THE FOUNDATION FOR SECURE MARKETS®

**Options Clearing Corporation**
125. S. Franklin Street, Suite 1200
Chicago, IL 60606
312 322 6200 | theocc.com

June 11, 2024

**<u>VIA CFTC PORTAL</u>**
Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

**Re: Rule Certification for Updates to OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and Rules**

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended ("Act"), and Commodity Futures Trading Commission ("CFTC") Regulation 40.6, The Options Clearing Corporation ("OCC") hereby certifies to the CFTC amendments to its Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description and its Rules. The date of implementation of the rule is at least 10 business days following receipt of the certification by the CFTC. The proposal has also been submitted to the Securities and Exchange Commission ("SEC") under Section 19(b) of the Securities Exchange Act of 1934 ("Exchange Act") and Rule 19b-4 thereunder. The change will not be implemented until OCC has obtained all necessary regulatory approvals.

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

## <u>Explanation and Analysis</u>

The purpose of this rule certification is to (1) implement additional stress scenarios designed to test the sufficiency of OCC's prefunded financial resources and (2) amend OCC's Rules to provide greater context and detail on margin collection and Clearing Fund sizing that may result from this type of sufficiency stress testing. The proposed changes to OCC's (A) Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management Description ("Methodology Description"); and (B) Rules are included in Confidential Exhibit A and Exhibit B. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text. All capitalized terms not defined herein have the same meaning as set forth in the OCC By-Laws and Rules.[1]

As the sole clearing agency for standardized equity options listed on a national securities exchange registered with the SEC, and for the other products it clears, OCC is exposed to certain risks, including credit risk and liquidity risk arising from its Clearing Members' cleared contracts, for which OCC becomes the buyer to every seller and the seller to every buyer. The management of credit and liquidity risks are essential elements of OCC's risk management framework. Given the critical role OCC plays within the U.S. financial markets, it is vital that OCC maintains sufficient financial resources to cover its exposures under normal and stressed conditions and adequate resources to satisfy liquidity needs arising from its settlement obligations. OCC manages its credit risk related to Clearing Members by collecting margin and Clearing Fund resources based on a Clearing Member's risk profile. OCC manages its liquidity risk by maintaining a reliable and diverse set of committed resources and liquidity providers, establishing a contingent funding plan for additional resources, and performing stress testing that covers a wide range of scenarios.

OCC performs daily stress testing of its financial resources using a wide range of scenarios. OCC's stress testing inventory contains, among others, scenarios[2] designed to measure the potential exposures that Clearing Member Group portfolios present relative to OCC's credit and liquidity resources and determine potential calls for additional collateral, either as margin or as Clearing Fund collateral, or adjust the forms of collateral on deposit ("Sufficiency Scenarios"); and monitor and assess the size of OCC's prefunded financial resources against a wide range of stress scenarios for informational and risk monitoring purposes ("Informational Scenarios"). OCC's stress tests are used for evaluating both credit and liquidity risk, and the output of these scenarios is also used for liquidity resource evaluation. Informational Scenarios are not used directly to size the Clearing Fund or drive calls for additional financial resources from OCC's Clearing Members. Informational Scenarios may be re-categorized as Adequacy, Sufficiency, or Sizing scenarios upon the approval of OCC's Risk Committee.

As part of the regular review of stress scenario output, OCC identified two of its existing Informational Scenarios that generated exposures that were consistently higher than those generated by the corresponding Sufficiency Scenarios. Such Informational Scenarios are variations of existing Sufficiency Scenarios representing the most extreme market rally and decline moves in 2008. The proposed scenarios differ from the existing scenarios in terms of how individual risk factor price shocks are determined, as further described below. OCC proposes to elevate these Informational

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1 OCC's By-Laws and Rules can be found on OCC's public website: https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules.

2 OCC's stress testing inventory also contains scenarios designed to assess whether the resources collected are adequate to cover OCC's risk tolerance of a 1-in-50 year statistical market event over a two-year lookback period ("Adequacy Scenarios") and to inform the size of OCC's financial resources ("Sizing Scenarios").

