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June 26, 2018

Mr. Brent Fields, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-0609

RE: The Options Clearing Corporation Rule Filing SR-OCC-2018-008

Dear Mr. Fields:

ABN AMRO Clearing Chicago LLC ("AACC") is submitting this letter in support of The Options Clearing Corporation ("OCC") Rule Filing SR-OCC-2018-008 ("Rule Filing"), which is a proposed rule change to modify OCC's stress testing and clearing fund methodologies. AACC urges the Commission to approve the Rule Filing as expeditiously as possible so that listed options markets continue to function in a safe and efficient manner, and without the undue capital burdens OCC's current clearing fund methodology places upon market participants.

As you are aware OCC is the only the U.S. clearinghouse for listed options, and plays a critical role in supporting the safety and security of the markets it serves.[1] OCC's clearing fund protects OCC and non-defaulting market participants from losses in the event a clearing member fails to meet its obligations to OCC. Currently, OCC sizes its clearing fund based upon anticipated clearing fund draws over a peak five-day rolling average observed over the preceding three months plus a prudential margin of safety (currently set at $1.8 billion).[2] Each clearing member's required clearing fund contribution is based upon an allocation methodology comprised of a weighted average of total risk (35%),[3] cleared volume (15%), and open interest (50%).

AACC believes the Rule Filing remediates two significant problems with OCC's current clearing methodology: 1) OCC's current clearing sizing methodology failing to contain sufficient anti-procyclicality measures, and 2) OCC's current clearing fund contribution allocation methodology failing to appropriately incentivize clearing member risk management. OCC's current clearing fund sizing methodology is fundamentally flawed in that it does not contain sufficient anti-procyclicality measures. Specifically, unexpected increases in the size of OCC's clearing fund in late 2017 and early 2018 improperly removed liquidity from the listed options market, which caused adverse

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[1] OCC also clears futures and stock loan products. *See* https://www.theocc.com/clearing/clearing-services/default.jsp
[2] *See* SR-OCC-2015-009 at https://www.sec.gov/rules/sro/occ/2015/34-74980.pdf.
[3] The "total risk" charge is derived from each clearing member's margin requirement.

downstream effects that exacerbated the problems that initially lead to such unexpected increases. Additionally, OCC's current clearing fund contribution allocation methodology disincentives clearing members from appropriately managing the risk they present to OCC by underweighting total risk and overweighting open interest. As described in additional detail below, AACC believes the Rule Filing makes significant advancements toward remediating these issues and urges the Commission to approve the Rule Filing.

Anti-Procyclicality Changes

AACC believes the Rule Filing implements a number of measures that are intended to provide much needed stability and consistency to the size of OCC's clearing fund. These measures, when considered holistically, should have anti-procylical effects and would remediate the aforementioned industry problems caused by OCC's current clearing fund sizing methodology.

Problems with OCC's Current Clearing Fund Sizing Methodology
Ideally, OCC's clearing fund would be sufficiently large to withstand a wide variety of extreme but plausible market events without a material re-sizing, but not sufficiently large to impact liquidity in the markets OCC serves. However, OCC's current clearing fund sizing methodology is designed to maintain a relatively small clearing fund that is able to quickly respond to sudden increases in exposure to OCC; specifically, increases in volatility.[4] In practice, OCC's current clearing fund sizing methodology has caused the size of OCC's clearing fund to disproportionately increase during periods of high volatility. From a numerical perspective, the size of OCC's clearing fund increased approximately 60% from October 2017 to March 2018 to just under $18 billion.[5] This disproportionate increase in the size of OCC's clearing fund has had procylical effects by causing higher spreads and less liquidity in listed options that, in turn, increase market volatility and tend to further increase the size of OCC's clearing fund under the current sizing methodology. Moreover, the disproportionally large size of OCC's clearing fund has a punitive effect on clearing members servicing market-maker and other risk-neutral customers. Specifically, such market participants experience increased trading costs as a result of OCC's larger clearing fund even though their offsetting and risk-neutral portfolios do not present a material increase in risk to OCC or the marketplace.

Improvements Offered by OCC's Proposed Clearing Fund Sizing Methodology
The clearing fund sizing methodology proposed in the Rule Filing constitutes significant improvements over the current clearing fund sizing methodology in that it: 1) sizes the clearing fund based on a variety of risk factors (not only volatility) thereby making the size of OCC's clearing fund less susceptible to dramatic changes to any one risk factor, and 2) tests the size of the clearing fund on a daily basis against extreme but plausible market events thereby lowering the likelihood that OCC's clearing fund would be

[4] *See* Note 2.
[5] *See* OCC Information Memorandum 42659 dated February 22, 2018.

insufficient to protect OCC and market participants in the event of a clearing member default.

The Rule Filing would implement a sizing methodology that is less reliant on volatility and based upon a more robust set of risk drivers common to the markets OCC serves. Specifically, the Rule Filing describes a sizing methodology based upon hypothetical stress tests that simulate four types of 1 in 80-year shocks to the following risk drivers: the S&P 500, U.S. Dollar Treasury yields (or Canadian Dollar government bond yields), and the Cboe Volatility Index. OCC plans to consistently monitor, review, and augment the shocks to each risk driver as market conditions change. From a theoretical perspective, OCC's proposed sizing methodology constitutes a significant improvement over the current sizing methodology in that the size of the clearing fund would be less influenced by changes in volatility because OCC is introducing other risk drivers into the sizing methodology as well as monitoring and augmenting such risk drivers on a daily basis based on market conditions.

