SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-100455; File No. SR-OCC-2024-006)

July 2, 2024

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change by The Options Clearing Corporation Concerning Amendments to Its Rules and Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description

I. Introduction

On May 2, 2024, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),[1] and Rule 19b-4 thereunder,[2] a proposed rule change (the "Proposed Rule Change") to amend its Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description ("Methodology Description") to incorporate additional stress scenarios into OCC's financial resource sufficiency monitoring and its Rules to clarify OCC's practice of collecting additional collateral from its members based on such monitoring. The Proposed Rule Change was published for comment in the *Federal Register* on May 21, 2024.[3] The Commission has not received any comments on the Proposed Rule Change. For the reasons discussed below, the Commission is approving the Proposed Rule Change.

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

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 100147 (May 15, 2024), 89 FR 44752 (May 21, 2024) (File No. SR-OCC-2024-006) ("Notice").

II. Description of the Proposed Rule Change

As a clearing agency, OCC faces a number of risks including credit and liquidity risk.[4] OCC manages its credit and liquidity risk, in part, by performing daily stress testing[5] that covers a wide range of scenarios.[6]

OCC groups its stress testing scenarios into different categories, including Sufficiency Scenarios and Informational Scenarios.[7] Sufficiency Scenarios are designed to measure the potential exposures that a Clearing Member Group's portfolios present relative to OCC's credit and liquidity resources so that OCC can determine the potential need to call for additional collateral, either as margin or as Clearing Fund collateral, or adjust the forms of collateral on deposit.[8] Specifically, depending on Sufficiency Scenario results, OCC Rules 609 or 1001 may allow or require OCC to call for additional margin or Clearing Fund resources from a Clearing Member.[9] Moreover, under OCC Rules 601 and 609, OCC could require that a Clearing Member provide additional resources in the form of cash.[10] In contrast, OCC uses Informational Scenarios to monitor and assess the size of OCC's prefunded financial resources against a wide range

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4 Credit Risk is the risk that a counterparty will be unable to meet fully its financial obligations when due, or at any time in the future. Liquidity Risk is the risk that a counterparty will have insufficient funds to meet its financial obligations as and when expected, although it may be able to do so in the future. Bank for International Settlements & International Organization of Securities Commissions, *Principles for Financial Market Infrastructures*, https://www.bis.org/cpmi/publ/d101a.pdf.

5 Stress testing is the estimation of credit or liquidity exposures that would result from the realization of potential stress scenarios, such as extreme price changes, multiple defaults, or changes in other valuation inputs and assumptions. 17 CFR 240.17Ad-22(a).

6 Notice, 89 FR at 44753; *see* OCC Rule 609, OCC Rule 1001.

7 Capitalized terms used but not defined herein have the meanings specified in OCC's Rules and By-Laws, available at *https://www.theocc.com/about/publications/bylaws.jsp*.

8 Notice, 89 FR at 44753.

9 *Id.*

10 *Id.* at 44754 n.20.

of stress scenarios for informational and risk monitoring purposes.[11] These scenarios are not used to determine the size of OCC's financial resources; however, OCC's Risk Committee may approve adjustments with respect to how OCC categorizes these scenarios.[12] For example, OCC's Risk Committee could approve the recategorization of an Informational Scenario as a Sufficiency Scenario.[13]

The Proposed Rule Change would make three groups of changes related to OCC's Sufficiency Scenarios. First, it would recategorize two Informational Scenarios as Sufficiency Scenarios by making changes to the Methodology Description.[14] As a result, the two recategorized scenarios would be used to determine potential calls for additional collateral. Second, the Proposed Rule Change would add detail to OCC's Rules outlining circumstances under which OCC could require Clearing Members to contribute additional collateral due to the results of Sufficiency Scenarios. Third, the Proposed Rule Change would make minor formatting and grammatical changes to the Methodology Description and the Rules.

A. Recategorization of Scenarios

OCC's Methodology Description lists a subset of the Sufficiency Scenarios that have been implemented in OCC's stress testing system. The Sufficiency Scenarios on this list are historical scenarios that replicate historical events under current market

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11 *Id.* at 44753.

