



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72804; File No. SR-OCC-2014-804)

August 11, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice to Permit OCC to Adjust the Size of its Clearing Fund Intra-Month and Clearing Member's Clearing Fund Contributions Intra-Month

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act")¹ and Rule 19b-4(n)(1)(i) of the Securities Exchange Act of 1934² notice is hereby given that on July 22, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.³ The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

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

This advance notice is filed by OCC in connection with a proposed change that would permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure and on an emergency basis. In addition, the proposed change provide [sic] that under certain circumstances OCC will increase a clearing member's required contribution to OCC's clearing fund intra-month.

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i).

³ OCC also filed the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. See SR-OCC-2014-17; 15 U.S.C. 78s(b)(1); 17 CFR 240.19b-4.

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

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

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

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

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

The proposed change would permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure or on an emergency basis as well as permit adjustments to a clearing member's required contribution to the clearing fund at any time, including between regular monthly calculations, under certain circumstances. OCC is filing this advance notice pursuant to Section 806(e)(1) of the Clearing Supervision Act⁴ because the change could be deemed to materially affect the nature or level of risks presented by OCC. The proposed change will also be filed as a proposed rule change filing.

⁴ 12 U.S.C. 5465(e)(1).

PURPOSE OF THE PROPOSED CHANGE

OCC is proposing to modify Rule 1001, which concerns the sizing of OCC's clearing fund and the allocation of clearing member contributions thereto. First, by adding Interpretation and Policy .05, Rule 1001 would be revised to permit OCC to increase the size of its clearing fund intra-month based upon observed changes in OCC's projected exposure or on an emergency basis. Second, by adding Interpretation and Policy .06, Rule 1001 would be revised to permit increases to a clearing member's required contribution to the clearing fund at any time, including between regular monthly calculations, under certain circumstances. Rule 1001(b) and 1001(f) would also be revised to clarify certain terminology relating to the calculation of clearing fund contributions, and an Interpretation and Policy would be added to Article VIII, Section 2 of the By-Laws to clarify that this section, which addresses rule changes that increase a clearing member's required clearing fund contributions, does not apply to actions taken under Interpretations and Policies .05 or .06 to Rule 1001.

Background

The primary purpose of OCC's clearing fund is to provide a high degree of assurance that market integrity will be maintained in the event that one or more clearing members fails to meet its obligations to OCC.⁵ The clearing fund can also be used to meet the obligations resulting from the default of any bank or securities or commodities clearing organization to which OCC is exposed. The clearing fund supplements the financial safeguards afforded by OCC's membership standards and margin requirements.

⁵ See, Article VIII, Section 1 of OCC's By-Laws which sets forth the purpose of the clearing fund.

Currently, the size of the clearing fund is adjusted monthly. On each business day OCC calculates its hypothetical exposure, at a confidence level of at least 99%, under simulated default scenarios that include an “idiosyncratic default” of a single clearing member group⁶ and a “minor systemic event” involving the near-simultaneous default of two random clearing members. OCC then treats the greater of these two hypothetical exposures as that day’s projected peak exposure. OCC also computes the projected draws from the clearing fund that would be necessary in connection with each business day’s projected peak exposure. To determine the overall size of the clearing fund, on the first business day of each month, OCC averages these daily projected clearing fund draws over the prior month and uses that average as the required size of the clearing fund for that month. However, notwithstanding this calculation, in no event will the size of the clearing fund be set at less than 110% of the size of OCC’s committed credit facilities secured by the clearing fund, in order to assure that at all times OCC will have collateral to pledge sufficient to draw the entire amount of such facilities. OCC publishes the new clearing fund requirement on the first business day of each month and clearing members have five business days to meet the new requirement.⁷

The foregoing calculations and the allocations among clearing members are based on the prescribed formulas included in Rules 1001(a) and 1001(b), respectively, as supplemented by Interpretation and Policy .01 to Rule 1001. These formulas were

⁵ A Clearing Member Group is a clearing member and any other clearing member that is affiliated with such clearing member. *See* Article 1, Section 1, C. (15) of OCC’s By-Laws.

⁷ *See* OCC Rules 1002 and 1003, respectively.

adopted pursuant to a change effective April 18, 2013.⁸ The Rules do not, however, provide for increases to the overall size of the clearing fund between such monthly adjustments, nor do the Rules provide for adjustments to a clearing member's required contribution between such monthly calculations.

Proposed Change to Authorize Certain Adjustments to the Total Size of the Clearing Fund and Individual Clearing Members' Required Contributions

In order to mitigate the risks of an underfunding of the clearing fund, the proposed changes to the Rules would provide OCC with the authority to increase the total size of the clearing fund intra-month upon a significant and sustained increase in exposure based on daily projected clearing fund draw calculations, as described above, and on an emergency basis for the protection of OCC or in the public interest. The proposed changes would also provide OCC with the authority to increase a clearing member's required clearing fund contribution under certain circumstances reflecting a change in the clearing member's financial condition or risk profile.

