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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-82355; File No. SR-OCC-2017-007]

### **Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to The Options Clearing Corporation's Margin Policy**

December 19, 2017

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 11, 2017, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by OCC. On December 18, 2017, OCC filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### **I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change**

The purpose of the proposed rule change is to formalize and update OCC's Margin Policy in connection with requirements applicable to OCC under Rule 17Ad-22(e)(6), which generally requires a covered clearing agency to have policies and

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> In Amendment No. 1, OCC modified a portion of its Margin Policy to: (i) state that OCC's Board of Directors (“Board”) is ultimately responsible for annual review and approval of the Policy, and (ii) correctly cite provisions in OCC's Rules governing its stock loan program. OCC did not propose any other changes in Amendment No. 1.

procedures reasonably designed to, among other things, cover its credit exposures to its participants through the establishment of a risk-based margin system meeting certain standards.<sup>4</sup> The Margin Policy is included as confidential Exhibit 5 of the filing. The policy is being submitted without marking to improve readability as it is being submitted in its entirety as new rule text.

The proposed rule change does not require any changes to the text of OCC's By-Laws or Rules. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>5</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. 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), (B), and (C) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

**Background**

On September 28, 2016 the Commission adopted amendments to Rule 17Ad-22<sup>6</sup> and added new Rule 17Ab2-2<sup>7</sup> pursuant to Section 17A of the Act<sup>8</sup> and the Payment,

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<sup>4</sup> 17 CFR 240.17Ad-22(e)(6).

<sup>5</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

<sup>6</sup> 17 CFR 240.17Ad-22.

Clearing, and Settlement Supervision Act of 2010 (“Clearing Supervision Act”)<sup>9</sup> to establish enhanced standards for the operation and governance of those clearing agencies registered with the Commission that meet the definition of a “covered clearing agency,” as defined by Rule 17Ad-22(a)(5)<sup>10</sup> (collectively, the new and amended rules are herein referred to as “CCA” rules). The CCA rules require that a covered clearing agency, among other things: “establish, implement, maintain and enforce written policies and procedures reasonably designed to . . . [c]over . . . its credit exposures to its participants by establishing a risk-based margin system” that satisfies certain criteria, including that it produces margin levels commensurate with the risks of particular products, collects margin at least daily, collects margin sufficient to cover exposure between the last margin collection and position closeout, uses reliable pricing sources, appropriately measures credit exposure and regularly reviews, tests and verifies its margin methodology.<sup>11</sup>

OCC is defined as a covered clearing agency under the CCA rules, and therefore is subject to the requirements of the CCA rules, including Rule 17Ad-22(e)(6).<sup>12</sup> Accordingly, OCC proposes to formalize its Margin Policy, as described below, to describe its approach for collecting margin and managing the credit exposures presented by its Clearing Members.

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<sup>7</sup> 17 CFR 240.17Ab2-2.

<sup>8</sup> 15 U.S.C. 78q-1.

<sup>9</sup> 12 U.S.C. 5461 et seq.

<sup>10</sup> 17 CFR 240.17Ad-22(a)(5).

<sup>11</sup> 17 CFR 240.17Ad-22(e)(6).

<sup>12</sup> Id.

## **Margin Policy**

The purpose of the Margin Policy is to describe OCC’s approach for collecting margin and managing the credit exposure presented by its Clearing Members, so as to ensure that its margin methodologies are governed and implemented in a manner that is compliant with Rule 17Ad-22(e)(6).<sup>13</sup> The Margin Policy describes, in general: (i) the treatment of the various types of positions held by Clearing Members in connection with margin calculations; (ii) OCC’s cross-margin programs with other clearing agencies; (iii) the treatment of collateral included in margin calculations; (iv) the model assumptions and market data OCC uses as inputs for its margin calculation methodologies; (v) OCC’s margin calculation methodologies; (vi) protocols surrounding OCC’s exercise of margin calls and adjustments; and (vii) daily back-testing and model validation that OCC conducts to measure performance of its margin methodologies.

The Margin Policy is designed to reflect OCC’s efforts to provide for robust internal controls and governance surrounding its margin methodologies and promote compliance with the CCA rules, in particular Rule 17Ad-22(e)(6),<sup>14</sup> as informed by the Commission in the adopting release for the CCA rules.<sup>15</sup> The Margin Policy is part of a broader framework, including OCC’s By-Laws, Rules and other policies, that is designed to support the resiliency of OCC by ensuring that it appropriately sizes margin to market

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<sup>13</sup> Id.

