supplemental Liquidity Deposit obligations associated with E&A/Delivery Transactions based on peak historical observations as calculated in accordance with applicable NSCC or OCC Rules and procedures.

- The term "Qualifying Liquid Resources" would be defined to have the meaning provided by Rule 17Ad-22(a)(14) of the Exchange Act, 17 CFR 240.17Ad-22(a)(14), or any successor Rule under the Exchange Act.

- The term "Settlement Date" would be defined to mean the date on which an E&A/Delivery Transaction is designated to be settled through payment for, and delivery of, the Eligible Securities underlying the exercised Stock Option[75] or matured Stock Future,[76] as the case may be.

- The term "Weekday Expiration" would be defined to mean any expiration for which the options expiration date occurs on a date other than a Friday or for which the Settlement Date is any date other than the first business date following a weekend.

- The term "Weekend Expiration" would be defined to mean any expiration for which the options expiration date occurs on a Friday or for which the Settlement Date is the first business date following a weekend.

The defined term that would be removed in Section 1 is as follows.

- "Guaranty Substitution Payment," which would be replaced by the new defined terms "Final Guaranty Substitution Payment" and "Historical Peak Guaranty Substitution Payment."

The defined terms that would be amended in Section 1 are as follows.

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75 *See supra* note 36.

76 *See supra* note 37.

- The definition for the term "Eligible Securities" generally contemplates the securities that are eligible to be used for physical settlement under the Existing Accord. In Phase 2, the term will be modified to exclude any transactions settled through NSCC's Balance Order System and any security undergoing a voluntary corporate action that is being supported by NSCC's CNS system. This is because the processing of E&A/Delivery Transactions and potential reversals of such transactions under the Phase 2 changes would not be feasible under the anticipated operation of NSCC's CNS and Balance Order Accounting Operations under the shortened T+1 settlement cycle.

Section 3 – Historical Peak Guaranty Substitution Payment

A new Section 3 would be added to describe the process by which OCC would send to NSCC evidence of sufficient funds to cover the Historical Peak Guaranty Substitution Payment. In particular, Section 3(a) would provide that on each Activity Date, at or before a time agreed upon by the Clearing Agencies (which may be modified on any given Activity Date with the consent of an authorized representative of OCC), NSCC will communicate to OCC the amount of the Historical Peak Guaranty Substitution Payment amount and the GSP Monitoring Data, which are to be used for informational purposes at OCC. The Historical Peak Guaranty Substitution Payment would reflect the largest GSP of the NSCC Participating Member and its affiliates over the prior twelve months and would be calculated based on the sum of the Required Fund Deposit deficits and Supplemental Liquidity Deposit associated with E&A/Delivery Transactions. Section 3(b) would provide that OCC would then submit to NSCC an acknowledgement of the Historical Peak Guaranty Substitution Payment amount and evidence that OCC has sufficient cash resources in the OCC Clearing Fund to cover the Historical Peak Guaranty Substitution Payment.

Section 3(c) would provide that if OCC does not provide NSCC with evidence within the designated time period that it has sufficient cash resources in the OCC Clearing Fund to cover the Historical Peak Guaranty Substitution Payment on the Activity Date, OCC will immediately contact NSCC to escalate discussions to discuss potential exposures and determine, among other things, whether OCC has other qualifying liquidity resources available to satisfy such amount.

As described above, the Historical Peak Guaranty Substitution Payment is designed to serve as a reasonable proxy for the largest potential Final Guaranty Substitution Payment. Its purpose is to allow OCC to provide evidence that it likely will be able to satisfy the Final Guaranty Substitution Payment in the event of a Common Member default, which will provide NSCC with reasonable assurances such that NSCC can begin processing E&A/Delivery Transactions upon receipt and prior to the Guaranty Substitution occurring, which will minimize the probability of reversals in a default event in light of the shortened settlement cycle. The Historical Peak Guaranty Substitution Payment amount also will provide OCC with information that will allow OCC to include the amount of a potential GSP in its liquidity resource planning.

Section 6 – Final Guaranty Substitution Payment; OCC's Commitment

A new Section 6 would be added to provide the process by which NSCC would communicate the amount of, and OCC would commit to pay, the Final Guaranty Substitution Payment. In particular, Section 6(a) would provide that on each Settlement Date (or each Saturday for Weekend Expirations), by no later than the time(s) agreed upon by NSCC and OCC, NSCC will communicate to OCC the Final Guaranty Substitution Payment for each Common Member calculated by NSCC. NSCC would make such calculation according to a calculation methodology described in a new Appendix A to the Accord. This calculation would represent the sum of the Required Fund Deposit[77] and the Supplemental Liquidity Deposit[78] for

[77] The Required Fund Deposit is the portion of the defaulted Common Member's Required Fund Deposit deficit to NSCC, calculated as a difference between the Required Fund Deposit deficit calculated on the entire portfolio and the Required Fund Deposit deficit calculated on the Common Member's portfolio prior to the submission of E&A/Delivery Transactions. The Phase 2 changes would refine the existing calculation methodology for the Required Fund Deposit in order to provide for a more accurate amount.

the Common Member. As with the Phase 1 Accord, payment of the Final Guaranty Substitution Payment would be contingent on the mutual suspension of the Common Member and payment of the Final Guaranty Substitution Payment would continue to be the means by which Guaranty Substitution may occur.

Section 6(b) would provide that, following NSCC's communication of the Final Guaranty Substitution Payment for each Common Member to OCC, and by no later than the agreed upon time, OCC must either (i) commit to NSCC that it will pay the Final Guaranty Substitution Payment in the event of a mutual suspension of a Common Member,[79] or (ii) notify NSCC that it will not have sufficient cash resources to pay the largest Final Guaranty Substitution Payment calculated for every Common Member. Section 6(b)(i) would further provide that for Weekday Expirations, OCC's submission of E&A/Delivery Transactions to NSCC would constitute OCC's commitment to pay the Final Guaranty Substitution Payment on the Settlement Date in the event of a mutual suspension of a Common Member.

Section 6(c) would provide that if OCC notifies NSCC that it will not have sufficient cash resources to pay the Final Guaranty Substitution Payment, NSCC may, in its sole discretion (i) reject or reverse all E&A/Delivery Transactions, or (ii) voluntarily accept E&A/Delivery Transactions subject to certain terms and conditions mutually agreed upon by NSCC and OCC.[80]

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78 If NSCC calculates a liquidity shortfall with respect to a defaulted Common Member, the Supplemental Liquidity Deposit is the portion of that shortfall that is attributable to the additional activity to be guaranteed.

79 If OCC does not have sufficient cash to pay the Final GSP, then it must confirm for NSCC the availability of other qualifying liquid resources and the expected timeline for converting such resources to cash.

80 Such terms and conditions may include, but would not be limited to, OCC's agreement to (i) pay NSCC available cash resources in partial satisfaction of the Final Guaranty Substitution Payment; (ii) collect or otherwise source additional resources that would constitute NSCC Qualifying Liquid Resources to pay the full Final Guaranty Substitution Payment amount; and/or (iii) reimburse NSCC for any losses associated with closing out such E&A/Delivery Transactions.

Section 6(c) would also provide that any necessary reversals of E&A/Delivery Transactions shall be delivered by NSCC to OCC at such time and in such form as the Clearing Agencies agree.

Section 6(d) would provide that if, at any time after OCC has acknowledged the Historical Peak Guaranty Substitution Payment in accordance with proposed Section 3(b) of the Accord or committed to pay the Final Guaranty Substitution Payment in accordance with proposed Section 6(b) of the Accord, OCC has a reasonable basis to believe it will be unable to pay the Final Guaranty Substitution Payment, OCC will immediately notify NSCC.

Section 8 – Default by an NSCC Participating Member or OCC Participating Member

Section 6(b)(i), which would be renumbered as Section 8(b)(i), would be amended to reflect the modified use of the Final Guaranty Substitution Payment in the event of a mutual suspension of a Common Member. Section 8(b)(i) would also be revised to remove the ability for OCC or NSCC to require that the Guaranty Substitution Payment be re-calculated in accordance with an alternative methodology. This will not be necessary under the calculation methodology used in the Phase 2 changes because the proposed methodology would result in a more accurate calculation. Section 8(b)(i) would further amend the Accord by providing NSCC with discretion to voluntarily accept Defaulted NSCC Member Transactions and assume the guaranty for such transactions, subject to certain terms and conditions mutually agreed upon by NSCC and OCC. The only remaining change to the Guaranty Substitution process from its operation under the Accord would be the shortened time duration under which OCC would elect (by way of its commitment) to make the Final Guaranty Substitution Payment and the timing under which the Guaranty Substitution will be processed in order to function in a T+1 environment.

