Subject: Comments on SR-OCC-2024-001 34-99393

Thank you for the opportunity to comment on SR-OCC-2024-001 34-99393 entitled “Proposed Rule Change by The Options Clearing Corporation Concerning Its Process for Adjusting Certain Parameters in Its Proprietary System for Calculating Margin Requirements During Periods When the Products It Clears and the Markets It Serves Experience High Volatility” (PDF, Federal Register) as a retail investor. I have several concerns about the OCC rule proposal, do not support its approval, and appreciate the opportunity to comment.

I’m concerned about the lack of transparency in our financial system as evidenced by this rule proposal, amongst others. The details of this proposal in Exhibit 5 along with supporting information (see, e.g., Exhibit 3) are significantly redacted which prevents public review making it impossible for the public to meaningfully review and comment on this proposal. Without opportunity for a full public review, this proposal should be rejected on that basis alone.

Public review is of the particular importance as the OCC’s Proposed Rule blames U.S. regulators for failing to require the OCC adopt prescriptive procyclicality controls (“U.S. regulators chose not to adopt the types of prescriptive procyclicality controls codified by financial regulators in other jurisdictions.” [1]). As “procyclicality may be evidenced by increasing margin in times of stressed market conditions” [2], an “increase in margin requirements could stress a Clearing Member's ability to obtain liquidity to meet its obligations to OCC” [Id.] which “could expose OCC to financial risks if a Clearing Member fails to fulfil its obligations” [3] that “could threaten the stability of its members during periods of heightened volatility” [2]. With the OCC designated as a SIFMU whose failure or disruption could threaten the stability of the US financial system, everyone dependent on the US financial system is entitled to transparency. As the OCC is classified as a self-regulatory organization, the OCC blaming U.S. regulators for not requiring the SRO adopt regulations to protect itself makes it apparent that the public can not fully rely upon the SRO and/or the U.S. regulators to safeguard our financial markets.

This particular OCC rule proposal appears designed to protect Clearing Members from realizing the risk of potentially costly trades by rubber stamping reductions in margin requirements as required by Clearing Members; which would increase risks to the OCC. Per the OCC rule proposal:

The OCC collects margin collateral from Clearing Members to address the market risk associated with a Clearing Member’s positions. [3]

OCC uses a proprietary system, STANS (“System for Theoretical Analysis and Numerical Simulation”), to calculate each Clearing Member's margin requirements with various models. One of the margin models may produce “procyclical” results where margin requirements are correlated with volatility which “could threaten the stability of its members during periods of heightened volatility”. [2]

An increase in margin requirements could make it difficult for a Clearing Member to obtain liquidity to meet its obligations to OCC. If the Clearing Member defaults, liquidating the Clearing Member positions could result in losses chargeable to the Clearing Fund which could create liquidity issues for non-defaulting Clearing Members. [2]

Basically, a systemic risk exists because Clearing Members as a whole are insufficiently capitalized and/or over-leveraged such that a single Clearing Member failure (e.g., from insufficiently managing risks arising from high volatility) could cause a cascade of Clearing Member failures. In layman’s terms, a Clearing Member who made bad bets on Wall St could trigger a systemic financial crisis because Clearing Members as a whole are all risking more than they can afford to lose.

The OCC's rule proposal attempts to avoid triggering a systemic financial crisis by reducing margin requirements using "idiosyncratic" and "global" control settings; highlighting one instance for one individual risk factor that "[a]fter implementing idiosyncratic control settings for that risk factor, aggregate margin requirements decreased $2.6 billion." [4] The OCC chose to avoid margin calling one or more Clearing Members at risk of default by implementing "idiosyncratic" control settings for a risk factor. According to footnote 35 [5], the OCC has made this "idiosyncratic" choice over 200 times in less than 4 years (from December 2019 to August 2023) of varying durations up to 190 days (with a median duration of 10 days). The OCC is choosing to waive away margin calls for Clearing Members over 50 times a year; which seems too often to be idiosyncratic. In addition to waiving away margin calls for 50 idiosyncratic risks a year, the OCC has also chosen to implement "global" control settings in connection with long tail [6] events including the onset of the COVID-19 pandemic and the so-called "meme-stock" episode on January 27, 2021. [7]

Fundamentally, these rules create an unfair marketplace for other market participants, including retail investors, who are forced to face the consequences of long-tail risks while the OCC repeatedly waives margin calls for Clearing Members by repeatedly reducing their margin requirements. For this reason, this rule proposal should be rejected and Clearing Members should be subject to strictly defined margin requirements as other investors are.

Per the OCC, this rule proposal and these special margin reduction procedures exist because a single Clearing Member defaulting could result in a cascade of Clearing Member defaults potentially exposing the OCC to financial risk. [8] Thus, Clearing Members who fail to properly manage their portfolio risk against long tail events become de facto Too Big To Fail. For this reason, this rule proposal should be rejected and Clearing Members should face the consequences of failing to properly manage their portfolio risk, including against long tail events. Clearing Member failure is a natural disincentive against excessive leverage and insufficient capitalization as others in the market will not cover their loss.