<sup>14</sup> Id.

<sup>15</sup> Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (“CCA Adopting Release”).

risks.<sup>16</sup> The key substantive aspects of the Margin Policy, and how they foster compliance with the requirements of the CCA rules, are described in greater detail below.

#### *Treatment of Various Types of Positions*

The Margin Policy describes the treatment of various types of positions, originating from different types of market participants, in connection with OCC's calculation of margin requirements. As specified in OCC's By-Laws, OCC utilizes different types of Clearing Member accounts in order to maintain compliance with the relevant Customer protection and segregation requirements of the Commission and the Commodity Futures Trading Commission ("CFTC"), which affects how margin is calculated because of different assumptions regarding how such accounts or positions would be liquidated in the event of a Clearing Member default. Taking into account these different types of products in different types of accounts, with different Clearing Member liquidation scenarios, enables OCC to set margin requirements commensurate with the actual risks presented by these positions and further its compliance with the requirements in Rule 17Ad-22(e)(6)(i) and (v), which require that a covered clearing agency's policies and procedures be reasonably designed to establish a risk-based margin system that takes into account the "risks and particular attributes of each relevant product, portfolio, and market" and use "an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products."<sup>17</sup>

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<sup>16</sup> CCA Adopting Release, *supra* note 14 at 70812 (noting that the requirements of Rule 17Ad-22(e)(6) "further support the resiliency of a covered clearing agency by requiring the covered clearing agency to have policies and procedures that are designed to appropriately size . . . margin to market risks.").

<sup>17</sup> 17 CFR 240.17Ad-22(e)(6)(i) and (v).

One category of positions addressed in the Margin Policy is long securities options positions. Under the Margin Policy, these positions are segregated from a Clearing Member's other positions under the assumption that such positions are fully paid and pose no additional risk to OCC, and the Margin Policy explains that a Clearing Member's segregated long positions are not included as part of its margin calculation. In addition, Clearing Members' customer segregated futures accounts are margined separately from Clearing Members' securities and/or proprietary accounts, and margin for these accounts is calculated on a gross basis by computing margin requirements for each customer account independently, and then aggregating the individual margin calculations to calculate the gross margin required from the Clearing Member. The Margin Policy further notes that OCC also computes the margin requirements for customer segregated futures accounts on a net basis and holds the greater of the net or gross margin requirement.

As described in the Margin Policy, stock loan/borrow positions are included as long/short stock positions in margin calculations on a net basis and may be offset against other positions held in an account. However, while OCC includes these positions in its risk calculations, it does not include the net asset value of these positions in its margin requirement calculations, which allows OCC to maintain financial resources in a manner that is consistent with the manner in which such positions would be liquidated during a Clearing Member default. In the event of such a default, OCC would instruct the non-defaulting Clearing Member to buy in or sell out of the position, with OCC compensating the Clearing Member for any difference between last mark and the closeout price.

#### *Cross-Margining*

The Margin Policy addresses the cross-margin programs that OCC maintains with other clearinghouses, which affects the calculation of margin with respect to positions in certain index options, options on centrally cleared fund shares, and futures and options on futures held as part of one of the programs, because positions are treated as if they were held within a single account at OCC. Under Rule 17Ad-22(e)(6)(v) a covered clearing agency’s policies and procedures must be reasonably designed to establish a risk-based margin system that uses appropriate margin methods for measuring “credit exposure . . . and portfolio effects across products,”<sup>18</sup> which the CCA Adopting Release expressly states should take into consideration cross-margining arrangements with other clearinghouses.<sup>19</sup> The Margin Policy’s allowance for offsets in required margin when calculating requirements for cross-margin products furthers compliance with this CCA rule.

### *Collateral*

To mitigate credit risk exposure, OCC generally requires Clearing Members to deposit collateral as margin with respect to each account type on the morning following the trade date. Collateral management is generally governed by OCC’s Collateral Risk Management Policy, but the Margin Policy does provide a general description of how the use of deposits in lieu of margin and collateral in margins may affect margin calculations. This furthers the purpose of Rules 17Ad-22(e)(6)(i) and (v) in that incorporating these elements enables OCC to set margin requirements commensurate with its actual credit exposure to its Clearing Members.<sup>20</sup>

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<sup>18</sup> 17 CFR 240.17Ad-22(e)(6)(v).