Scenarios to Sufficiency Scenarios by amending a list in the Methodology Description.[3] Such list represents a subset of Adequacy, Sizing, and Sufficiency Scenarios that have been implemented in OCC's stress testing system. OCC believes that the proposed change would enhance its ability to manage risks by considering a different approach to the determination of price shocks to evaluate how such an event could occur under current market conditions. While the proposed change to implement additional Sufficiency Scenarios could have an impact on Clearing Members if OCC called for additional financial resources based on the results of the new Sufficiency Scenarios in accordance with OCC's Rules, OCC believes the proposed Sufficiency Scenarios would generate stress test exposures that are generally in line with its current, most impactful Sufficiency Scenarios.

Based on the results of the Sufficiency Scenarios, OCC may call for additional financial resources from its Clearing Members. For example, the results of OCC's Sufficiency Stress Tests may require the collection of intra-day margin from a Clearing Member Group under OCC Rule 609[4] or an intra-month resizing of the Clearing Fund under OCC Rule 1001(c).[5] While these Rules provide the authority or requirement to call for additional resources based on the Sufficiency Stress Tests, details about how the calculations related to the relevant thresholds are made are documented in OCC's Clearing Fund Methodology Policy.[6] Based on feedback received from staff of the SEC, OCC proposes to amend Rules 609 and 1001(c) to provide additional context and detail about the circumstances in which OCC would exercise this authority to call for additional resources. OCC does not believe the proposed changes to the Rules would have any effect on Clearing Members because the changes would merely incorporate additional detail already in effect under the Clearing Fund Methodology Policy.

OCC is proposing to (1) take two of its existing informational stress scenarios and add them to the list of stress scenarios designed to test the sufficiency of OCC's prefunded financial resources in the Methodology Description and (2) amend Rules 609 and 1001(c) to provide greater context and

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3 The Methodology Description describes the Comprehensive Stress Testing & Clearing Fund Methodology, and Liquidity Risk Management that OCC uses to analyze the adequacy of its financial resources and to challenge its risk management framework.

4 See OCC Rule 609(a)(5) (providing that OCC may require the deposit of intra-day margin when a Sufficiency Stress Test identifies an exposure that exceeds 75% of the current Clearing Fund requirement less deficits).

5 See OCC Rule 1001(c) (providing that if 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 by the greater of $1 billion or 125% of the difference between the relevant risk exposure and the then-current Clearing Fund size).

6 OCC's Clearing Fund Methodology Policy summarizes the manner in which OCC determines the level of financial resources necessary to satisfy the regulatory requirements and the Board's direction with respect to the additional financial resources necessary to withstand a wide range of foreseeable stress scenarios including, but are not limited to, the default of the two Clearing Member Groups that would potentially cause the largest aggregate credit exposure in extreme but plausible market conditions.

detail in the Rules on margin collection and Clearing Fund sizing that may result from this type of sufficiency stress testing.

**Proposed Changes to the Methodology Description**

OCC proposes to elevate two of its existing Informational Scenarios to Sufficiency Scenarios. OCC's inventory of Sufficiency Scenarios under the Methodology Description consists of historical scenarios designed to replicate historical events, including the most extreme market rally and decline moves ("Largest Rally/Decline") in 2008 and 2020, under current market conditions. The proposed Sufficiency Scenarios are a variation of the existing Largest Rally/Decline Sufficiency Scenarios from 2008.

Price shocks are applied to individual securities or risk factors to replicate historical events under the Methodology Description. The existing Sufficiency Scenarios are historically based scenarios that employ a waterfall approach to determine which price shocks to apply to risk factors.[7] To start, the actual return of the risk factor during the historical event is utilized as the price shock, if available. If unavailable,[8] a proxy market return from a corresponding sector is utilized as the price shock. Finally, if data is unavailable for both actual and sector returns, the price shock is determined by the "beta"[9] of the risk factor to its assigned risk driver[10] multiplied by the corresponding risk driver shock (the "risk driver beta derived price shock"). The risk driver shock is the actual return of a given risk driver from the historical event. For example, the risk driver beta derived price shock for equity security ABC would be derived by multiplying ABC's historical beta to SPX (its risk driver) by the SPX risk driver shock.