12 *Id.*

13 *Id.*

14 The Methodology Description describes the Comprehensive Stress Testing and Clearing Fund Methodology, and Liquidity Risk Management Description that OCC uses to analyze the adequacy of its financial resources and to challenge its risk management framework. *Id.* at 44573 n.5.

conditions. For example, among the listed Sufficiency Scenarios are scenarios that replicate the largest rally/decline in 2008.

To replicate historical events in its current Sufficiency Scenarios, OCC applies one of three price shocks to risk factors in a predetermined order, also referred to as a waterfall.[15] As its first choice for a price shock, OCC uses the returns of the risk factor observed during the historical event. If such returns do not exist, or are otherwise unavailable, OCC uses the market return from the risk factor's corresponding sector as the price shock. If neither the risk factor return nor the market sector return is available, OCC uses a beta approach to set the price shock.[16] Currently, OCC applies this waterfall to determine price shocks for the 2008 largest rally/decline Sufficiency Scenarios.

Some of OCC's Informational Scenarios use a different approach to determine the price shock applied to risk factors than the existing Sufficiency Scenarios use, which yields different outcomes. For example, some existing Informational Scenarios are variations of the 2008 largest rally/decline Sufficiency Scenarios that directly apply the risk driver beta-derived price shock as the price shock instead of using the waterfall approach. As part of the regular review of the output of its stress scenarios, OCC found that the variations of the 2008 largest rally/decline Informational Scenarios described above yielded exposures that were consistently higher than those generated by the

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15 Risk factors are products or attributes whose historical data are used to estimate and simulate the risk for an associated product. *Id.* at 44574 n.12.

16 Beta is the sensitivity of a security with respect to its corresponding risk driver. *Id.* at 44754 n.14. Examples of risk drivers include price and volatility with respect to equity securities. Different categories of products—for example, collateral positions in U.S. Government Securities versus Canadian Government Securities—have different risk drivers. *Id.* at 44754 n.15. The risk driver shock is the return of a risk driver from a historical event. *Id.* at 44754. The beta approach is the application of the shock of a risk driver to the beta of the related risk factor, which generates a "risk driver beta derived price shock."

corresponding Sufficiency Scenarios.[17] To enhance its ability to manage risks, OCC proposes recategorizing such variations of the 2008 largest rally/decline scenarios from Informational Scenarios to Sufficiency Scenarios by adding them to the Sufficiency Scenarios listed in OCC's Methodology Description.[18] This would allow the newly-recategorized Sufficiency Scenarios to be used to drive the size of the Clearing Fund and calls for additional margin, which is not the case while they remain categorized as Informational Scenarios.[19]

B. Changes to the Rules Related to Intra-Day Margin and the Clearing Fund

OCC also proposes changes to its Rules to clarify OCC's practice of collecting additional collateral from its members based on stress scenario monitoring. Specifically, OCC proposes changes to Rule 609, which governs intra-day margin, and Rule 1001(c), which governs intra-month clearing fund sizing adjustments. OCC proposes these changes to align the Rules with OCC's current practices and procedures.[20]

Some of the proposed changes to Rule 609 clarify OCC's approach to situations where a Clearing Member Group is subject to an intra-day margin call under more than one Sufficiency Stress Test. Rule 609(a)(5) currently provides that OCC may require the Clearing Member Group responsible for a stress test exposure to deposit intra-day margin if a Sufficiency Stress Test identifies an exposure that exceeds 75% of the current Clearing Fund requirement less deficits.[21] In the event of such a margin call, OCC's

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17 *Id.* at 44753.

18 *Id.*

19 *Id.*

20 *Id.* at 44754-55.