<sup>19</sup> CCA Adopting Release, supra note 14, at 70819.

<sup>20</sup> 17 CFR 240.17Ad-22(e)(6)(i) and (v).

The Margin Policy describes that OCC permits Clearing Members to make deposits in lieu of margin, which enable them to meet their margin requirements for securities options by posting escrow or specific deposits, *i.e.*, typically customer securities that have been fully paid and that represent the securities deliverable upon assignment of a short option or a deposit of acceptable collateral equal to the underlying value or aggregate exercise price of the option being covered, depending on the type of option. Because these short positions are fully collateralized, the Margin Policy specifies that OCC does not include deposits in lieu of margin when calculating margin requirements.

The Margin Policy also indicates that OCC's margin methodology takes into account certain forms of posted margin when calculating a Clearing Member's margin requirement, a practice OCC refers to as "collateral in margins." OCC computes margin requirements based on a combination of open positions in cleared contracts and any deposits of collateral eligible for inclusion in OCC's margin methodologies, *e.g.*, stocks, exchange-traded fund securities and eligible government securities. OCC's margin methodologies also incorporate scenarios that could exacerbate or mitigate risk exposure as a result of the collateral type deposited into its margin requirement calculations, thereby mitigating risk by creating an incentive for Clearing Members to deposit collateral that hedges their exposures in cleared contracts. The Margin Policy's recognition of the risk interactions between these open positions and collateral deposited as margin is consistent with the requirement of Rule 17Ad-22(e)(6)(v) that a covered clearing agency's policies and procedures be reasonably designed to establish a risk-

based margin system that takes into account “portfolio effects across products” when measuring credit exposure.<sup>21</sup>

*Model Assumptions, Sensitivity Analyses and Market Data*

The Margin Policy has historically specified that OCC performs: (i) daily backtesting of each Clearing Member Account, (ii) daily backtesting of OCC’s margin methodology and (iii) monthly review of the assumptions used in performing the backtesting. The Margin Policy has also specified that all critical margin model assumptions should be consistent with OCC’s default management assumptions. OCC performed the aforementioned backtesting in order to monitor whether the margin methodology is functioning as intended and appropriately captures the risks that OCC’s Clearing Members present to it.

With the adoption of the CCA rules, and to enhance OCC’s monitoring of its margin methodology, the proposed Margin Policy would establish additional monthly reviews of its margin methodology. First, the Margin Policy would specify that key model parameters and assumptions are also subject to a monthly, or more frequently when market conditions warrant, sensitivity analysis. In identifying which parameters and assumptions should be subject to this sensitivity analysis, OCC surveyed relevant industry guidance on the appropriate parameters and assumptions to first include in the sensitivity analysis. OCC plans to increase the number of assumptions and parameters included in the sensitivity analysis on an iterative basis as the process becomes more mature. Second, the Margin Policy would specify that OCC performs a monthly review of its parameters for business backtesting. OCC determined that all parameters contained

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<sup>21</sup> 17 CFR 240.17Ad-22(e)(6)(v).

in its margin methodology should be included in this monthly parameter review, and has identified all of these. The Margin Policy would also specify that this sensitivity analysis and parameter review would make use of both actual and hypothetical portfolios. These additions to the Margin Policy are designed to be consistent with Rules 17Ad-22(e)(6)(vi)(B) and (C), which require that policies and procedures of a covered clearing agency be reasonably designed to establish a risk-based margin system that incorporates monthly, or more frequent, sensitivity analyses and review of its parameters and assumptions for backtesting.<sup>22</sup>

The proposed Margin Policy would specify that the results of all such analyses are reported no less frequently than monthly to OCC's Model Risk Working Group, which then may escalate any issues to OCC's Management Committee. This reporting requirement is designed to be consistent with Rule 17Ad-22(e)(6)(vi)(D), which requires policies and procedures of a covered clearing agency to be reasonably designed to establish a risk-based margin system under which such analyses are reported to the covered clearing agency's "appropriate decision maker," who may use "these results to evaluate the adequacy of and adjust its margin methodology, model parameters, and any other relevant aspects of its credit risk framework."<sup>23</sup>

The Margin Policy describes how OCC obtains the market data that it uses to value Clearing Members' portfolios and collateral deposits, perform mark-to-market calculations, support expiration processing, generate theoretical values for margin and Clearing Fund calculations, and support customer-level margin calculations. Rule 17Ad-22(e)(6)(iv) requires that a covered clearing agency's policies and procedures be

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<sup>22</sup> 17 CFR 240.17Ad-22(e)(6)(v)(B) and (C).