In particular, Section 8(b)(i) would provide that, with respect to a Mutually Suspended

Member, if OCC has committed to make the Final Guaranty Substitution Payment, it will make such cash payment in full by no later than the agreed upon time(s). Upon NSCC's receipt of the full amount of the Final Guaranty Substitution Payment, NSCC's Guaranty would attach (and OCC's Guaranty will no longer apply) to the Defaulted NSCC Member Transactions. NSCC would have no obligation to accept a Final Guaranty Substitution Payment and attach the NSCC Guaranty to any Defaulted NSCC Member Transactions for more than the Activity Date on which it has ceased to act for that Mutually Suspended Member and one subsequent Activity Date. If NSCC does not receive the full amount of the Final Guaranty Substitution Payment in cash by the agreed upon time, the Guaranty Substitution Time would not occur with respect to the Defaulted NSCC Member Transactions and Section 8(b)(ii), described below, would apply. NSCC would, however, have discretion to voluntarily accept Defaulted NSCC Member Transactions and assume the guaranty for such transactions, subject to certain terms and conditions mutually agreed upon by NSCC and OCC.

Section 6(b)(ii), which would be renumbered as Section 8(b)(ii), would also be amended to reflect the modified use of the Final Guaranty Substitution Payment in the event OCC continues to perform or does not make the Final Guaranty Substitution Payment. In particular, Section 8(b)(ii) would add an additional criterion of OCC not satisfying any alternative agreed upon terms for Guaranty Substitution to reflect this as an additional option under the Phase 2 changes. As amended, Section 8(b)(ii) would provide that if OCC does not suspend an OCC Participating Member for which NSCC has ceased to act, OCC does not commit to make the Final Guaranty Substitution Payment, NSCC does not receive the full amount of the Final Guaranty Substitution Payment in cash by the agreed upon time, or OCC does not satisfy any alternative agreed upon terms for Guaranty Substitution, Guaranty Substitution with respect to all Defaulted NSCC Member Transactions for that Activity Date will not occur, all Defaulted NSCC Member Transactions for that Activity Date will be reversed and exited from NSCC's CNS accounting system, and NSCC will have no obligation to guaranty or settle such Defaulted NSCC Member Transactions. NSCC may, however, exercise its discretion to voluntarily accept the Defaulted NSCC Member Transactions, and assume the guaranty for such transactions, subject to certain agreed upon terms and conditions.

Section 8(b) would also be modified to provide for escalated discussion between the Clearing Agencies in the event of an intraday NSCC Cease to Act and/or NSCC Participating Member Default, particularly to confirm that OCC has sufficient qualifying liquid resources to pay the projected Final Guaranty Substitution Payment for the Defaulting NSCC Member's projected E&A/Delivery Transactions based on information provided in GSP Monitoring Data for such Defaulting NSCC Member.

Conforming changes would also be made to Section 8(d) to reflect the use of the new defined term "Final Guaranty Substitution Payment."

Other Proposed Changes as Part of Phase 2

Certain other technical changes are also proposed as part of the Phase 2 changes, including to conform the Accord to the proposed changes described above. For example, Section 9(c) would be revised regarding information sharing to reflect the introduction of the Historical Peak and Final Guaranty Substitution Payments and the GSP Monitoring Data; Section 4(c)(ix) would be conformed to reflect the addition of "Settlement Date" as a defined term in Section 1; various sections would be renumbered and internal cross-references would be adjusted to reflect the addition of new sections proposed herein; correct current references throughout the Accord to "NSCC Rules and Procedures" would be changed to simply read "the

NSCC Rules;" and various non-substantive textual changes would be made to increase clarity.

Section 4(a) would also be modified to reflect that the Eligibility Master Files referenced in that paragraph, which identify Eligible Securities to OCC, are described in the SLA between OCC and NSCC. Section 9(b) would be modified to include OCC's available liquidity resources, including Clearing Fund cash balances in the information OCC provides to NSCC, and to specify that information will be provided on each Activity Date at an agreed upon time and in an agreed upon form by the Clearing Agencies. Finally, Section 16(b) would be modified to provide the correct current delivery address information for NSCC.

The Phase 2 changes would also include an Appendix A that would describe in detail the calculation methodology for the Guaranty Substitution Payment. This would provide the detailed technical calculation to determine each of the Mutually Suspended Member's Required Fund Deposit deficit and liquidity shortfall to NSCC. The full text of Appendix A is filed confidentially with the Commission as Exhibit 5 to this filing.

Phase 2 Guaranty Substitution Process Changes

As described above, the Phase 2 changes would modify the Guaranty Substitution process to reflect the shortened time duration under which the Guaranty Substitution will be processed in order to function in a T+1 environment. Below is a description of how that process would operate. The actual process would be implemented pursuant to a modified SLA between the Clearing Agencies.[81] All times provided below are in Eastern Time and represent the latest time by which the specified action must occur, unless otherwise agreed by the Clearing Agencies.

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[81] OCC provided a draft of the SLA illustrating such changes to the Commission as confidential Exhibit 3F to this filing.

<u>Weekend Expirations</u>: On Friday (the Activity Date), NSCC would provide OCC with the Historical Peak GSP amount by 8:00 AM. By 5:00 PM on Friday, OCC must acknowledge the Historical Peak GSP and provide evidence of OCC's Clearing Fund cash resources sufficient to cover that amount, following which NSCC would provide the Eligibility Master File by 5:45 PM. By 1:00 AM on Saturday, OCC would then provide NSCC with the E&A/Delivery Transactions file and by 8:00 AM NSCC would provide OCC with the Final GSP, which OCC must commit to pay by 9:00 AM in the event of a mutual suspension of a Common Member.[82] By 8:00 AM Monday (the Settlement Date), if a cease to act is declared over the weekend (or the later of 10:00 AM or one hour after the cease to act is declared if declared on Monday), OCC must pay the Final GSP if there has been a mutual suspension of a Common Member. Finally, by 1:00 PM on Monday, OCC must provide reversals for the defaulted member's E&A/Delivery Transactions if OCC has not satisfied (or will not satisfy) the Final GSP.

<u>Weekday Expirations</u>: On the Activity Date, NSCC would provide OCC with the Historical Peak GSP amount by 8:00 AM. By 5:00 PM on the Activity Date, OCC must acknowledge the Historical Peak GSP and provide evidence of its cash resources in the OCC Clearing Fund sufficient to cover that amount, following which NSCC would provide the Eligibility Master File by 5:45 PM. By 1:00 AM on the Settlement Date (the day after the Activity Date in the T+1 environment), OCC would then provide NSCC with the E&A/Delivery Transactions file, which also constitutes OCC's commitment to pay the Final GSP. By 8:00 AM NSCC would provide OCC with the Final GSP. By the later of 10:00 AM on the Settlement

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[82] If OCC does not have sufficient cash resources to pay the Final GSP and the Clearing Agencies are unable to reach an agreement on additional terms for NSCC to accept E&A/Delivery Transactions, OCC must submit a reversal file by 12:30 AM on Monday so that NSCC can remove the E&A/Delivery Transactions from CNS prior to the start of NSCC's overnight processing. *See* confidential Exhibit 3H to this filing for additional details on action deadlines and processing times.

Date or one hour after a cease to act is declared, OCC must pay the Final GSP if there has been a mutual suspension of a Common Member. Finally, by 1:00 PM on the Settlement Date, OCC must provide reversals for the defaulted member's E&A/Delivery Transactions if OCC has not satisfied (or will not satisfy) the Final GSP.

For both Weekend Expirations and Weekday Expirations, Guaranty Substitution will take place only after the Common Members meet their start of day margin funding requirements at NSCC, if any. In a Common Member default event, the Guaranty Substitution will take place when OCC pays the Final GSP to NSCC.

The Clearing Agencies note that the Phase 2 changes described above are designed to change the process by which the GSP is implemented such that the use of the GSP as a mechanism to facilitate the acceptance of settlement obligations by NSCC can continue to operate within the condensed timing for clearance and settlement in a T+1 environment. However, the ultimate use of the GSP, its purpose, and its substantive import would remain consistent with the Phase 1 changes.