Adjustments to the Overall Size of the Clearing Fund

OCC would have the authority to increase the overall size of the clearing fund intra-month in the event that the five-day rolling average of the projected draws against the clearing fund are 150% or more of the size of the clearing fund. This threshold is intended to ensure that intra-month increases in clearing fund size are limited to occasions in which the increase in exposure is significant and prolonged. Based on OCC staff's analysis of historical clearing fund data beginning in July 2011, the use of this 150% threshold would have resulted in only four changes to the clearing fund's size

⁸ Securities Exchange Act Release No. 69403 (April 18, 2013), 78 FR 24257 (April 24, 2013) (SR-OCC-2013-02).

during this period, one of which related to firm-specific changes and three of which related to increased volatility prior to and during the events related to the downgrade of the U.S. Government's credit rating and the ongoing debt crisis of that period. In the event that the 150% threshold is exceeded over a five-day period, OCC's Executive Chairman or President would have the authority to approve an increase in the clearing fund's size. The Risk Committee of OCC's Board would be informed of such officer's determination as soon as practicable. OCC would also provide notification to the SEC and CFTC in the same manner as if an emergency waiver or suspension of OCC's Rules occurred.⁹

The Risk Committee would also be permitted to approve an increase in the clearing fund's size on an emergency basis upon its determination that such action is necessary for the protection of OCC or in the public interest, and OCC would then provide notification to the Board of Directors, SEC and CFTC in the same manner as if an emergency waiver or suspension of OCC's Rules occurred.¹⁰ OCC believes that these processes ensure proper management and board-level oversight regarding decisions to increase the clearing fund size.

⁹ See OCC's By-Laws Article IX, Section 14.

¹⁰ In recommending that the Risk Committee approve an emergency increase in the size of the clearing fund, OCC would follow the process set forth in OCC's By-Laws Article IX, Section 14 in that the Executive Chairman, Management Vice Chairman or President, in his, her or their judgment, would determine that: (1) an emergency exists, and (2) such an increase is necessary or advisable for the protection of OCC or otherwise in the public interest.

Upon an intra-month increase in the clearing fund's size, clearing members would generally be given two business days to satisfy any deficit,¹¹ and the increase would generally remain in effect until the next regular monthly calculation occurs unless the Risk Committee determines that a further increase is warranted or the 150% threshold is triggered more than once during the same month. The foregoing changes to OCC's Rules would not affect the basic clearing fund methodology as previously approved by the SEC, nor would they affect allocation of the clearing fund among clearing members.¹² OCC has discussed the proposed changes with its Financial Risk Advisory Council, a working group consisting of representatives of clearing members and exchanges formed by OCC to review and comment on various risk management proposals. They additionally were discussed with the OCC Operations Roundtable, also consisting of representatives of clearing members and exchanges, which considers operational efficiencies and improvements. No concerns were raised by either working group during the course of these discussions.

Adjustments to Individual Clearing Members' Required Contributions

The proposed change would also permit OCC to increase individual clearing members' required clearing fund contributions in three circumstances. The first

¹¹ Intra-month clearing fund adjustments will only occur in limited circumstances and will be due to certain events that could materially affect the overall liquidity of OCC. Based on feedback OCC received from clearing members, OCC believes that providing a clearing member with one day to absorb the increase, including determining the most effective manner in which to collateralize the increase, and a second day to fund the increase strikes the proper balance between effective risk management and not causing material disruptions to a clearing member's business.

¹² In particular, the contributions of futures-only affiliated clearing members and clearing members depositing the required minimum clearing fund contribution, respectively, would not be adjusted in connection with any increase in the clearing fund size.

circumstance exists when a clearing member's required clearing fund contribution exceeds its net capital.¹³ In this situation, the clearing member is placed on OCC's "Watch Level III" surveillance, which is used to assess a clearing member's ability to meet a call to replenish its clearing fund contribution and requires certain OCC executive officers to consider protective measures with respect to such clearing member. One such protective measure would be to add the amount of such excess to the clearing member's required clearing fund contribution, thereby funding such difference in advance of the regular monthly calculation.¹⁴ No subsequent adjustment thereunder would be permitted under the applicable Rule provision until the earlier of the next adjustment of the clearing fund (either as a result of the next monthly adjustment or as a result of an increase in the total clearing fund pursuant to the changes described above) or the next required reporting of the clearing member's net capital.