<sup>23</sup> 17 CFR 240.17Ad-22(e)(6)(v)(D).

reasonably designed to establish a risk-based margin system that uses “reliable sources of timely price data” and uses “procedures and sound valuation models for addressing circumstances in which pricing data are not readily available or reliable.”<sup>24</sup> In compliance with this requirement, the Margin Policy requires OCC to take measures to ensure the quality and completeness of any market data it acquires. Primary among these measures is the use of redundant sources for market data and pricing system infrastructure and, when selecting vendors, prioritizing the quality and reliability of a data provider’s service and its ability to provide data in a variety of market conditions, including periods of market stress. This aspect of the Margin Policy is specifically responsive to the Commission’s statement in the CCA Adopting Release that a covered clearing agency should consider the ability of the vendor to provide data in a variety of market conditions, including periods of market stress and not just based on cost alone.<sup>25</sup>

The Margin Policy explains how, in order to ensure the integrity of this data, OCC monitors for delays in its receipt of price data and overall system health, as well as erroneous price data or interruptions in pricing data availability. The Margin Policy specifies that, in certain cases, OCC may be obligated to use settlement prices that are provided directly by the listing exchange<sup>26</sup> and prescribes procedures for utilizing alternative data sources where a final settlement value is not available from the listing exchange.

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<sup>24</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

<sup>25</sup> CCA Adopting Release, supra note 14, at 70819.

<sup>26</sup> In such a case, the listing exchange transmits price files to OCC, and the data is then processed by OCC systems and manually validated.

The Margin Policy also specifies that OCC utilizes sound valuation models, such as price-editing and smoothing,<sup>27</sup> as well as system edit checks, and automated and manual controls with any price data it obtains. Where OCC does not receive pricing information on a daily basis for a product, the Margin Policy specifies that OCC would rely on modeled prices. These requirements are designed to facilitate OCC's compliance with the Rule 17Ad-22(e)(6)(iv) requirement to maintain policies reasonably designed to establish a risk-based margin system that addresses "circumstances in which pricing data are not readily available or reliable."<sup>28</sup>

### *Margin Methodology*

OCC's Margin Policy contains a description of OCC's System for Theoretical Analysis and Numerical Simulations ("STANS"), its margin methodology for all positions it margins on a net basis. As required in Rule 17Ad-22(e)(6), STANS is a risk-based methodology that is designed to produce a margin requirement that exceeds OCC's minimum regulatory obligations. OCC achieves this through the use of an Expected Shortfall methodology ("ES"), which is effectively a weighted average of tail losses beyond the 99% Value-at-Risk ("VaR") level.

As a statistical methodology that relies on randomized Monte Carlo simulations to generate ES estimates, STANS will produce slightly different ES estimates when Monte Carlo simulations are performed on each Clearing Member account; OCC refers to such variance in ES estimates as the "standard error." However, significant variations in ES

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<sup>27</sup> "Smoothing" is a process OCC uses to calculate final prices, volatility measures, delta values and vega values for securities and futures options. The purpose of smoothing is to minimize arbitrage opportunities while producing final prices that remain within the bid-ask spread provided to OCC by the market.

<sup>28</sup> 17 CFR 240.17Ad-22(e)(6)(iv).

estimates among Clearing Member accounts may also signify other issues, such as underlying issues with STANS or its appropriateness for estimating ES for a particular Clearing Member account. Previously, OCC has relied on the expert judgment of its staff and undefined, qualitative factors to identify whether STANS may not be functioning as expected. After performing statistical analysis on the size of the standard error, and at what level an observed error is greater than the standard error at a statistically significant level, the proposed Margin Policy would state that the tolerance for the standard error of a typical, or median, Clearing Member account ES measurement in STANS is 5%.<sup>29</sup> This tolerance would define a statistical error threshold above which OCC must investigate whether STANS is appropriately measuring a Clearing Member's account.