21 *Id.* at 44754; OCC Rule 609(a)(5).

current practice is to compare the margin call amount to existing intra-day margin call amounts for the monthly period under OCC Rule 609(a)(5). A new margin call is issued when the margin call amount is greater than existing intra-day margin call amounts under Rule 609(a)(5). The updated margin call amount would remain in effect until either the next monthly resizing of the Clearing Fund, or the amount is superseded by a larger margin call amount.[22] To reflect this current practice,[23] and consistent with the Clearing Fund Methodology Policy,[24] OCC proposes adding language to Rule 609(a)(5) noting that if a Clearing Member Group is subject to intra-day margin calls under more than one Sufficiency Stress Test, the largest call will be applied and remain in effect until the next monthly resizing.[25]

Separately, OCC proposes to conform Rule 609(a)(5) to OCC's existing policies.[26] As noted above, current Rule 609(a)(5) requires the Clearing Member Group responsible for a stress test exposure to deposit margin intra-day if a Sufficiency Stress Test identifies an exposure that exceeds 75% of the current Clearing Fund requirement less deficits. OCC's Clearing Fund Methodology Policy contains similar language with a notable difference. Specifically, the Clearing Fund Methodology Policy does not include the "less deficits" language, while such language is in OCC Rule 609(a)(5).[27] This

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22 Notice, 89 FR at 44754.

23 *Id.*

24 Securities Exchange Act Release No. 83406 (June 11, 2018), 83 FR 28018, 28025 (June 15, 2018) (File No. SR-OCC-2018-008).

25 While a margin call imposed as the result of a Sufficiency Stress Test will remain in effect until the next monthly Clearing Fund resizing, the imposition of such a margin call would not preclude OCC from making additional margin calls driven by subsequent Sufficiency Stress Tests prior to the monthly resizing.

26 Notice, 89 FR at 44755.

27 *Id.*

language was removed from the Clearing Fund Methodology Policy in an effort to conform the Clearing Fund Methodology Policy to changes to OCC's Rules, shortening the number of days a Clearing Member has to meet funding obligations related to the Clearing Fund.[28] Given the previous change to its rules, OCC considers the "less deficits" language in each document unnecessary.[29] As such, OCC proposes removing the "less deficits" language from Rule 609(a)(5) to promote consistency within its rules.[30]

OCC also proposes changes to Rule 1001(c) to reflect its current practices.[31] Rule 1001(c) currently indicates that, if at any time between regular monthly calculations of the size of the Clearing Fund a Sufficiency Stress Test identifies a breach that exceeds 90% of the size of the Clearing Fund requirement (less any margin collected as a result of a Sufficiency Stress Test breach pursuant to Rule 609), the calculated size of the Clearing Fund shall be increased. As is reflected in OCC's Clearing Fund Methodology Policy, OCC's current practice is to include margin called, rather than only margin collected, in the amount subtracted in the calculation from Rule 1001(c).[32] To align the descriptions in OCC's Rules with OCC's current practices, OCC proposes adding "or to be collected" to the text or Rule 1001(c).[33]

C. Minor Formatting and Grammatical Changes

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28 Securities Exchange Act Release No. 94950 (May 19, 2022), 87 FR 31916, 31918 (May 25, 2022) (File No. SR-OCC-2022-004). Prior to approval of SR-OCC-2022-004, Clearing Members had two days to deposit additional required Clearing Fund assets. In SR-OCC-2022-004, OCC proposed to shorten this period. *Id.*; Notice, 89 FR at 44755.

29 Notice, 89 FR at 44755.

30 *Id.*

31 *Id.*

32 *Id.* at 44755 n.27.

33 *Id.* at 44755.

OCC also proposes several minor formatting and grammatical changes to its rules. In the Methodology Description, OCC proposes minor edits to correct the formatting of footnotes. Additionally, in the Rules, OCC proposes replacing the words "such that" with "from" and adding the word "that" to Rule 609(a)(5) so that it reads "stress test exposures from a Sufficiency Stress Test (as defined in Rule 1001(a)) that identifies an exposure" instead of "stress test exposures such that a Sufficiency Stress Test (as defined in Rule 1001(a)) identifies an exposure."

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act requires the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the Proposed Rule Change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the organization.[34] Under the Commission's Rules of Practice, the "burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change."[35]

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,[36] and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent

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34 15 U.S.C. 78s(b)(2)(C).