The second circumstance is the merger or consolidation of two or more clearing members, in which case the variable amount of the required clearing fund contribution for the surviving clearing member would be adjusted so that it equals the sum of such amount for the surviving clearing member and the total of such amounts for all other clearing members involved in the transaction. Such adjusted amount would be

¹³ In this context, and for clearing members that are registered broker-dealers, net capital means net capital computed in accordance with Securities Exchange Act Rule 15c3-1. For clearing members that are futures commission merchants, net capital means adjusted net capital computed in accordance with CFTC Regulation Section 1.17 and for Canadian clearing members, net capital means risk-adjusted capital computed in accordance with Investment Industry Regulatory Organization of Canada Rule 17.1.

¹⁴ Pursuant to Interpretation and Policy .01 to Article VIII, Section 5 of OCC's By-Laws, a clearing member's clearing fund contribution is used to determine the clearing member's share of any clearing fund deficiency resulting from a clearing member insolvency.

substituted for the variable amount previously calculated for the surviving clearing member.

The third circumstance is the transfer of positions between clearing members, in which case OCC would be able to adjust the clearing fund contributions of the transferor clearing member and the transferee clearing member after giving effect to the transfer, subject to the agreement of the two clearing members. The amount of such adjustment would affect the variable amount of each clearing member's required clearing fund contribution and, irrespective of the amount or size of the positions transferred, each clearing member would continue to be required to maintain OCC's minimum clearing fund contribution.

Proposed Changes to By-Laws and Rules

OCC is proposing to add an Interpretation and Policy .05 under Rule 1001 to provide for the authority to increase the size of the clearing fund on an intra-month basis. Subparagraph (a) of proposed Interpretation and Policy .05 would authorize OCC's Executive Chairman or President, or the Risk Committee, to increase the clearing fund size as described above (*i.e.*, based on the daily calculations or by the Risk Committee on an emergency basis). Proposed Interpretation and Policy .06 under Rule 1001 would provide for the authority to increase individual clearing members' required clearing fund contributions in certain circumstances. Subparagraph (a) would provide for an increase when a clearing member's required clearing fund contribution exceeds its net capital, subparagraph (b) would provide for an increase in the event of a merger or consolidation involving clearing members and subparagraph (c) would provide for an increase in the

event of a transfer of positions between clearing members, in each case as described above.

Subparagraph (b) of proposed Interpretation and Policy .05 and subparagraphs (a), (b) and (c) of proposed Interpretation and Policy .06 would provide that if the total size of the clearing fund size or an individual clearing member's required contribution is increased, as applicable, the variable amount would be increased accordingly for each clearing member, and this increase would be effective for all purposes under OCC's By-Laws and Rules, including each clearing member's required contribution in the event the clearing fund is fully depleted in connection with the insolvency of a clearing member.¹⁵ However, subparagraph (b) of proposed Interpretation and Policy .05 and subparagraphs (a), (b) and (c) of proposed Interpretation and Policy .06 would specify that the variable amount would remain subject to nonstandard calculations for futures-only affiliated clearing members and clearing members that have deposited the minimum required clearing fund contribution.

An example will illustrate the manner in which the total size of the clearing fund and individual clearing members' contributions could be adjusted pursuant to Interpretation and Policy .05 to Rule 1001. The example assumes that OCC's total clearing fund requirement is \$1 million divided among five clearing members. Member One has the minimum requirement of \$150,000, Member Two has a requirement of \$212,500 and the other three comprise the remainder in differing amounts. If OCC determined, based on the most recent five-day rolling average of clearing fund draws, that it should resize the fund to \$1.5 million, Member One would maintain the minimum

¹⁵ See Interpretation and Policy .01 to Article VIII, Section 5 of OCC's By-Laws.

requirement of \$150,000 and the other four members would be assessed the incremental amount totaling \$500,000. Member Two would be assessed \$125,000 because the firm's *pro rata* share of the original clearing fund requirement excluding Member One's minimum requirement equaled 25%, *i.e.*, \$212,500 divided by \$850,000. Member Two's new clearing fund requirement would be \$337,500 until the next clearing fund sizing calculation. The other three members would be assessed their share of the remaining \$375,000 (using a denominator of \$850,000 as with Member Two) so that the total clearing fund requirement of \$1.5 million is satisfied.

Subparagraph (c) of proposed Interpretation and Policy .05 and subparagraph (d) of proposed Interpretation and Policy .06 would provide that as soon as practicable after any increase in the total size of the clearing fund size or an individual clearing member's required contribution, as applicable, OCC would provide notice to the affected clearing members, and such clearing members would be required to satisfy their deficits within two business days of such notice in the case of adjustments pursuant to Interpretation and Policy .05 and one business day in the case of adjustments pursuant to Interpretation and Policy .06. If, however, any deficit would be required to be satisfied on the first, second, third or fourth business day of a calendar month, it may instead be satisfied by the fifth business day of the calendar month. These subparagraphs also set forth that a resulting change in a clearing member's contribution to the clearing fund due to an increase in the clearing fund's size or an individual adjustment will be reflected on one or more reports made available by OCC, but that OCC will not revise the clearing member's Clearing Fund Statement.