Furthermore, any margin requirement calculated by STANS is on a "portfolio" basis, which inherently reflects offsets between products within each portfolio. This is intended to meet the Rule 17Ad-22(e)(6)(iii) requirement, as explained in the CCA Adopting Release, that a covered clearing agency's policies and procedures be reasonably designed to establish a risk-based margin system that calculates margin on a portfolio level and set initial margin requirements that meet "an established single-tail confidence level of at least 99 percent" with respect to each portfolio's distribution of future exposure.<sup>30</sup>

The Margin Policy also describes how STANS utilizes Monte Carlo simulations of portfolio values at a two-day risk horizon, based on the behavior of various risk factors affecting values of Clearing Member accounts, including implied volatility surfaces of

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<sup>29</sup> This use of a 5% ES error tolerance is a proposed enhancement to OCC's existing margin policies and procedures.

<sup>30</sup> CCA Adopting Release, supra note 14, at 70819; 17 CFR 240.17Ad-22(e)(6)(iii).

options for all equity and index risk factors. These risk factors are relevant to the products in a Clearing Member's portfolio and are critical drivers of the inherent exposure OCC has to its Clearing Members' portfolios. Including them in STANS therefore enhances the robustness of OCC's margin resources and incentivizes Clearing Members to be aware of the risks in their portfolios and mitigate those risks to avoid higher margin requirements. The use of risk factors is intended to comply with Rule 17Ad-22(e)(6)(v), which requires that a covered clearing agency's policies and procedures be reasonably designed to establish a risk-based margin system that uses "an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products."<sup>31</sup>

For purposes of calculating margin requirements, STANS assumes a two-day liquidation period for all positions margined on a net basis. The Margin Policy explains that this assumption is based on a thorough analysis of market conditions and the risks associated with the products OCC clears. As the Commission noted in the CCA Adopting Release, the assumed liquidation period in a margin model should be tailored to the market conditions and the risks of the products being cleared.<sup>32</sup> OCC's assumed two-day liquidation period is so tailored, and the Margin Policy is designed to enable OCC to comply with Rule 17Ad-22(e)(6)(iii), under which a covered clearing agency's policies and procedures must be reasonably designed to establish a risk-based margin system requirement that covers potential future exposure to Clearing Members in the interval between the last margin collection and the close-out of a Clearing Member's positions

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<sup>31</sup> 17 CFR 240.17Ad-22(e)(6)(v).

<sup>32</sup> CCA Adopting Release, *supra* note 14, at 70818 ("... liquidation periods generally should be tailored to the market conditions and risks of the products being cleared.").

should it default.<sup>33</sup> This assumption allows OCC to maintain consistency with the timeframes required to facilitate the hedging or close-out of a position, which OCC would employ under its default management procedures.

The Margin Policy describes other aspects of STANS that are designed to address the particular attributes and risk factors of the products being margined, as is consistent with Rule 17Ad-22(e)(6)(i) and (v).<sup>34</sup> This includes the use of 500 business days of “look-back” historical data, where available, in its econometric models and the incorporation of multiple stress tests components into STANS that are designed to identify increases in OCC’s exposure that may arise from atypical market movements.

The Margin Policy provides for daily evaluation of the market data that supports STANS’ econometric models and monthly recalibration of STANS to ensure that it accounts for changes to market conditions over the past month. These recalibrations incorporate a long-run historical volatility estimate, which serves as a minimum volatility value during periods of low market volatility, reducing procyclicality in OCC’s margin estimates by not allowing margin rates to drop below a certain long-run measure of market volatility. The Margin Policy also provides that on a daily basis OCC utilizes a “scale factor” to account for daily changes in market volatility that may occur between monthly recalibrations. In some instances, products less dependent on the monthly recalibration process – such as Treasury and volatility contracts – may have their econometric models recalibrated on a daily basis.

The Margin Policy provides for the use of alternatives to STANS for certain products or accounts. For example, OCC has the ability to apply add-on charges to cover

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<sup>33</sup> 17 CFR 240.17Ad-22(e)(6)(iii).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(6)(i) and (v).