35 Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

36 *Id.*

with the Exchange Act and the applicable rules and regulations.[37] Moreover, "unquestioning reliance" on an SRO's representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.[38]

After carefully considering the Proposed Rule Change, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, for the reasons given below, the Commission finds that the Proposed Rule Change is consistent with Section 17A(b)(3)(F) of the Act[39] and Rule 17Ad-22(e)(4) thereunder.[40]

A. Consistency with Section 17A(b)(3)(F) of the Act

Under Section 17A(b)(3)(F) of the Act, OCC's rules, among other things, must be "designed to promote the prompt and accurate clearance and settlement of securities transactions . . . derivative agreements, contracts, and transactions . . . and to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible."[41] Based on its review of the record, and for the reasons discussed below, OCC's changes are consistent with Section 17A(b)(3)(F) of the Act[42] because they decrease the likelihood of loss mutualization, may increase, and cannot decrease, the amount of financial resources that OCC collects to address credit

37 *Id.*

38 *Susquehanna Int'l Group, LLP v. Securities and Exchange Commission*, 866 F.3d 442, 447 (D.C. Cir. 2017) ("Susquehanna").

39 15 U.S.C. 78q-1(b)(3)(F).

40 17 CFR 240.17Ad-22(e)(4).

41 15 U.S.C. 78q-1(b)(3)(F).

42 *Id.*

losses that could arise from the default of a Clearing Member, and support OCC's robust default management system.

OCC's proposal to elevate Informational Scenarios to Sufficiency Scenarios may decrease the likelihood of loss mutualization. As noted above, OCC proposes to expand the scope of stress scenarios against which OCC monitors its financial resources by elevating, from Informational Scenarios to Sufficiency Scenarios, variations on their 2008 largest rally/decline scenarios, which first apply the risk driver beta-derived price shock as the price shock as opposed to using the waterfall approach. Once these scenarios are elevated to Sufficiency Scenarios, they would be used to determine whether it is necessary to call for additional margin intra-day or an increase to the size of the Clearing Fund intra-month.[43] By elevating the Informational Scenarios to Sufficiency Scenarios, OCC creates a wider range of stress scenarios. Having a wider range of stress scenarios may, in turn, increase the likelihood that OCC will have sufficient collateral on hand to address a default without resorting to loss mutualization through the use of non-defaulting Clearing Members' contributions to the Clearing Fund. Because it avoids loss mutualization, the Proposed Rule Change is consistent with the safeguarding of securities and funds which are in OCC's custody or control.

OCC's proposed changes to its Sufficiency Stress Tests also may increase, and cannot decrease, the amount of financial resources that OCC collects to address credit losses that could arise from the default of a Clearing Member. Based on the impact analyses filed with this Proposed Rule Change, the proposed change could result in OCC calling for additional resources available for resolving a member default. The data

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[43] OCC Rule 609(a)(5); OCC Rule 1001(c).

provided demonstrates that the proposed scenarios could produce more conservative results relative to the current 2008 largest rally/decline scenarios. Because OCC does not propose removing any of its existing Sufficiency Scenarios, the proposed changes could not reduce the resources OCC would collect. By maintaining, and potentially increasing, the financial resources OCC collects to address credit losses that could arise from the default of a Clearing Member, the proposed change to OCC's stress tests would potentially help OCC recover from the default of a Clearing Member and could make OCC's default waterfall more robust. As such, it would increase the likelihood that OCC would be able to provide clearing services during and after a Clearing Member default, which is consistent with OCC's ability to promptly and accurately clear and settle securities transactions for participants in the options markets during periods of market stress.