Proposed Liquidity Risk Management Framework Changes

OCC proposes changes to the Liquidity Risk Management Framework to incorporate the Phase 2 changes into its liquidity risk management practices. In the Contingency Funding Plan section, OCC would specify that it endeavors to maintain sufficient cash resources to cover its projected settlement demands. Projected settlement demands may include settlements associated with option exercise & assignment activity that create obligations for OCC under the Accord (e.g., Final GSP, Historical Peak GSP). Final and Historical Peak GSP would be defined in the Definitions section. OCC proposes a footnote referencing the proposed Phase 1 changes to the Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management

Description with respect to the Final GSP. Namely, to account for the liquidity demand associated with the potential payment of a Final GSP, OCC would include the peak amount of the entire actual NSCC Required Fund Deposit deficits and SLD start-of-day obligations, without regard to allocation between NSCC and OCC, specific to each CMO Group for the relevant type of expiration on a rolling twelve-month lookback. Moreover, OCC may require the deposit of cash by a Clearing Member pursuant to its current Rules if projected settlement demands exceed OCC liquidity resources available to make settlement in the event of a Clearing Member default.

OCC also proposes related and clarifying changes in the document. For example, OCC would include a minor clarifying change to the Liquidity Risk Identification section to define GSP as a firm-specific liquidity demand. OCC would also amend the Stress Testing and Liquidity Resource Sizing section to incorporate information pertaining to GSP obligations into the annual analysis presented to the Board on projected liquidity demands that OCC may face under a variety of scenarios.

Proposed By-Law Changes

OCC proposes to update its By-Laws to conform with the revised Accord. OCC proposes to remove a reference to Balance Order Accounting Operation to align with the exclusion of transactions settled through NSCC's Balance Order System under the amended definition of Eligible Securities in the Phase 2 Accord.

Implementation Framework

The proposed Phase 1 and Phase 2 changes will be implemented as follows:

- Phase 1: Within 120 days after the date OCC and NSCC receive all necessary regulatory approvals for these proposed changes to the Accord, OCC will implement all Phase 1 changes. OCC would announce the implementation date by an Information Memorandum posted to its public website at least seven days prior to implementation.

- Phase 2: On the compliance date with respect to the final T+1 amendments to Exchange Act Rule 15c6-1(a) established by the SEC, OCC will implement all Phase 2 changes, keep in place any applicable Phase 1 changes that carry over to Phase 2, and decommission all Phase 1 changes that do not apply to Phase 2.[83]

B. Statutory Basis

OCC believes the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, OCC believes the proposed changes are consistent with Section 17A(b)(3)(F) of the Act.[84] Section 17A(b)(3)(F)[85] of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, in general, to protect investors and the public interest. As described above in the Phase 1 changes, OCC believes that modifying its stress testing procedures to enhance its ability to call for additional liquidity resources 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 prompt and accurate clearance and settlement because it would ensure that NSCC accepts the relevant securities settlement obligations 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

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[83] If, due to the timing of regulatory approval, the implementation dates for Phase 1 and Phase 2 overlap, OCC would implement only the Phase 2 changes and Phase 1 changes that carry over to Phase 2.

[84] 15 U.S.C. 78q-1(b)(3)(F).

[85] 15 U.S.C. 78q-1(b)(3)(F).

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. The Phase 2 changes are also consistent with Section 17A(b)(3)(F)[86] of the Act and would promote the prompt and accurate clearance and settlement of securities transactions and protect investors and the public interest because, as described above, they would facilitate implementation of the new settlement cycle and support the Commission's stated goal of implementing necessary risk reducing changes in connection with the move to T+1 settlement, currently set for May 28, 2024. The Phase 2 changes would further enable OCC to provide certain assurances that would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring – thereby promoting the continued effectiveness of the Guaranty Substitution process in an environment with a shorter settlement cycle. For these reasons, OCC believes that the proposed changes would be beneficial to and protective of OCC, NSCC, their participants, and the markets that they serve and that the proposed changes are therefore designed, in general, to protect investors and the public interest.

OCC believes that the proposed changes are also consistent with the SEC rules that apply to OCC as a covered clearing agency.[87] 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

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[86] 15 U.S.C. 78q-1(b)(3)(F).

[87] 17 CFR 240.17Ad-22(a)(5).

or more other clearing agencies, financial market utilities, or trading markets.[88] As described in OCC's publicly available disclosure framework for financial market infrastructures,[89] 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) that 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).[90] 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.[91] SEC Rule 17Ad-22(e)(7) requires OCC, in relevant part, to establish, implement, maintain and

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88 17 CFR 240.17Ad-22(e)(20).

89 *See* The Options Clearing Corporation Disclosure Framework for Financial Market Infrastructures, pg. 105, (2023), *available at https://www.theocc.com/risk-management/pfmi-disclosures*.

90 17 CFR 240.17Ad-22(e)(3), (7).

91 17 CFR 240.17Ad-22(e)(3).

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.[92] 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 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 Guaranty 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 increasing the promotion of market stability. Regarding the Phase 2 changes, OCC believes that the continued ability in a T+1 environment 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.

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92 17 CFR 240.17Ad-22(e)(7).

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

Section 17A(b)(3)(I) of the Act[93] requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposal would impose any burden on competition. The Phase 1 changes would implement changes that would permit OCC in certain circumstances to make a Guaranty Substitution Payment to NSCC so that the NSCC Guaranty would take effect for the Defaulted NSCC Member Transactions and the OCC Guaranty would end. The Phase 2 changes would further implement changes that would allow OCC to provide certain assurances to NSCC prior to the default of a Common Member that would enable NSCC to begin processing E&A/Delivery Transactions before the NSCC central counterparty trade guaranty attaches. The proposed changes would not inhibit access to OCC's services in any way, apply to all Clearing Members and do not disadvantage or favor any particular user in relationship to another user. Accordingly, OCC does not believe that the proposed rule change would have any impact or impose a burden on competition.

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

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

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

OCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Act[94] for Commission action.

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[93] 15 U.S.C. 78q-1(b)(3)(I).

[94] 15 U.S.C. 78s(b)(2).

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

Not applicable.

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

Not applicable.

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

Not applicable.

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

Not applicable.

Item 11. Exhibits

Exhibit 1A. Completed Notice of Proposed Rule Change 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 Phase 1 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 for Phase 1. Confidential treatment is requested in part for Exhibit 3B pursuant to SEC Rule 24b-2.

Exhibit 3C Phase 1 SLA. This Exhibit 3C contains changes to the SLA for Phase 1. 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 3F Phase 2 SLA. This Exhibit 3F contains changes to the SLA for Phase 2. 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 3F pursuant to SEC Rule 24b-2.

Exhibit 3G Phase 2 Close-out Timing. This Exhibit 3G contains information regarding the assumptions and timelines leading up to the mutual declaration of a default for a Common Member and the anticipated timing of OCC's payment of the Final GSP in a T+1 environment. Confidential treatment is requested in part for Exhibit 3G pursuant to SEC Rule 24b-2.

Exhibit 3H T+1 Analysis. This Exhibit 3H includes OCC's analysis regarding the move to T+1 settlement, including relevant timelines, communications between OCC and NSCC on Phase 2 elements, OCC liquidity risk management, and certain terms and conditions associated with the Phase 2 changes. Confidential treatment is requested in part for Exhibit 3H pursuant to SEC Rule 24b-2.

Exhibit 4A Proposed Changes to Amended and Restated Stock Options and Futures Settlement Agreement Between OCC and NSCC by Amendment. Confidential treatment is requested for Exhibit 4A pursuant to SEC Rule 24b-2.

Exhibit 4B Proposed Changes to OCC's Liquidity Risk Management Framework by Amendment. Confidential treatment is requested for Exhibit 4B pursuant to SEC Rule 24b-2.

Exhibit 4C. Proposed Changes to OCC By-Laws by Amendment.

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-2023-007)

[January __, 2024]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Amendment No. 2 to Proposed Rule Change by The Options Clearing Corporation 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 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),[1] and Rule 19b-4 thereunder,[2] notice is hereby given that on January 23, 2024, The Options Clearing Corporation ("OCC" or "Corporation") filed with the Securities and Exchange Commission ("SEC" or "Commission") this amendment ("Amendment No. 2") to the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. <u>Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change</u>

This Amendment No. 2 to the proposed rule change SR-OCC-2023-007 would (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")[3] to

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 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).