Stock Loan position exposures arising from Clearing Member specific preferences and surcharges for certain Clearing Members with higher risk levels. Furthermore, the Margin Policy explains that OCC utilizes the Standard Portfolio Analysis of Risk margin methodology (“SPAN”), instead of STANS, to compute gross margin for the segregated futures customer accounts of Clearing Members. SPAN is a market simulation-based VaR system that assesses risk on a portfolio basis for a wide variety of financial instruments. SPAN uses “scan ranges” that estimate price movements based on historical volatility data of specific products, which are in turn used to estimate movements in affected portfolios. “Scan ranges” also serve as minimum estimates of portfolio volatility in times of low market volatility to guard against the effects of procyclicality, and are regularly monitored and recalibrated by OCC’s Pricing & Margins team. A description of SPAN is provided in the Margin Policy. Like STANS, SPAN is intended to comply with Rule 17Ad-22(e)(6), including the Rule 17Ad-22(e)(6)(iii) requirement that a covered clearing agency’s policies and procedures be reasonably designed to establish a risk-based margin system that calculates margins on a portfolio level and sets initial margin requirements that meet “an established single-tailed confidence level of at least 99 percent” with respect to each portfolio’s distribution of future exposure.<sup>35</sup> The Margin Policy indicates that OCC will also calculate a segregated futures customers account’s net margin requirement under STANS, and that if the STANS-calculated requirement exceeds the SPAN-calculated requirement, an add-on is applied to the Clearing Member’s account so that the Clearing Member is effectively required to meet the greater of the gross SPAN or two-day net STANS requirement.

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<sup>35</sup> CCA Adopting Release, supra note 14, at 70819; 17 CFR 240.17Ad-22(e)(6)(iii).

### *Margin Calls and Adjustments*

The Margin Policy provides for OCC calculating and collecting margin requirements on a daily basis, as well as making intraday margin calls and adjustments. This is consistent with Rule 17Ad-22(e)(6)(ii), under which a covered clearing agency must maintain policies and procedures reasonably designed to establish a risk-based margin system that “collects margin . . . at least daily” and includes “the authority and operational capacity to make intraday margin calls in defined circumstances.”<sup>36</sup>

As described in the Margin Policy, OCC issues margin calls during standard trading hours within a timeframe established in OCC’s procedures, when unrealized losses<sup>37</sup> exceeding 50% of an account’s total risk charges are observed for that account, based on start-of-day positions. Intraday margin calls are also subject to a minimum value established in OCC’s procedures, and must be approved by a Vice President or above. The Margin Policy describes the process by which margin calls may be deferred and evaluated and for execution of a margin call outside of the time frame described above.

The Margin Policy provides for certain exceptions to the above intraday margin call time frame. For instance, in the case of extended trading hours (“ETH”), OCC may issue a margin call prior to 9:00 AM Central Time when (1) unrealized losses observed for an account, based on new ETH positions, exceed 25% of that account’s total risk charges and (2) the overall Clearing Member portfolio is also experiencing losses. ETH margin calls are limited to price changes in ETH-eligible products, and similarly remain

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<sup>36</sup> 17 CFR 240.17Ad-22(e)(6)(ii).

<sup>37</sup> This excludes accounts holding only collateral positions or long option positions where the account’s net asset value could never become negative.

subject to a minimum value established in OCC's procedures and must be approved by a Vice President or above. In the case of bank holidays, margin calls may be issued against Clearing Members on the day prior to the bank holiday when it coincides with a day one or more of OCC's markets are open for trading.

The Margin Policy indicates that additional margin adjustments may be performed as the need arises and following approval by an officer of OCC.

#### *Back-Testing and Model Validation*

OCC's Margin Policy provides that OCC conducts daily back-tests for each margin account, analyzing in detail all accounts exhibiting losses in excess of calculated margin requirements. This is intended to comply with Rule 17Ad-22(e)(6)(vi)(A), which calls for back-tests of the margin model at least daily, "using standard predetermined parameters and assumptions."<sup>38</sup> To the extent the results of these back-tests reflect losses in excess of the aggregate ES and stress test add-on charges required for a Clearing Member's account, the test result will be classified as an "exceedance," and all such exceedances will be reported no less frequently than monthly and evaluated through OCC's governance process for model risk management.

The Margin Policy states that OCC's Model Validation Group ("MVG"), an independent group with a separate reporting line from model developers, is responsible for evaluating the overall performance of STANS and its associated models on at least an annual basis. This aspect of the policy is intended to comply with Rule 17Ad-22(e)(6)(vii), under which a covered clearing agency's policies and procedures must be reasonably designed to establish a risk-based margin system that requires "a model

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<sup>38</sup> 17 CFR 240.17Ad-22(e)(6)(vi)(A).

validation for the covered clearing agency’s margin system and related models to be performed not less than annually” or more frequently as may be contemplated by the agency’s risk management framework.<sup>39</sup> MVG presents its findings and recommendations to the Risk Committee of OCC’s Board.