The proposed Sufficiency Scenarios, which are currently classified as Informational, are a variation of the existing Largest Rally/Decline from 2008 Sufficiency Scenarios, the only difference being the determination of price shocks applied to individual risk factors. Namely, unlike the existing Largest Rally/Decline from 2008 Sufficiency Scenarios, the proposed Sufficiency Scenarios would not utilize the waterfall approach described above to apply price shocks. Instead, the

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7 A "risk factor" is a product or attribute whose historical data is used to estimate and simulate the risk for an associated product. Risk factors include the returns on individual equity securities, returns on equity indexes, and returns on implied volatility risk factors, among others.

8 An actual return may be unavailable as not all current risk factors existed during a given historical period. For example, TSLA, a current risk factor, was not a risk factor in 2008.

9 The "beta" is the sensitivity of a security with respect to its corresponding risk driver (i.e., the sensitivity of the price of the security relative to the price of the risk driver).

10 The main risk drivers are price and volatility for equity securities. For example, the Cboe S&P 500 Index ("SPX") and Cboe Volatility Index ("VIX") are the main risk drivers for shocks of the equity risk factors. Other relevant risk drivers are utilized, including but not limited to, risk drivers to cover U.S. and Canadian Government Security collateral positions, risk drivers to cover commodity-based exchange traded funds and risk drivers to cover commodity-based futures products.

proposed scenarios would directly apply the risk driver beta derived price shock. This approach is consistent with other statistical scenarios, including the Sizing Scenarios, which directly apply risk driver beta derived price shocks. Given that these existing Informational Scenarios generated exposures that were consistently higher than those generated by the corresponding Sufficiency Scenarios, OCC proposes to elevate these Informational Scenarios to Sufficiency Scenarios. To effect such changes, OCC would update the list of scenarios contained in the Methodology Description to include the proposed Sufficiency Scenarios. Additionally, OCC proposes to make minor typographical edits to correct the formatting of footnotes throughout the text of the Methodology Description.

Elevating the subject Informational Scenarios to Sufficiency Scenarios will serve to enhance the existing suite of Sufficiency Scenarios by considering a different determination of price shocks to evaluate how such an event could occur under current market conditions. In their current state as Informational Scenarios, these scenarios do not drive the size of the Clearing Fund or calls for additional resources. However, as Sufficiency Scenarios, they would be used to measure the exposure of OCC's Clearing Fund to the portfolios of individual Clearing Member Groups and determine whether any such exposure is sufficiently large as to necessitate OCC calling for additional resources in the form of margin or an intra-month resizing of the Clearing Fund. The proposed change would enable OCC to test the sufficiency of its financial resources under a wider range of relevant stress scenarios and respond quickly when OCC believes additional financial resources are necessary. The proposed change would thereby improve OCC's ability to measure, monitor and manage its exposures to its participants and enhance OCC's ability to manage risks in its role as a systemically important financial market utility. OCC's analysis indicates that the proposed Sufficiency Scenarios generate stress test exposures that are generally in line with its current, most impactful Sufficiency Scenarios.

**Proposed Changes to the Rules**

OCC proposes to provide further context and detail in the Rules on current Sufficiency Stress Test practices. As described above, Sufficiency Stress Tests are run through OCC's Sufficiency Scenarios, which, under the proposal, would include the proposed Sufficiency Scenarios. The results of OCC's Sufficiency Stress Tests may require the collection of intra-day margin from a Clearing Member Group or an intra-month resizing of the Clearing Fund. For example, pursuant to OCC Rule 609(a)(5),[11] if any of OCC's Sufficiency Scenarios identify exposures that exceed 75% of the current Clearing Fund requirement less deficits, OCC may require additional margin deposits ("intra-day margin") from the Clearing Member Group(s) driving the breach. Additionally, pursuant to Rule 1001(c),[12] if a Sufficiency Scenario identifies a breach that exceeds 90% of the current Clearing Fund requirement (after subtracting any margin collected in accordance with a breach of the 75% threshold), OCC will promptly take action to initiate an increase in the size of the Clearing

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11 See Exchange Act Release No. 83406 (June 11, 2018), 83 FR 28018, 28025 (June 15, 2018).