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 and to make certain related revisions to OCC By-Laws, OCC Rules,[4] OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and OCC's Liquidity Risk Management Framework ("Phase 1") and (2) to improve information sharing between the Clearing Agencies to facilitate the upcoming transition to a T+1 standard securities settlement cycle and allow OCC, after the compliance date under amended Exchange Act Rule 15c6-1(a), to provide certain assurances to NSCC prior to the default of a common clearing participant that would enable NSCC to begin processing E&A/Delivery Transactions (defined below) before the central counterparty trade guaranty attaches to certain obligations of that participant ("Phase 2").[5] This Amendment No. 2 would amend and replace the Initial Filing and Amendment No. 1 in their entirety.

The proposed changes are included in Exhibits 5A and 5B and confidential Exhibits 5C, 5D, and 5E of Amendment No. 2 to File No. SR-OCC-2023-007. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text.

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[4] 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*.

[5] OCC initially filed a proposed rule change concerning the proposed Phase 1 changes on August 10, 2023. *See* Securities Exchange Act Release No. 98215 (Aug. 24, 2023), 88 FR 59976 (Aug. 30, 2023) (File No. SR–OCC–2023–007) ("Initial Filing"). OCC subsequently submitted a partial amendment to clarify the proposed implementation plan for the Initial Filing. *See* Securities Exchange Act Release No. 98932 (Nov. 14, 2023), 88 FR 80781 (Nov. 20, 2023) (File No. SR–OCC–2023–007) ("Amendment No. 1"). NSCC also has filed a proposed rule change with the Commission in connection with this proposal. *See* Securities Exchange Act Release No. 98213 (Aug. 24, 2023), 88 FR 59968 (Aug. 30, 2023) (File No. SR–NSCC–2023–007); Securities Exchange Act Release No. 98930 (Nov. 14, 2023), 88 FR 80790 (Nov. 20, 2023) (Partial Amendment No. 1 to File No. SR–NSCC–2023–007).

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

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

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

(1) Purpose

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).[6] 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

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6 The term "physically-settled" as used throughout the OCC Rules 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.

physically settled options and futures cleared by OCC that result in settlement obligations 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.[7] 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 E&A/Delivery 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 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

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[7] Under the Existing Accord, such options and futures are defined as "E&A/Delivery Transactions," which refers to "Exercise & Assignment Delivery Transactions."

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 Guaranty Substitution Payments, 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 system[8] 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.

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8 *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*.

To address these problems, the Clearing Agencies are proposing certain changes as part of Phase 1 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 (the "Guaranty Substitution Payment" or "GSP") to NSCC following the default of a Common Member[9] 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. In connection with this proposal, OCC also would 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

[9] 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 4. The term "Member" as used herein has the meaning provided in NSCC's Rules. *See* NSCC's Rules, *supra* note 8.

OCC provides clearance and settlement would benefit from OCC's ability to choose to make a cash payment to effect settlement through the facilities of NSCC. This change would 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.[10]

Finally, the Clearing Agencies are also proposing certain changes as part of Phase 2 that, if approved, would not be implemented until after the Commission shortens the standardized settlement cycle under Exchange Act Rule 15c6-1(a) from two days after the traded date ("T+2") to one day after the trade date ("T+1"), which currently is set for May 28, 2024. The Phase 2 changes would address the operational realities concerning the Accord that will result from the Commission's adoption and implementation of a new standard settlement cycle of T+1 pursuant to Rule 15c6-1(a) under the Act. The Phase 2 changes generally are designed to allow OCC to provide certain assurances with respect to OCC's ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing Common Members' E&A/Delivery Transactions in a shortened settlement cycle prior to Guaranty Substitution occurring by introducing new or amended terms and setting out the processes associated therewith.

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

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10 OCC provided its analysis of the financial impact of alternate means of settlement as confidential Exhibit 3A to this filing.

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 system[11] or through its Balance Order Accounting system,[12] 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 at NSCC. 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.[13] 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 Rules[14] 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.

Summary of the Existing Accord

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[11] *See* Rule 11 (CNS System) and Procedure VII (CNS Accounting Operation) of the NSCC Rules, *supra* note 8.

[12] *See* Rule 8 (Balance Order and Foreign Security Systems) and Procedure V (Balance Order Accounting Operation) of the NSCC Rules, *supra* note 8.

[13] *See* Chapter IX of OCC's Rules (Delivery of Underlying Securities and Payment), *supra* note 4.

[14] *See* OCC Rule 901, *supra* note 4.

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")[15] begins with respect to E&A/Delivery Transactions. However, in the case of a Common Member default[16] NSCC can reject these settlement obligations, in which case the settlement guaranty would 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.[17] More specifically, this could involve broker-to-broker settlement between OCC Clearing Members.[18] This settlement method is operationally

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15 *See* Addendum K and Procedure III of the NSCC Rules, *supra* note 8.

16 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".

17 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 confidential Exhibit 3A to this filing.

18 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 would remain open on OCC's books indefinitely until the time both parties have provided notice of settlement to OCC.

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 would 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.[19]

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[19] 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.[20] At this point, NSCC is solely responsible for settling the transactions.[21]

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 submission[22] or if NSCC "ceases to act" for a Common Member,[23] NSCC's Guaranty would 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,

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20 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 8.

21 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 with respect to E&A/Delivery Transactions is referred to as "Guaranty Substitution."

22 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.

23 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 8. 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.

deliver to NSCC a reversal file containing a list of all transactions that OCC already 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 Phase 1 Changes

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 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.[24] OCC could use all Clearing Member contributions to the OCC Clearing Fund[25] and certain Margin Assets[26] 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")[27] and the unpaid Supplemental Liquidity Deposit[28] 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

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24 Acceptance of such transactions by NSCC would be subject to NSCC's standard validation criteria for incoming trades. *See* NSCC Rule 7, *supra* note 8.

25 The term "OCC Clearing Fund" as used herein has the same meaning as the term "Clearing Fund" in OCC's By-Laws, *supra* note 4.

26 The term "Margin Assets" as used herein has the same meaning as provided in OCC's By-Laws, *supra* note 4.

27 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 8.

28 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 8.

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.[29] 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,[30] current technology constraints prohibit NSCC from performing a precise calculation of the GSP on a daily basis for every Common Member.[31]

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

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[29] OCC provided a draft of the revised SLA to the Commission as confidential Exhibit 3C to this filing.

[30] 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* confidential Exhibit 3D to this filing for additional detail related to the referenced study.

[31] OCC and NSCC agreed that performing the necessary technology build during Phase 1 would delay the implementation of Phase 1 of this proposal. NSCC will incorporate those technology updates in connection with Phase 2 of this proposal.

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.[32] 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.[33] 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

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32 *See* confidential Exhibit 3A to this filing for additional detail related to the referenced study.

33 As of September 30, 2023, OCC held approximately $12.37 billion in qualifying liquid resources. *See OCC Quantitative Disclosure*, July – September 2023, *available at https://www.theocc.com/risk-management/pfmi-disclosures*.

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.[34] 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

34 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.

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 would 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.[35] Furthermore, the benefits of netting through NSCC's systems would be reduced for any activity submitted to NSCC after that time.

To implement the proposed Phase 1 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.

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[35] OCC provided data regarding such events in confidential Exhibit 3B to this filing. 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.

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 Options[36] or Stock Futures[37] 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,[38] the Securities Investor Protection Act,[39] 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 term "Mutually Suspended Member" would mean "any OCC Participating Member[40] that has been suspended by OCC that is also an NSCC Participating Member[41] for which NSCC has ceased to act."

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36 The term "Stock Options" is defined in the Existing Accord within the definition of "Eligible Securities" and refers to options issued by OCC.

37 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.

38 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).

39 15 U.S.C. §§ 78aaa – lll, including §78eee(b)(2)(C) (exceptions to the stay).

40 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.

41 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

- 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.

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,

OCC’s By-Laws); or (iii) [Canadian Depository for Securities Limited 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.

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.[42]

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.[43] This provision would be amended to clarify that it applies in respect

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42 *See* Rule 46 (Restrictions on Access to Services) of the NSCC Rules, *supra* note 8.

43 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.