This rule proposal codifies an inherent conflict of interest for the Financial Risk Management (FRM) Officer. While the FRM Officer's position is allegedly to protect OCC's interests, the situation outlined by the OCC proposal where a Clearing Member failure exposes the OCC to financial risk necessarily requires the FRM Officer to protect the Clearing Member from failure to protect the OCC. Thus, the FRM Officer is no more than an administrative rubber stamp to reduce margin requirements for Clearing Members at risk of failure. Unfortunately, rubber stamping margin requirement reductions for Clearing Members at risk of failure vitiates the protection from market risks associated with Clearing Member's positions provided by the margin collateral that would have been collected by the OCC. For this reason, this rule proposal should be rejected and the OCC should enforce sufficient margin requirements to protect the OCC and minimize the size of any bailouts that may already be required.

As the OCC's Clearing Member Default Rules and Procedures [9] Loss Allocation waterfall allocates losses to "3. OCC's own pre-funded financial resources" (OCC 's "skin-in-the-game" per SR-OCC-2021-801 34-91491 [10]) before "4. Clearing fund deposits of non-defaulting firms", any sufficiently large Clearing Member default which exhausts both "1. The margin deposits of the suspended firm" and "2. Clearing fund deposits of the suspended firm" automatically poses a financial risk to the OCC. As this rule proposal is concerned with potential liquidity issues for non-defaulting Clearing Members as a result of charges to the Clearing Fund, it is clear that the OCC is concerned about risk which exhausts OCC's own pre-funded financial resources. With the first and foremost line of protection for the OCC being "1. The margin deposits of the suspended firm", this rule proposal to reduce margin requirements for at risk Clearing Members via idiosyncratic control settings is blatantly illogical and nonsensical. By the OCC's own admissions regarding the potential scale of financial risk posed by a defaulting Clearing Member, the OCC should be increasing the amount of margin collateral required from the at risk Clearing Member(s) to increase their protection from market risks associated with Clearing Member's positions and promote appropriate risk management of

Clearing Member positions. Curiously, increasing margin requirements is exactly what the OCC admits is predicted by the allegedly “procyclical” STANS model [2] that the OCC alleges is an overestimation and seeks to mitigate [11]. If this rule proposal is approved, mitigating the procyclical margin requirements directly reduces the first line of protection for the OCC, margin collateral from at risk Clearing Member(s), so this rule proposal should be rejected, made fully available for public review, and approved only with significant amendments to address the issues raised herein.

In light of the issues outlined above, please consider the following modifications:

Increase and enforce margin requirements commensurate with risks associated with Clearing Member positions instead of reducing margin requirements. Clearing Members should be encouraged to position their portfolios to account for stressed market conditions and long-tail risks. This rule proposal currently encourages Clearing Members to become Too Big To Fail in order to pressure the OCC with excessive risk and leverage into implementing idiosyncratic controls more often to privatize profits and socialize losses.

External auditing and supervision as a “fourth line of defense” similar to that described in The “four lines of defence model” for financial institutions [12] with enhanced public reporting to ensure that risks are identified and managed before they become systemically significant.

Swap “3. OCC’s own pre-funded financial resources” and “4. Clearing fund deposits of non-defaulting firms” for the OCC’s Loss Allocation waterfall so that Clearing fund deposits of non-defaulting firms are allocated losses before OCC’s own pre-funded financial resources and the EDCP Unvested Balance. Changing the order of loss allocation would encourage Clearing Members to police each other with each Clearing Member ensuring other Clearing Members take appropriate risk management measures as their Clearing Fund deposits are at risk after the deposits of a suspended firm are exhausted. This would also increase protection to the OCC, a SIFMU, by allocating losses to the clearing corporation after Clearing Member deposits are exhausted. By extension, the public would benefit from lessening the risk of needing to bail out a systemically important clearing agency.

Thank you for the opportunity to comment as all investors benefit from a fair, transparent, and resilient market.

[1] https://www.federalregister.gov/d/2024-01386/p-11

[2] https://www.federalregister.gov/d/2024-01386/p-8

[3] https://www.federalregister.gov/d/2024-01386/p-7

[4] https://www.federalregister.gov/d/2024-01386/p-50

[5] https://www.federalregister.gov/d/2024-01386/p-51

[6] https://en.wikipedia.org/wiki/Long_tail

[7] https://www.federalregister.gov/d/2024-01386/p-45

[8] https://www.federalregister.gov/d/2024-01386/p-79

[9] https://www.theocc.com/getmedia/e8792e3c-8802-4f5d-bef2-ada408ed1d96/default-rules-and-procedures.pdf, which is publicly available and linked to from the OCC’s web page on Default Rules & Procedures at https://www.theocc.com/risk-management/default-rules-and-procedures

[10] https://www.federalregister.gov/documents/2021/04/12/2021-07454/self-regulatory-organizations-the-options-clearing-corporation-notice-of-no-objection-to-advance

[11] https://www.federalregister.gov/d/2024-01386/p-16

[12] https://www.bis.org/fsi/fsipapers11.pdf

Sincerely,

A Concerned Retail Investor