Separately, the proposed changes to conform OCC's Rules 609 and 1001 to current practice would continue to support OCC's risk management systems. As described above, the proposed changes would make minor changes, remove unnecessary language, and acknowledge that, when determining whether to call for additional collateral based on OCC's Sufficiency Stress Tests, if a Clearing Member Group is subject to intra-day margin calls under more than one Sufficiency Stress Test, only the largest margin call will be applied and remain in effect until the next monthly resizing. Further, OCC proposes that it account for margin called as a result of a Sufficiency Stress Test breach under Rule 609 when determining whether it must increase the size of the Clearing Fund. Such changes would not reduce the total resources called by OCC. Continuing to require that members contribute resources based on the exposures they pose (as measured by the Sufficiency Scenarios) would increase the likelihood that OCC would have sufficient resources to manage its exposure to such a member in the event of a default. This would increase the likelihood that OCC could promptly and accurately clear transactions in the event of a default. Additionally, requiring members to contribute resources based on the exposures they pose would increase OCC's ability to manage a default with the defaulter's resources and would reduce the risk that OCC would be required to use the resources of other members to manage a default, consistent with OCC's ability to safeguard the funds and securities of such non-defaulting members.

Further, OCC's rules require that members meet such calls in a timely manner.[44] As a result, OCC's rules do not preclude OCC from taking additional steps, such as suspending a member, if it does not receive the required resources promptly. Thus, OCC's rules, both current and as proposed, allow OCC to act quickly to mitigate potential losses and liquidity shortfalls. Such authority reduces the risk that OCC would be unable to continue providing clearance and settlement services, which is consistent with the promotion of the prompt and accurate settlement of securities for the markets OCC serves.

Based on the foregoing, the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Act.[45]

B. Consistency with Rule 17Ad-22(e)(4) under the Act

Rule 17Ad-22(e)(4) requires covered clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively

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[44] *See e.g.*, OCC Rule 609(a) (requiring that members meet intra-day margin calls within one hour of issuance).

[45] 15 U.S.C. 78q-1(b)(3)(F).

identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes by testing the sufficiency of its total financial resources available to meet the minimum financial resource requirements under Rules 17Ad-22(e)(4)(i) through (iii) under the Act.[46] Under Rule 17Ad-22(e)(4)(vi)(A), OCC's policies and procedures should provide that OCC conduct such stress testing of its total financial resources once each day using standard predetermined parameters and assumptions.[47]

The Proposed Rule Change is consistent with Rule 17Ad-22(e)(4)(vi) because it broadens the scope of stress scenarios that OCC conducts to test its financial resources. Expanding the scope of stress scenarios against which OCC monitors its financial resources would increase the likelihood that OCC maintains sufficient financial resources at all times.[48] This Proposed Rule Change would expand the scope of stress scenarios by elevating two Informational Scenarios to Sufficiency Scenarios. This expansion could result in the collection of additional resources available for resolving a member default, which, in turn, would increase the likelihood that OCC maintains sufficient financial resources at all times.[49]

Based on the foregoing, the Proposed Rule Change is consistent with the requirements of Rule 17Ad-22(e)(4) under the Act.[50]

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46 17 CFR 240.17Ad-22(e)(4)(vi).

47 17 CFR 240.17Ad-22(e)(4)(vi)(A).

48 *See* Securities Exchange Act Release No. 90827 (Dec. 30, 2020), 86 FR 659, 661 (Jan. 6, 2021) (File No. SR-OCC-2020-015); Securities Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855, 37863 (Aug. 2, 2018) (File No. SR-OCC-2018-008).

49 The Proposed Rule Change does not alter OCC's daily implementation of its Sufficiency Stress Tests. Notice, 89 FR at 44753. Thus, the OCC's Sufficiency Stress Testing continues to be consistent with Rule 17Ad-22(e)(4)(vi)(A)'s daily testing requirements.

50 17 CFR 240.17Ad-22(e)(4).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Act, and in particular, Section 17A(b)(3)(F) of the Act[51] and Rule 17Ad-22(e)(4).[52]

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act that the Proposed Rule Change (SR-OCC-2024-006) be, and hereby is, approved.[53]

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.[54]

Sherry R. Haywood,

Assistant Secretary.

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51 15 U.S.C. 78q-1(b)(3)(F).

52 17 CFR 240.17Ad-22(e)(4).

53 In approving the Proposed Rule Change, the Commission considered the proposal's impacts on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

54 17 CFR 200.30-3(a)(12).