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 Deposit[44] and Supplemental Liquidity Deposit[45] obligations of the Mutually Suspended Member attributable to the Defaulted NSCC Member Transactions. By a time agreed upon by the parties,[46] 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

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[44] 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 8.

[45] The Supplemental Liquidity Deposit is calculated pursuant to Rule 4A (Supplemental Liquidity Deposits) of the NSCC Rules, *see supra* note 8.

[46] The time by which OCC would be required to 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.

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.[47]

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

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

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.[48]

Other Proposed Changes as Part of Phase 1

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 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.

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[48] 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.

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.[49] Similarly, Section 3(e) generally provides that OCC will no longer submit E&A/Delivery Transactions to NSCC involving an NSCC Participating Member[50] 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 Deposit and Supplemental Liquidity Deposit obligations, to include the Supplemental Liquidity Deposit obligation in this notice requirement, and additionally

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[49] *See supra* note 40 defining OCC Participating Member.

[50] *See supra* note 41 defining NSCC Participating Member.

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.

Proposed Changes to OCC By-Laws and Rules as Part of Phase 1

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.[51] Fourth, the proposed changes to OCC's Comprehensive Stress Testing and Clearing Fund Methodology, and Liquidity

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51 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.

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-eligible[52] 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.

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52 The term "CCC-Eligible" as used herein has the meaning provided in OCC's By-Laws, *supra* note 4.

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.[53]

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[53] 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.

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.[54] 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

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[54] *See* NSCC Rules 4 (defining "Required Fund Deposit") and 4A (defining "Supplemental Liquidity Deposit"), *supra* note 8.

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 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.[55]

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."[56] 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

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55 The terms "Clearing Member" and "Appointed Clearing Member" as used herein have the meanings provided in OCC's By-Laws, *supra* note 4.

56 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)."

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.[57] 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 lien[58] 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

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[57] 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).

[58] 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 4.

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.[59] 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 lien[60] 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.[61]

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

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59 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 4.

60 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 4.

61 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.

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 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.

Proposed Changes to Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and Liquidity Risk Management Framework as Part of Phase 1

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.[62]

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

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

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;[63]
- 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.

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[63] 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 confidential Exhibit 3E to this filing.

OCC believes these five categories are appropriate after an analysis of notional activity sent to NSCC by OCC.[64] More specifically, the standard Friday monthly expiration far exceeds the needs associated with any other category.[65] 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.[66] 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.[67]

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

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64 OCC provided its analysis of notional activity sent to NSCC by OCC in support of the creation of the five categories as confidential Exhibit 3E to this filing. 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.

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

66 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.

67 OCC provided its analysis of the impact of the GSP, including with respect to calls for collateral and liquidity demands as confidential Exhibit 3E to this filing.

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.[68]

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."

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68 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.

Proposed Phase 2 Changes

On February 15, 2023, the Commission adopted amendments to Rule 15c6-1(a) under the Act[69] to shorten the standard settlement cycle for most broker-dealer transactions in securities from T+2 to T+1. In doing so, the Commission stated that a shorter settlement cycle "can promote investor protection, reduce risk, and increase operational and capital efficiency."[70] Moreover, the Commission stated that delaying the move to a shorter settlement cycle would "allow undue risk to continue to exist in the U.S. clearance and settlement system"[71] and that it "believes that the May 28, 2024, compliance date will help ensure that market participants have sufficient time to implement the changes necessary to reduce risk, such as risks associated with the potential for increases in settlement fails."[72] The Phase 2 changes proposed herein serve those risk reduction objectives related to securities settlements by endeavoring to limit market disruption following a Common Member default. The proposed changes would allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC in a shortened settlement cycle, which would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring. This, in turn, would promote settlement through NSCC that is less operationally complex and would be expected to require less collateral and liquidity from market participants than if OCC engaged in the alternative settlement processes discussed above.

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69 17 CFR 240.15c6-1.

70 Securities Exchange Act Release No. 96930 (Feb. 15, 2023), 88 FR 13872, 13873 (Mar. 6, 2023).

71 *Id.* at 13881.

72 *Id.* at 13917.

To address the operational realities concerning the Accord that will result from the Commission's adoption and implementation of a new standard settlement cycle of T+1 pursuant to Rule 15c6-1(a) under the Act, OCC and NSCC are proposing Phase 2 changes to further modify the Accord after the T+1 settlement cycle becomes effective. As described in greater detail below, the Phase 2 changes would allow the GSP and other changes that are part of the Phase 1 changes to continue to function appropriately and efficiently in the new T+1 settlement environment. Because of the phased approach, a separate mark-up is provided in confidential Exhibit 5C to this filing of the Phase 2 changes against the Accord as modified through the Phase 1 changes.

As described in more detail below, shortening the settlement cycle to T+1 will require NSCC to process stock settlement obligations arising from E&A Delivery Transactions one day earlier, i.e., on the day after the trade date, than is currently the case. Moving processing times ahead by a full day will require processing to occur before the guaranty transfers from OCC to NSCC.[73] In this new T+1 processing environment, the Phase 2 changes would limit market disruption following a Common Member default because the Phase 2 changes would allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing the defaulting Common Member's E&A/Delivery Transactions prior to Guaranty Substitution occurring. This, in turn, will promote settlement through NSCC that is less operationally complex and would be expected to require less collateral and liquidity from market participants than if OCC

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[73] Given the reduction in the settlement cycle and existing processes that must be completed for settlement, it is OCC's understanding that the NSCC would not be able to safely compress its processing times further to allow processing to occur after the guaranty transfers from OCC to NSCC. OCC provided proposed processing timelines in confidential Exhibit 3G to this filing.

engaged in alternative settlement processes. The specific changes included in Phase 2 are described below. The changes would facilitate the continued ability of the GSP to function in an environment with a shorter settlement cycle. These changes are generally designed to allow OCC to provide certain assurances with respect to its ability to make a GSP in the event of a Common Member default to NSCC that would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring by introducing new or amended terms and setting out the processes associated therewith. All of the descriptions below explain the changes to the Accord as they would be made after the Accord has already been modified through prior implementation of the proposed Phase 1 changes.

Section 1 – Definitions

First, new definitions would be added, and existing definitions would be amended or removed in Section 1.

The new defined terms would be as follows.

- The term "GSP Monitoring Data" would be defined to mean a set of margin and liquidity-related data points provided by NSCC on each Activity Date prior to the submission of E&A/Delivery Transactions by OCC to be used for informational purposes at OCC and NSCC.

- The term "Final Guaranty Substitution Payment" would be defined to mean an amount calculated by NSCC for each Settlement Date in accordance with Appendix A to the Accord, to include two components: (i) a portion of the NSCC Participating Member's[74] Required Fund Deposit deficit to NSCC calculated as a difference between the Required Fund Deposit deficit calculated on the NSCC Participating Member's entire portfolio and the Required Fund Deposit deficit calculated on the NSCC Participating Member's portfolio prior to submission of the E&A/Delivery Transactions; and (ii) the portion of the NSCC Participating Member's unpaid Supplemental Liquidity Deposit obligation attributable to the additional activity to be guaranteed.

[74] *See supra* note 41.

- The term "Historical Peak Guaranty Substitution Payment" would be defined to mean the largest Final Guaranty Substitution Payment for an NSCC Participating Member and its affiliates that are also NSCC Participating Members over the 12 months immediately preceding the Activity Date, to include two components: (i) the Required Fund Deposit deficits associated with E&A/Delivery Transactions based on peak historical observations of the largest NSCC Participating Member and its affiliates that are also NSCC Participating Members; and (ii) the Supplemental Liquidity Deposit obligations associated with E&A/Delivery Transactions based on peak historical observations as calculated in accordance with applicable NSCC or OCC Rules and procedures.

- The term "Qualifying Liquid Resources" would be defined to have the meaning provided by Rule 17Ad-22(a)(14) of the Exchange Act, 17 CFR 240.17Ad-22(a)(14), or any successor Rule under the Exchange Act.

- The term "Settlement Date" would be defined to mean the date on which an E&A/Delivery Transaction is designated to be settled through payment for, and delivery of, the Eligible Securities underlying the exercised Stock Option[75] or matured Stock Future,[76] as the case may be.

- The term "Weekday Expiration" would be defined to mean any expiration for which the options expiration date occurs on a date other than a Friday or for which the Settlement Date is any date other than the first business date following a weekend.