(2) Statutory Basis

Section 17A(b)(3)(F) of the Act<sup>40</sup> requires, among other things, that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible and, in general, to protect investors and the public interest. Through each of its respective sections, the Margin Policy provides a framework for managing margin and credit exposure presented by OCC’s Clearing Members. To manage these exposures, the Margin Policy establishes the manner in which OCC requires Clearing Members to deposit margin to assure performance and to mitigate their credit exposures if a Clearing Member defaults. The Margin Policy also describes the types of positions OCC will use in making margin calculations, how OCC will manage margin risk arising from its cross-margining program, key assumptions of OCC’s margin methodologies, OCC’s margin methodologies, how OCC administers margin calls on both daily and intraday bases, and how OCC monitors and reports on the performance of its margin systems. The Margin Policy’s promotion of each aforementioned activity ultimately inures to the protection of investors and the public interest, as well as the safeguarding of securities and funds in

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<sup>39</sup> 17 CFR 240.17Ad-22(e)(6)(vii).

<sup>40</sup> 15 U.S.C. 78q-1(b)(3)(F).

OCC's custody or control<sup>41</sup> in a manner consistent with Section 17A(b)(3)(F) of the Act.<sup>42</sup>

OCC also believes that the Margin Policy is consistent with the requirements of Rule 17Ad-22(e)(6), as detailed above.<sup>43</sup> For example, the Margin Policy is reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that meets the minimum regulatory requirements in: collecting margin on a daily or intraday basis at levels commensurate with the risks and particular attributes of each relevant product, portfolio and market, as is consistent with Rules 17Ad-22(e)(6)(i), (ii) and (v);<sup>44</sup> calculating margin requirements sufficient to cover potential future exposures to a defaulting Clearing Member during the interval between last margin collection and closeout, as is consistent with Rule 17Ad-22(e)(6)(iii);<sup>45</sup> using reliable sources of timely price data and sound valuation models and procedures when data is unavailable, as is consistent with Rule 17Ad-(22)(e)(6)(iv);<sup>46</sup> using appropriate methods for measuring credit exposures that account for relevant product risk factors and portfolio effects across products, as is consistent with Rules 17Ad-22(e)(6)(i) and (v);<sup>47</sup> and conducting daily backtests of its margin models, conducting sensitivity analyses of the underlying parameters and assumptions monthly, or more frequently, and engaging in

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<sup>41</sup> These activities, in turn, help ensure that OCC remains capable of continuing its operations and services in a manner that promotes the prompt and accurate clearance and settlement of securities transactions.

<sup>42</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>43</sup> See supra notes 12-20, 21-24, 27, 29-35, 37 and 38 and accompanying text.

<sup>44</sup> See supra notes 16, 33 and 35 and accompanying text.

<sup>45</sup> See supra note 32 and accompanying text.

<sup>46</sup> See supra notes 23 and 27 and accompanying text.

<sup>47</sup> See supra notes 16, 17, 20 and 30 and accompanying text.

model validation not less frequently than annually, as is consistent with Rules 17Ad-22(e)(vi) and (vii).<sup>48</sup>

The proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act<sup>49</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposed rule change would impact or impose any burden on competition. The proposed rule change sets forth the framework surrounding OCC's margin methodologies. The Margin Policy primarily describes OCC's existing policies and practices with respect to margin, much of which is also addressed in OCC's By-Laws and Rules. All Clearing Members are subject to the same methodologies for determining their margin requirements, dictated by the overall risk to OCC presented by the positions in their respective portfolios. Consequently, no Clearing Member is provided a competitive advantage over any other Clearing Member. Further, the Margin Policy does not affect Clearing Members' access to OCC's services or impose any direct burdens on Clearing Members. Accordingly, the proposed rule change would not unfairly inhibit access to OCC's services or disadvantage or favor any particular user in relationship to another user.

For the foregoing reasons, OCC believes that the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and would not impact or impose a burden on competition.

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<sup>48</sup> See supra notes 37 and 38 and accompanying text.

<sup>49</sup> 15 U.S.C. 78q-1(b)(3)(I).

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2017-007 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2017-007. 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 proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at [https://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_17\\_007.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_17_007.pdf).

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2017-007 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated Authority.<sup>50</sup>

**Eduardo A. Aleman,**

*Assistant*

*Secretary.*

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<sup>50</sup> 17 CFR 200.30-3(a)(12).

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