Subparagraph (d) of proposed Interpretation and Policy .06 would further specify that OCC may require any deficit resulting from a merger of clearing members or the transfer of positions between clearing members to be satisfied prior to the occurrence of the merger or transfer. Moreover, subparagraph (e) of proposed Interpretation and Policy .06 would clarify that the individual adjustments under subparagraphs (a), (b), and (c) of proposed Interpretation and Policy .06 may result in an adjustment to the total size of the clearing fund.

To enhance the readability of the new Interpretations and Policies added to Rule 1001, the term “fixed amount” would be used to refer to the portion of a clearing member’s clearing fund contribution calculated pursuant to clause (x) of Rule 1001(b), and the term “variable amount” would be used to refer to the portion of a clearing member’s clearing fund contribution calculated pursuant to clause (y) of Rule 1001(b). Rule 1001(b) and 1001(f) would be amended solely for the purpose of introducing these defined terms.

Article VIII, Section 2(b) of OCC’s By-Laws provides, among other things, that if a clearing member’s clearing fund contribution is increased as a result of an amendment of the Rules, the increase will not be effective until the clearing member is given five business days’ notice of the amendment. OCC proposes to add Interpretation and Policy .01 to Article VIII, Section 2 to clarify that such section shall not apply to increases in the total size of the clearing fund pursuant to Interpretation and Policy .05 of Rule 1001, nor to an increase in an individual clearing member’s contribution pursuant to Interpretation and Policy .05 or .06 of Rule 1001.

While the proposed change may require clearing members to increase their clearing fund contributions at any time during a month, any such increase in the overall size of the clearing fund would correspond to a material change in OCC's projected exposure and would affect all clearing members proportionally in the same manner as a monthly adjustment, and any such increase in an individual clearing member's required contribution would correspond to a material change in the clearing member's business or financial condition, as well as use of OCC's resources. OCC therefore does not believe that clearing members will have significant problems in complying with the change. In addition to the prior communications with clearing members described above, in connection with the filing of this change, OCC will inform clearing members of the proposed change via an information memorandum, in order to advise clearing members of the procedures OCC intends to implement in support of the proposed change, including notice procedures to advise clearing members of any increases in contribution amounts.

STATUTORY BASIS FOR THE PROPOSED CHANGE

OCC believes that the proposed change to OCC's Rules is consistent with Section 805(b) of the Clearing Supervision Act¹⁶ because the proposed change will reduce systemic risk.¹⁷ OCC believes that the proposed changes to its clearing fund sizing, as described above, will reduce the risk that the size of OCC's clearing fund would be insufficient should OCC need to use clearing fund assets to close-out positions of a defaulted clearing member. For the same reasons, the proposed change will reduce

¹⁶ 12 U.S.C. 5464(b).

¹⁷ 12 U.S.C. 5464(b)(3).

systemic risk because it will promote confidence that OCC will be able to timely meet its settlement obligations because the proposed change will diminish the likelihood that OCC's clearing fund would be insufficient in the event of a clearing member default. The proposed change is not inconsistent with the existing Rules of OCC, including any other Rules proposed to be amended or any advance notice filings pending with the Commission.

ANTICIPATED EFFECT ON AND MANAGEMENT OF RISK

OCC believes that the proposed change will reduce OCC's overall level of risk because the proposed change makes it less likely that OCC's clearing fund would be insufficient should OCC need to use its clearing fund to manage a clearing member default. As described above, the proposed change would provide OCC with the ability to increase the overall size of its clearing fund as result of a projected increase in anticipated draws or for the protection of OCC. In addition, OCC would have the ability to increase individual clearing member's clearing fund contribution as a result of certain events such as a change in net capital, a merger or a transfer of positions. This flexibility will allow OCC to adjust the size of its clearing fund in response to events that may occur in between normal monthly clearing fund calculations, and therefore makes it less likely that OCC's clearing fund would be insufficient should OCC need to use its clearing fund to manage a clearing member default. Accordingly, OCC's overall level of risk will be reduced as a result of this proposed change. Moreover, and for the same reasons, the proposed change will facilitate OCC's ability to manage risk.

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

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension. The designated clearing agency may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Commission, or the date the Commission receives any further information it requested, if the Commission notifies the designated clearing agency in writing that it does not object to the proposed change and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.

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

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.¹⁸

¹⁸ OCC also filed the the proposals contained in this advance notice as a proposed rule change under Section 19(b)(1) of the Securities Exchange Act of 1934 and Rule 19b-4 thereunder. *See supra* note 3.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. 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-2014-804 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2014-804. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of

the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_804.pdf

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-804 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

By the Commission.

Kevin M. O'Neill
Deputy Secretary

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