- The term "Weekend Expiration" would be defined to mean any expiration for which the options expiration date occurs on a Friday or for which the Settlement Date is the first business date following a weekend.

The defined term that would be removed in Section 1 is as follows.

- "Guaranty Substitution Payment," which would be replaced by the new defined terms "Final Guaranty Substitution Payment" and "Historical Peak Guaranty Substitution Payment."

The defined terms that would be amended in Section 1 are as follows.

- The definition for the term "Eligible Securities" generally contemplates the securities that are eligible to be used for physical settlement under the Existing Accord. In Phase 2, the term will be modified to exclude any

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75 *See supra* note 36.

76 *See supra* note 37.

> transactions settled through NSCC's Balance Order System and any security undergoing a voluntary corporate action that is being supported by NSCC's CNS system. This is because the processing of E&A/Delivery Transactions and potential reversals of such transactions under the Phase 2 changes would not be feasible under the anticipated operation of NSCC's CNS and Balance Order Accounting Operations under the shortened T+1 settlement cycle.

Section 3 – Historical Peak Guaranty Substitution Payment

A new Section 3 would be added to describe the process by which OCC would send to NSCC evidence of sufficient funds to cover the Historical Peak Guaranty Substitution Payment. In particular, Section 3(a) would provide that on each Activity Date, at or before a time agreed upon by the Clearing Agencies (which may be modified on any given Activity Date with the consent of an authorized representative of OCC), NSCC will communicate to OCC the amount of the Historical Peak Guaranty Substitution Payment amount and the GSP Monitoring Data, which are to be used for informational purposes at OCC. The Historical Peak Guaranty Substitution Payment would reflect the largest GSP of the NSCC Participating Member and its affiliates over the prior twelve months and would be calculated based on the sum of the Required Fund Deposit deficits and Supplemental Liquidity Deposit associated with E&A/Delivery Transactions. Section 3(b) would provide that OCC would then submit to NSCC an acknowledgement of the Historical Peak Guaranty Substitution Payment amount and evidence that OCC has sufficient cash resources in the OCC Clearing Fund to cover the Historical Peak Guaranty Substitution Payment.

Section 3(c) would provide that if OCC does not provide NSCC with evidence within the designated time period that it has sufficient cash resources in the OCC Clearing Fund to cover the Historical Peak Guaranty Substitution Payment on the Activity Date, OCC will immediately contact NSCC to escalate discussions to discuss potential exposures and determine, among other things, whether OCC has other qualifying liquidity resources available to satisfy such amount.

As described above, the Historical Peak Guaranty Substitution Payment is designed to serve as a reasonable proxy for the largest potential Final Guaranty Substitution Payment. Its purpose is to allow OCC to provide evidence that it likely will be able to satisfy the Final Guaranty Substitution Payment in the event of a Common Member default, which will provide NSCC with reasonable assurances such that NSCC can begin processing E&A/Delivery Transactions upon receipt and prior to the Guaranty Substitution occurring, which will minimize the probability of reversals in a default event in light of the shortened settlement cycle. The Historical Peak Guaranty Substitution Payment amount also will provide OCC with information that will allow OCC to include the amount of a potential GSP in its liquidity resource planning.

Section 6 – Final Guaranty Substitution Payment; OCC's Commitment

A new Section 6 would be added to provide the process by which NSCC would communicate the amount of, and OCC would commit to pay, the Final Guaranty Substitution Payment. In particular, Section 6(a) would provide that on each Settlement Date (or each Saturday for Weekend Expirations), by no later than the time(s) agreed upon by NSCC and OCC, NSCC will communicate to OCC the Final Guaranty Substitution Payment for each Common Member calculated by NSCC. NSCC would make such calculation according to a calculation methodology described in a new Appendix A to the Accord. This calculation would represent the sum of the Required Fund Deposit[77] and the Supplemental Liquidity Deposit[78] for the Common Member. As

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77 The Required Fund Deposit is the portion of the defaulted Common Member's Required Fund Deposit deficit to NSCC, calculated as a difference between the Required Fund Deposit deficit

with the Phase 1 Accord, payment of the Final Guaranty Substitution Payment would be contingent on the mutual suspension of the Common Member and payment of the Final Guaranty Substitution Payment would continue to be the means by which Guaranty Substitution may occur.

Section 6(b) would provide that, following NSCC's communication of the Final Guaranty Substitution Payment for each Common Member to OCC, and by no later than the agreed upon time, OCC must either (i) commit to NSCC that it will pay the Final Guaranty Substitution Payment in the event of a mutual suspension of a Common Member,[79] or (ii) notify NSCC that it will not have sufficient cash resources to pay the largest Final Guaranty Substitution Payment calculated for every Common Member. Section 6(b)(i) would further provide that for Weekday Expirations, OCC's submission of E&A/Delivery Transactions to NSCC would constitute OCC's commitment to pay the Final Guaranty Substitution Payment on the Settlement Date in the event of a mutual suspension of a Common Member.

Section 6(c) would provide that if OCC notifies NSCC that it will not have sufficient cash resources to pay the Final Guaranty Substitution Payment, NSCC may, in its sole discretion (i) reject or reverse all E&A/Delivery Transactions, or (ii) voluntarily accept E&A/Delivery Transactions subject to certain terms and conditions mutually

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calculated on the entire portfolio and the Required Fund Deposit deficit calculated on the Common Member's portfolio prior to the submission of E&A/Delivery Transactions. The Phase 2 changes would refine the existing calculation methodology for the Required Fund Deposit in order to provide for a more accurate amount.

78 If NSCC calculates a liquidity shortfall with respect to a defaulted Common Member, the Supplemental Liquidity Deposit is the portion of that shortfall that is attributable to the additional activity to be guaranteed.

79 If OCC does not have sufficient cash to pay the Final GSP, then it must confirm for NSCC the availability of other qualifying liquid resources and the expected timeline for converting such resources to cash.

agreed upon by NSCC and OCC.[80] Section 6(c) would also provide that any necessary reversals of E&A/Delivery Transactions shall be delivered by NSCC to OCC at such time and in such form as the Clearing Agencies agree.

Section 6(d) would provide that if, at any time after OCC has acknowledged the Historical Peak Guaranty Substitution Payment in accordance with proposed Section 3(b) of the Accord or committed to pay the Final Guaranty Substitution Payment in accordance with proposed Section 6(b) of the Accord, OCC has a reasonable basis to believe it will be unable to pay the Final Guaranty Substitution Payment, OCC will immediately notify NSCC.

Section 8 – Default by an NSCC Participating Member or OCC Participating Member

Section 6(b)(i), which would be renumbered as Section 8(b)(i), would be amended to reflect the modified use of the Final Guaranty Substitution Payment in the event of a mutual suspension of a Common Member. Section 8(b)(i) would also be revised to remove the ability for OCC or NSCC to require that the Guaranty Substitution Payment be re-calculated in accordance with an alternative methodology. This will not be necessary under the calculation methodology used in the Phase 2 changes because the proposed methodology would result in a more accurate calculation. Section 8(b)(i) would further amend the Accord by providing NSCC with discretion to voluntarily accept Defaulted NSCC Member Transactions and assume the guaranty for such transactions,

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80 Such terms and conditions may include, but would not be limited to, OCC's agreement to (i) pay NSCC available cash resources in partial satisfaction of the Final Guaranty Substitution Payment; (ii) collect or otherwise source additional resources that would constitute NSCC Qualifying Liquid Resources to pay the full Final Guaranty Substitution Payment amount; and/or (iii) reimburse NSCC for any losses associated with closing out such E&A/Delivery Transactions.

subject to certain terms and conditions mutually agreed upon by NSCC and OCC. The only remaining change to the Guaranty Substitution process from its operation under the Accord would be the shortened time duration under which OCC would elect (by way of its commitment) to make the Final Guaranty Substitution Payment and the timing under which the Guaranty Substitution will be processed in order to function in a T+1 environment.

