



8011-01p
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74894; File No. SR-OCC-2015-007)

May 7, 2015.

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Enhance the Measurement Used to Establish Minimum Capital Requirements for Banks Approved to Issue Letters of Credit

On March 6, 2015, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2015-007 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² On March 25, 2015, the proposed rule change was published for comment in the Federal Register.³ The Commission did not receive any comments on the proposed rule change. This order approves the proposed rule change.

I. Description

OCC is amending its by-laws and rules in order to enhance the measurement used to establish minimum capital requirements for banks approved to issue letters of credit that may be deposited by clearing members as a form of margin asset. Currently, OCC’s Rule 604, Interpretation and Policy .01, requires U.S. banks to have \$100,000,000 or more in shareholders’ equity, and non-U.S. banks to have \$200,000,000 or more in shareholders’ equity, in order to be approved as an issuer of letters of credit that may be deposited by clearing members to meet their margin obligations at OCC. The purpose of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 74536 (March 19, 2015), 80 FR 15846 (March 25, 2015) (SR-OCC-2015-007).

these minimum capital requirements is to ensure that issuers of letters of credit whose letters of credit are deposited at OCC as a margin asset by clearing members have the ability to honor a demand for payment by OCC under such letters of credit should a need to do so arise, such as in the case of a clearing member default.

The financial requirements set forth in OCC's Rule 604 concerning issuers of letters of credit have been in place for many years.⁴ However, since OCC adopted Rule 604 and Interpretation and Policy .01 under Rule 604, bank financial reporting standards have changed. Today, bank regulators place a greater emphasis on Tier 1 Capital as opposed to shareholders' equity⁵ such that Tier 1 Capital is now considered the primary component of a bank's total regulatory capital.⁶ Moreover, OCC notes that Tier 1 Capital is a more conservative measure of a bank's financial health as it ignores subordinated debt, intermediate-term preferred stock, cumulative and long-term preferred stock and a portion of a bank's allowance for loan and lease losses.

OCC believes that by measuring a bank's financial health based on Tier 1 Capital, instead of shareholders' equity, OCC will reduce its credit risk to banks issuing letters of credit deposited by clearing members as a form of margin asset. As stated above, Tier 1

⁴ See Securities and Exchange Act Release No. 19422 (January 12, 1983), 48 FR 2481 (SR-OCC-1982-08).

⁵ Tier 1 Capital is the measure used by the Basel Committee on Banking Supervision to measure the financial health of a bank. The goal of the Basel Committee on Banking Supervision is to strengthen the regulation, supervision and risk management of the banking sector. The Basel Committee on Banking Supervision's most recent set of reform measures, Basel III, is located at: <http://www.bis.org/publ/bcbs189.pdf>.

⁶ See <https://www.kansascityfed.org/Publicat/BasicsforBankDirectors/BasicsforBankDirectors.pdf>.

Capital is a more conservative measure of a bank's financial health. Should OCC need to demand payment on a letter of credit deposited by a clearing member as a margin asset, such as in the case of a clearing member default, it is less likely that the bank issuing such letter of credit will not perform upon its payment commitment because the bank will be required to hold a greater amount of capital in order to be an OCC letter of credit bank. In turn, credit risk presented to OCC as a result of accepting letters of credit as a form of margin asset is reduced.⁷

In light of the more universal acceptance of Tier 1 Capital for bank financial reporting standards and the potential to reduce the credit risk associated with the issuance of letters of credit, OCC is amending Rule 604, Interpretation and Policy .01, to substitute Tier 1 Capital for shareholders' equity. Pursuant to the rule change, as approved, OCC is also adding paragraph "c" to Interpretation and Policy .01 under Rule 604 to adopt a definition of Tier 1 Capital that leverages the definition of Tier 1 Capital used by a bank's regulatory agency. OCC believes that such a definition is appropriate given that OCC accepts letters of credit from banks regulated by different regulatory authorities.⁸ In addition, OCC is making a conforming change to OCC Rule 604, Interpretation and

⁷ OCC does not anticipate that the proposed rule change will impact any of the banks already approved to issue letters of credit that may be deposited by clearing members as a form of margin since all such banks maintain amounts of Tier 1 Capital that exceed, as applicable, \$100 million for U.S. banks or \$200 million for Non-U.S. banks.

⁸ *See* OCC Rule 604(c). For example, OCC accepts letters of credit issued by banks regulated by The Federal Reserve Board, The Office of the Comptroller of the Currency, The Australian Prudential Regulation Authority and The German Federal Financial Supervisory Authority.

Policy .04, so that any one bank may not issue letters of credit for an individual clearing member exceeding 15% of the bank's Tier 1 Capital (instead of shareholders' equity).

II. Discussion and Commission Findings

Section 19(b)(2)(C) of the Act⁹ directs 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 such organization.

The Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act, which requires, among other things, that the rules of a clearing agency are designed to assure the safeguarding of securities and funds which are in the custody and control of the clearing agency or for which it is responsible.¹⁰ The rule change, as proposed, should help ensure the safeguarding of securities and funds which are in the custody and control of OCC, or for which OCC is responsible, because OCC will assess banks that issue letters of credit to be deposited as margin by clearing members using a more conservative capital requirement. This more conservative capital requirement thereby increases the likelihood that the bank will have the ability to honor a demand for payment made by OCC. For the same reason, OCC believes that the adoption of a more conservative capital requirement for banks approved to issue letters of credit that may be deposited by clearing members as a form of margin asset is consistent with the requirement of Rule 17Ad-22(d)(3), promulgated under the Act, which requires

⁹ 15 U.S.C. 78s(b)(2)(C).

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

OCC hold assets in a manner that minimizes risk of loss or delay in access to them.¹¹

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act, and in particular, with the requirements of Section 17A of the Act¹² and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-OCC-2015-007) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Robert W. Errett,
Deputy Secretary.

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¹¹ 17 CFR 240.17Ad-22(d)(3).

¹² In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).