12 Id. at 28025-26.

Fund on an intra-month basis to ensure that it continues to maintain sufficient prefunded financial resources.[13]

OCC proposes to amend Rule 609 to address the case where a Clearing Member is subject to multiple intra-day margin calls over the course of a month (i.e., between resizing of the Clearing Fund, which is typically conducted monthly). Under OCC Rule 609(a)(5), if any of OCC's Sufficiency Scenarios identify exposures that exceed 75% of the current Clearing Fund requirement less deficits, OCC may require intra-day margin deposits from the Clearing Member Group(s) driving the breach. Currently, prior to the issuance of such margin call, OCC confirms the margin call amount against any existing intra-day margin call amounts for the monthly period under OCC Rule 609(a)(5). If the margin call amount is greater, a new margin call is issued for that amount.[14] The new margin call remains in effect until the next monthly resizing of the Clearing Fund or it is superseded by a larger margin call amount. Accordingly, OCC proposes language in the Rule to specify 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. This proposed language is consistent with the language in OCC's Clearing Fund Methodology Policy.[15]

OCC also proposes minor changes for clarity and readability in Rule 609(a)(5). For example, OCC proposes replacing "such that" with "from." Additionally, OCC proposes to remove "less deficits" in reference to OCC's Sufficiency Scenarios identifying exposures that exceed 75% of the current Clearing Fund requirement less deficits. Such language was relevant when OCC's Rules provided a two-day period for Clearing Members to deposit additional required Clearing Fund assets.[16] OCC has since shortened this collection period following Clearing Fund resizing from two business days to the next Settlement Time, making the reference to "less deficits" unnecessary as

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[13] In addition to these Rules, which provide OCC authority to call for additional financial resources to mitigate credit risk identified under the Sufficiency Scenarios, OCC also may address liquidity risk identified under such Sufficiency Scenarios. See, e.g., OCC Rules 601(g) & 609(b) (providing OCC authority to require the Clearing Member Group to provide additional cash collateral ("Required Cash Deposits") if OCC forecasts that a Clearing Member's potential settlement obligations, including potential settlement obligations under stressed market conditions, could be in excess of OCC's liquidity resources to satisfy such obligations).

[14] For the avoidance of doubt, a new margin call is not issued if the margin call amount is equal to, or smaller than, an existing margin call amount for the monthly period.

[15] The Clearing Fund Methodology Policy states that, if a Clearing Member Group's Clearing Fund draws exceed the 75% threshold in more than one Sufficiency Stress Test scenario, the Clearing Member Group "shall be subject to the largest margin call." See supra note 11 at 28025.

[16] See Exchange Act Release No. 94950 (May 19, 2022), 87 FR 31916, 31918 (May 25, 2022) (File No. SR-OCC-2022-004) (describing the then-current process that allows members two business days to meet routine funding obligations related to the Clearing Fund).

OCC considers such deficits covered.[17] The removal of such language is also consistent with the Clearing Fund Methodology Policy.[18] OCC believes such changes would provide additional transparency in the Rules by including greater context and detail, would not change current practices, and would promote consistency between OCC Rules and related policies.

OCC also proposes to amend Rule 1001(c) to provide additional transparency and clarity regarding intra-month Clearing Fund sizing adjustments. Under OCC Rule 1001(c), if a Sufficiency Scenario identifies a breach that exceeds 90% of the size of the Clearing Fund requirement (after subtracting any margin "collected" in accordance with a breach of the 75% threshold), OCC will promptly take action to initiate an increase in the size of the Clearing Fund on an intra-month basis. OCC proposes to amend the parenthetical to more clearly include amounts to be collected from a breach of the 75% threshold by adding "or to be collected." This change would provide greater clarity to reflect that any margin calls issued pursuant to Rule 609(a)(5) are also subtracted in the calculation in Rule 1001(c).[19] Such change would conform with OCC's current practices set out in the Clearing Fund Methodology Policy, which does not limit the parenthetical in Rule 1001(c) to previously collected margin call amounts.[20]