In particular, Section 8(b)(i) would provide that, with respect to a Mutually Suspended Member, if OCC has committed to make the Final Guaranty Substitution Payment, it will make such cash payment in full by no later than the agreed upon time(s). Upon NSCC's receipt of the full amount of the Final Guaranty Substitution Payment, NSCC's Guaranty would attach (and OCC's Guaranty will no longer apply) to the Defaulted NSCC Member Transactions. NSCC would have no obligation to accept a Final Guaranty Substitution Payment and attach the NSCC Guaranty to any Defaulted NSCC Member Transactions for more than the Activity Date on which it has ceased to act for that Mutually Suspended Member and one subsequent Activity Date. If NSCC does not receive the full amount of the Final Guaranty Substitution Payment in cash by the agreed upon time, the Guaranty Substitution Time would not occur with respect to the Defaulted NSCC Member Transactions and Section 8(b)(ii), described below, would apply. NSCC would, however, have discretion to voluntarily accept Defaulted NSCC Member Transactions and assume the guaranty for such transactions, subject to certain terms and conditions mutually agreed upon by NSCC and OCC.

Section 6(b)(ii), which would be renumbered as Section 8(b)(ii), would also be amended to reflect the modified use of the Final Guaranty Substitution Payment in the event OCC continues to perform or does not make the Final Guaranty Substitution Payment. In particular, Section 8(b)(ii) would add an additional criterion of OCC not satisfying any alternative agreed upon terms for Guaranty Substitution to reflect this as an additional option under the Phase 2 changes. As amended, Section 8(b)(ii) would provide that if OCC does not suspend an OCC Participating Member for which NSCC has ceased to act, OCC does not commit to make the Final Guaranty Substitution Payment, NSCC does not receive the full amount of the Final Guaranty Substitution Payment in cash by the agreed upon time, or OCC does not satisfy any alternative agreed upon terms for Guaranty Substitution, Guaranty Substitution with respect to all Defaulted NSCC Member Transactions for that Activity Date will not occur, all Defaulted NSCC Member Transactions for that Activity Date will be reversed and exited from NSCC's CNS accounting system, and NSCC will have no obligation to guaranty or settle such Defaulted NSCC Member Transactions. NSCC may, however, exercise its discretion to voluntarily accept the Defaulted NSCC Member Transactions, and assume the guaranty for such transactions, subject to certain agreed upon terms and conditions.

Section 8(b) would also be modified to provide for escalated discussion between the Clearing Agencies in the event of an intraday NSCC Cease to Act and/or NSCC Participating Member Default, particularly to confirm that OCC has sufficient qualifying liquid resources to pay the projected Final Guaranty Substitution Payment for the Defaulting NSCC Member's projected E&A/Delivery Transactions based on information provided in GSP Monitoring Data for such Defaulting NSCC Member.

Conforming changes would also be made to Section 8(d) to reflect the use of the new defined term "Final Guaranty Substitution Payment."

Other Proposed Changes as Part of Phase 2

Certain other technical changes are also proposed as part of the Phase 2 changes, including to conform the Accord to the proposed changes described above. For example, Section 9(c) would be revised regarding information sharing to reflect the introduction of the Historical Peak and Final Guaranty Substitution Payments and the GSP Monitoring Data; Section 4(c)(ix) would be conformed to reflect the addition of "Settlement Date" as a defined term in Section 1; various sections would be renumbered and internal cross-references would be adjusted to reflect the addition of new sections proposed herein; correct current references throughout the Accord to "NSCC Rules and Procedures" would be changed to simply read "the NSCC Rules;" and various non-substantive textual changes would be made to increase clarity.

Section 4(a) would also be modified to reflect that the Eligibility Master Files referenced in that paragraph, which identify Eligible Securities to OCC, are described in the SLA between OCC and NSCC. Section 9(b) would be modified to include OCC's available liquidity resources, including Clearing Fund cash balances in the information OCC provides to NSCC, and to specify that information will be provided on each Activity Date at an agreed upon time and in an agreed upon form by the Clearing Agencies. Finally, Section 16(b) would be modified to provide the correct current delivery address information for NSCC.

The Phase 2 changes would also include an Appendix A that would describe in detail the calculation methodology for the Guaranty Substitution Payment. This would provide the detailed technical calculation to determine each of the Mutually Suspended Member's Required Fund Deposit deficit and liquidity shortfall to NSCC. The full text of Appendix A is filed confidentially with the Commission as Exhibit 5 to this filing.

Phase 2 Guaranty Substitution Process Changes

As described above, the Phase 2 changes would modify the Guaranty Substitution process to reflect the shortened time duration under which the Guaranty Substitution will be processed in order to function in a T+1 environment. Below is a description of how that process would operate. The actual process would be implemented pursuant to a modified SLA between the Clearing Agencies.[81] All times provided below are in Eastern Time and represent the latest time by which the specified action must occur, unless otherwise agreed by the Clearing Agencies.

<u>Weekend Expirations</u>: On Friday (the Activity Date), NSCC would provide OCC with the Historical Peak GSP amount by 8:00 AM. By 5:00 PM on Friday, OCC must acknowledge the Historical Peak GSP and provide evidence of OCC's Clearing Fund cash resources sufficient to cover that amount, following which NSCC would provide the Eligibility Master File by 5:45 PM. By 1:00 AM on Saturday, OCC would then provide NSCC with the E&A/Delivery Transactions file and by 8:00 AM NSCC would provide OCC with the Final GSP, which OCC must commit to pay by 9:00 AM in the event of a mutual suspension of a Common Member.[82] By 8:00 AM Monday (the Settlement Date), if a cease to act is declared over the weekend (or the later of 10:00 AM or one hour after the cease to act is declared if declared on Monday), OCC must pay the Final GSP if there

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81 OCC provided a draft of the SLA illustrating such changes to the Commission as confidential Exhibit 3F to this filing.

82 If OCC does not have sufficient cash resources to pay the Final GSP and the Clearing Agencies are unable to reach an agreement on additional terms for NSCC to accept E&A/Delivery Transactions, OCC must submit a reversal file by 12:30 AM on Monday so that NSCC can remove the E&A/Delivery Transactions from CNS prior to the start of NSCC's overnight processing. *See* confidential Exhibit 3H to this filing for additional details on action deadlines and processing times.

has been a mutual suspension of a Common Member. Finally, by 1:00 PM on Monday, OCC must provide reversals for the defaulted member's E&A/Delivery Transactions if OCC has not satisfied (or will not satisfy) the Final GSP.

Weekday Expirations: On the Activity Date, NSCC would provide OCC with the Historical Peak GSP amount by 8:00 AM. By 5:00 PM on the Activity Date, OCC must acknowledge the Historical Peak GSP and provide evidence of its cash resources in the OCC Clearing Fund sufficient to cover that amount, following which NSCC would provide the Eligibility Master File by 5:45 PM. By 1:00 AM on the Settlement Date (the day after the Activity Date in the T+1 environment), OCC would then provide NSCC with the E&A/Delivery Transactions file, which also constitutes OCC's commitment to pay the Final GSP. By 8:00 AM NSCC would provide OCC with the Final GSP. By the later of 10:00 AM on the Settlement Date or one hour after a cease to act is declared, OCC must pay the Final GSP if there has been a mutual suspension of a Common Member. Finally, by 1:00 PM on the Settlement Date, OCC must provide reversals for the defaulted member's E&A/Delivery Transactions if OCC has not satisfied (or will not satisfy) the Final GSP.

For both Weekend Expirations and Weekday Expirations, Guaranty Substitution will take place only after the Common Members meet their start of day margin funding requirements at NSCC, if any. In a Common Member default event, the Guaranty Substitution will take place when OCC pays the Final GSP to NSCC.

The Clearing Agencies note that the Phase 2 changes described above are designed to change the process by which the GSP is implemented such that the use of the GSP as a mechanism to facilitate the acceptance of settlement obligations by NSCC can continue to operate within the condensed timing for clearance and settlement in a T+1 environment. However, the ultimate use of the GSP, its purpose, and its substantive import would remain consistent with the Phase 1 changes.

Proposed Liquidity Risk Management Framework Changes

OCC proposes changes to the Liquidity Risk Management Framework to incorporate the Phase 2 changes into its liquidity risk management practices. In the Contingency Funding Plan section, OCC would specify that it endeavors to maintain sufficient cash resources to cover its projected settlement demands. Projected settlement demands may include settlements associated with option exercise & assignment activity that create obligations for OCC under the Accord (e.g., Final GSP, Historical Peak GSP). Final and Historical Peak GSP would be defined in the Definitions section. OCC proposes a footnote referencing the proposed Phase 1 changes to the Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description with respect to the Final GSP. Namely, to account for the liquidity demand associated with the potential payment of a Final GSP, OCC would include the peak amount of the entire actual NSCC Required Fund Deposit deficits and SLD start-of-day obligations, without regard to allocation between NSCC and OCC, specific to each CMO Group for the relevant type of expiration on a rolling twelve-month lookback. Moreover, OCC may require the deposit of cash by a Clearing Member pursuant to its current Rules if projected settlement demands exceed OCC liquidity resources available to make settlement in the event of a Clearing Member default.