Additionally, it appears the changes proposed in the Rule Filing should cause the size of OCC's clearing fund to become more stable because OCC would test for adequacy and sufficiency on a daily basis using a series of historical and hypothetical stress tests that are rooted in extreme but plausible market events. Specifically, OCC represented it would test, on a daily basis, the adequacy of the total amount of financial resources it collects from all clearing members to ensure it could cover the default of two clearing members in the event of a 1 in 50-year market event. OCC also represented it would test clearing members' individual portfolios to ensure the clearing fund is sufficiently large enough to cover: 1) the default of two clearing members in the event of a repeat of the 2008 financial crisis, and 2) the default of one clearing member in the event of a repeat of the October 1987 market crash. If a clearing member fails a stress test, OCC would collect additional margin from such clearing member before increasing the size of the clearing fund. These measures would seemingly keep the size of the clearing fund sufficiently large so that OCC would not be required to unexpectedly, materially, increase the clearing fund's size under a majority of extreme but plausible market conditions.

Positive Effects of OCC's Proposed Clearing Fund Sizing Methodology
AACC believes the clearing fund sizing methodology changes OCC proposed in the Rule Filing would provide market participants with a level of stability and predictability the current clearing fund sizing methodology fails to deliver because it would lessen the clearing fund's sensitivity to changes in any one risk factor, and is more likely to appropriately size the clearing fund so that additional and unexpected capital contributions from clearing members are not required. In turn, market participants would be provided with greater certainty regarding the amount of capital available to invest in listed options, which would continue to allow for efficient, liquid, and robust listed options markets. Specifically, market participants would be able to invest their capital when opportunities present themselves without fear of having to meet additional and unexpected required clearing fund contributions as well as continue their trading activities without fear of higher trading costs, and decreased liquidity, caused by a disproportionately large clearing fund. When considered in their entirety, the proposed

changes in the Rule Filing constitute a material step forward toward remediating the problems embedded within OCC's current clearing fund sizing methodology.

Contribution Allocation Methodology Changes to More Appropriately Account For Risk

AACC applauds OCC for proposing changes to its clearing fund contribution allocation methodology, and believes such changes would better align clearing members' required clearing fund contribution to the risk they present to OCC and other market participants. Specifically, OCC is proposing to change is clearing fund contribution allocation methodology to 70% total risk, 15% cleared volume, and 15% open interest from 35% total risk, 15% cleared volume, and 50% open interest. These changes would place more emphasis on the economic risk presented by a clearing member's cleared contracts than the operational risk presented by a high volume clearing member, thereby better recognizing certain types of clearing members (i.e., clearing members with market-maker and other risk-neutral customers) present a relatively lower risk to OCC even though they may represent a higher percentage of overall activity. Put another way, OCC is appropriately recognizing that the economic, or directional, risk created by a clearing member's net position at OCC is more likely to strain OCC's financial resources than the operational risk associated with clearing a large number of contracts. Such recognition would allow market-makers and other liquidity providers to function without undue capital burdens and continue their important role in facilitating safe, deep, and liquid markets in listed options.

The proposed contribution allocation methodology changes in the Rule Filing also make sense from a default and liquidation perspective. Specifically, in the event of a clearing member default, and in order to reduce the default management related costs incurred by OCC that are charged against the clearing fund, the defaulting clearing member would likely attempt to quickly port its positions or OCC would likely sell such positions at auction.[6] The defaulting clearing member or OCC would be more successful porting or auctioning, as applicable, a risk-neutral portfolio than one with economic risk, particularly given the limited number of clearing members that service institutional customers. In any default situation time is of the essence, and non-defaulting clearing members are less likely to acquire incremental economic risk without a careful analysis of the type and amount of risk being acquired. Conversely, a portfolio with little to no economic risk could be quickly sold to other clearing members or auction participants without such an analysis.[7] Therefore a defaulting clearing member with a risk-neutral portfolio (i.e., lower "total risk") would place a lower strain OCC's clearing fund (when compared to a defaulting clearing member with a risky portfolio) because its portfolio is more likely to be timely sold to another clearing member or market participant.

Based on the above, a clearing member with a risk neutral portfolio should not be required to contribute the same amount to OCC's clearing fund as a clearing member with a risky

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[6] *See* OCC Rule 1104, which delineates OCC's auction process.

[7] Specifically, OCC endeavors to maintain a pool of pre-qualified auction bidders. *See* OCC Rule 1104, Interpretation and Policy .02(c).

portfolio, and AACC praises OCC's appropriate decision to increase the emphasis on total risk and decrease the emphasis on open interest in its clearing fund contribution allocation methodology.

Conclusion

AACC is supportive of the clearing fund sizing and contribution allocation methodology changes OCC proposed in the Rule Filing, and believes such changes would have positive effects on the listed options market. Specifically, market participants would have greater certainty regarding their required capital contributions to OCC's clearing fund as well as be appropriately charged for the risk they present to OCC, the listed options market, and other market participants. Holistically, the changes proposed in the Rule Filing would more appropriately allocate capital to market-makers and other risk-neutral market participants that create liquidity and provide stability in the markets OCC serves. For these reasons, the Commission should work as expeditiously as possible to approve the Rule Filing.

Respectfully submitted,

Andrej Bolkovic
CEO

AB/SK/cjb