OCC believes the proposed changes are intended to better align the descriptions in the Rules with OCC's current practices for the collection of intra-day margin or an intra-month resizing of the Clearing Fund resulting from OCC's Sufficiency Stress Tests. These changes would have no impact on Clearing Members and would not affect the Clearing Fund size, as they are consistent with the Clearing Fund Methodology Policy.

**Consistency with DCO Core Principles**

OCC reviewed the DCO core principles ("Core Principles") as set forth in the Act, the regulations thereunder, and the provisions applicable to a DCO that elects to be subject to the

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17 Id. (describing the changes designed to require funding by the next Settlement Time, effectively requiring funding by the business day following notice of an obligation).

18 A conforming reference to remove "less deficits" was made to OCC's Clearing Fund Methodology Policy in reference to OCC's Sufficiency Scenarios identifying exposures that exceed 75% of the current Clearing Fund requirement as part of File No. SR-OCC-2022-004. Id. ("These changes are intended to conform the Clearing Fund Methodology Policy with the proposed changes to OCC's Rules and support the reduced operational complexity that OCC expects to achieve by creating a more uniform settlement time.").

19 In practice deficits due to an intra-month resizing are due by the first Settlement Time following notification or such later time as provided by OCC pursuant to Rule 1005(b).

20 The current Clearing Fund Methodology Policy states that, if a Sufficiency Stress Test identifies a Clearing Fund draw that exceeds 90% of the current Clearing Fund requirement "after subtracting margin calls resulting from a breach of [the 75% threshold]," OCC will promptly act to initiate an intra-month increase in the Clearing Fund size.

provisions of 17 CFR Subpart C. During this review, OCC identified the following as potentially being impacted:

**Risk Management.** OCC believes that the proposed changes are consistent with Core Principle D,[21] which require in relevant part that a DCO possess the ability to manage the risks associated with discharging its responsibilities through the use of appropriate tools and procedures. As described above, the proposed changes would enhance OCC's framework for measuring, monitoring, and managing its credit risks. Implementation of the additional Sufficiency Scenarios would enable OCC to test the sufficiency of its prefunded financial resources under a wider range of stress scenarios and respond quickly when OCC believes the collection of additional financial resources is necessary.

**Legal Risk Considerations.** OCC believes that the proposed changes are consistent with Core Principle R[22], which requires a DCO to have a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the DCO. As described above, the changes to the OCC Rules would enhance clarity and transparency regarding OCC practices on intra-day margin collection and intra-month Clearing Fund sizing adjustments resulting from Sufficiency Stress Tests. Such changes would promote understanding of the Rules by market participants and ensure consistency of the Rules with existing policies to reduce potential confusion and promote a well-founded, transparent, and enforceable legal framework.

For these reasons, OCC believes that the proposed changes are consistent with the requirements of the DCO Core Principles and the CFTC Regulations thereunder.

## Opposing Views

No substantive opposing views were expressed related to the rule amendments by OCC's Board members, Clearing Members or market participants. Public comments on the proposed rule change filed with the SEC, if any, may be viewed on the SEC's public website.[23]

## Notice of Pending Rule Certification

OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of the proposed changes on OCC's website concurrently with the filing of this submission.

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[21] 7 U.S.C. 7a-1(c)(2)(D).

[22] 7 U.S.C. 7a-1(c)(2)(R).

[23] See Options Clearing Corporation (OCC) Rulemaking at https://www.sec.gov/rules/sro/occ.htm.

Certification

OCC hereby certifies that the rules set forth in Confidential Exhibit A and Exhibit B of the enclosed filing comply with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,

/s/ Maria Alarcon
Maria Alarcon
Assistant General Counsel
The Options Clearing Corporation

Enclosure: Confidential Exhibit A and Exhibit B