OCC also proposes related and clarifying changes in the document. For example, OCC would include a minor clarifying change to the Liquidity Risk Identification section to define GSP as a firm-specific liquidity demand. OCC would also amend the Stress Testing and Liquidity Resource Sizing section to incorporate information pertaining to GSP obligations into the annual analysis presented to the Board on projected liquidity demands that OCC may face under a variety of scenarios.

Proposed By-Law Changes

OCC proposes to update its By-Laws to conform with the revised Accord. OCC proposes to remove a reference to Balance Order Accounting Operation to align with the exclusion of transactions settled through NSCC's Balance Order System under the amended definition of Eligible Securities in the Phase 2 Accord.

Implementation Framework

The proposed Phase 1 and Phase 2 changes will be implemented as follows:

- Phase 1: Within 120 days after the date OCC and NSCC receive all necessary regulatory approvals for these proposed changes to the Accord, OCC will implement all Phase 1 changes. OCC would announce the implementation date by an Information Memorandum posted to its public website at least seven days prior to implementation.

- Phase 2: On the compliance date with respect to the final T+1 amendments to Exchange Act Rule 15c6-1(a) established by the SEC, OCC will implement all Phase 2 changes, keep in place any applicable Phase 1 changes that carry over to Phase 2, and decommission all Phase 1 changes that do not apply to Phase 2.[83]

(2) <u>Statutory Basis</u>

OCC believes the proposed changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a registered clearing agency. In particular, OCC believes the proposed changes are consistent with Section

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83 If, due to the timing of regulatory approval, the implementation dates for Phase 1 and Phase 2 overlap, OCC would implement only the Phase 2 changes and Phase 1 changes that carry over to Phase 2.

17A(b)(3)(F) of the Act.[84] Section 17A(b)(3)(F)[85] of the Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and, in general, to protect investors and the public interest. As described above in the Phase 1 changes, OCC believes that modifying its stress testing procedures to enhance its ability to call for additional liquidity resources 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 prompt and accurate clearance and settlement because it would ensure that NSCC accepts the relevant securities settlement obligations 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. The Phase 2 changes are also consistent with Section 17A(b)(3)(F)[86] of the Act and would promote the prompt and accurate clearance and settlement of securities transactions and protect investors and the public interest

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84 15 U.S.C. 78q-1(b)(3)(F).

85 15 U.S.C. 78q-1(b)(3)(F).

86 15 U.S.C. 78q-1(b)(3)(F).

because, as described above, they would facilitate implementation of the new settlement cycle and support the Commission's stated goal of implementing necessary risk reducing changes in connection with the move to T+1 settlement, currently set for May 28, 2024. The Phase 2 changes would further enable OCC to provide certain assurances that would permit NSCC to begin processing E&A/Delivery Transactions prior to Guaranty Substitution occurring – thereby promoting the continued effectiveness of the Guaranty Substitution process in an environment with a shorter settlement cycle. For these reasons, OCC believes that the proposed changes would be beneficial to and protective of OCC, NSCC, their participants, and the markets that they serve and that the proposed changes are therefore designed, in general, to protect investors and the public interest.

OCC believes that the proposed changes are also consistent with the SEC rules that apply to OCC as a covered clearing agency.[87] 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.[88] As described in OCC's publicly available disclosure framework for financial market infrastructures,[89] 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) that implementation of the ability for

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[87] 17 CFR 240.17Ad-22(a)(5).

[88] 17 CFR 240.17Ad-22(e)(20).

[89] *See* The Options Clearing Corporation Disclosure Framework for Financial Market Infrastructures, pg. 105, (2023), *available at https://www.theocc.com/risk-management/pfmi-disclosures*.

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).[90] 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.[91] 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.[92] 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

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[90] 17 CFR 240.17Ad-22(e)(3), (7).

[91] 17 CFR 240.17Ad-22(e)(3).

[92] 17 CFR 240.17Ad-22(e)(7).

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 Guaranty 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 increasing the promotion of market stability. Regarding the Phase 2 changes, OCC believes that the continued ability in a T+1 environment 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.

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

Section 17A(b)(3)(I) of the Act[93] requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposal would impose any burden on competition. The Phase 1 changes would implement changes that would permit OCC in certain circumstances to make a Guaranty Substitution Payment to NSCC so that the

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[93] 15 U.S.C. 78q-1(b)(3)(I).

NSCC Guaranty would take effect for the Defaulted NSCC Member Transactions and the OCC Guaranty would end. The Phase 2 changes would further implement changes that would allow OCC to provide certain assurances to NSCC prior to the default of a Common Member that would enable NSCC to begin processing E&A/Delivery Transactions before the NSCC central counterparty trade guaranty attaches. The proposed changes would not inhibit access to OCC's services in any way, apply to all Clearing Members and do not disadvantage or favor any particular user in relationship to another user. Accordingly, OCC does not believe that the proposed rule change would have any impact or impose a burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

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

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

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

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

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

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 proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2023-007 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-2023-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules.

Do not include personal identifiable information in submissions; you should submit only information that you wish to make available publicly. We may redact in part or withhold entirely from publication submitted material that is obscene or subject to copyright protection.

All submissions should refer to File Number SR-OCC-2023-007 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.[94]

Secretary

[94] 17 CFR 200.30-3(a)(12).

<u>Exhibit 3A</u>

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]

<u>Exhibit 3B</u>

Phase 1 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 for Phase 1. The remainder of Exhibit 3B has been redacted.

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__**Exhibit 3C**__

Phase 1 SLA

This Exhibit 3C contains changes to the SLA for Phase 1. 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.

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<u>Exhibit 3D</u>

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.

[Redacted Pursuant to Rule 24b-2]

<u>Exhibit 3E</u>

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.

[Redacted Pursuant to Rule 24b-2]

<u>Exhibit 3F</u>

Phase 2 SLA

This Exhibit 3F contains changes to the SLA for Phase 2. 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.

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Exhibit 3G

Phase 2 Close-Out Timing

This Exhibit 3G contains information regarding the assumptions and timelines leading up to the mutual declaration of a default for a Common Member and the anticipated timing of OCC's payment of the Final GSP in a T+1 environment.

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<u>Exhibit 3H</u>

T+1 Analysis

This Exhibit 3H includes OCC's analysis regarding the move to T+1 settlement, including relevant timelines, communications between OCC and NSCC on Phase 2 elements, OCC liquidity risk management, and certain terms and conditions associated with the Phase 2 changes.

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Exhibit 4A

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Exhibit 4B

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EXHIBIT 4C

This Exhibit 4C shows amendments to the proposed text as set forth in Exhibit 5A of SR-OCC-2023-007. **Double underlined** text indicates new text and ~~**double strikethrough**~~ text indicates deleted text for Phase 2.

OCC

By-Laws

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.

* * *

C.

(1) – (5) [No change.]

CCC-Eligible
(6) The term "CCC-eligible," as used at any point in time with reference to an underlying security shall mean that securities contracts in the underlying security arising from the exercise or maturity of a cleared security are eligible as of that point in time for settlement through the Continuous Net Settlement Accounting Operation ~~or the Balance Order Accounting Operation~~ of the National Securities Clearing Corporation.

* * *

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 5A

OCC

By-Laws

Underlined text indicates new text and ~~strikethrough~~ text indicates deleted text for Phase 1.

Double underlined text indicates new text and ~~double strikethrough~~ text indicates deleted text for Phase 2.

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.

* * *

C.

(1) – (5) [No change.]

CCC-Eligible
(6) The term "CCC-eligible," as used at any point in time with reference to an underlying security shall mean that securities contracts in the underlying security arising from the exercise or maturity of a cleared security are eligible as of that point in time for settlement through the Continuous Net Settlement Accounting Operation ~~or the Balance Order Accounting Operation~~ of the National Securities Clearing Corporation.

* * *

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, (~~i~~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, (vii) 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 (vii) 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

* * *

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 ordinadary 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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