

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90827; File No. SR-OCC-2020-015)

December 30, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Accelerated Approval of Proposed Rule Change Concerning the Implementation of New Sufficiency Scenarios in The Options Clearing Corporation's Stress Testing Inventory

I. INTRODUCTION

On December 2, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2020-015 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to implement additional stress test scenarios to OCC’s Comprehensive Stress Testing & Clearing Fund Methodology, and to its Liquidity Risk Management Description.³ The Proposed Rule Change was published for public comment in the Federal Register on December 14, 2020.⁴ The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change on an accelerated basis.

II. BACKGROUND

The Proposed Rule Change by OCC would take existing informational stress test scenarios and add them to the list of stress test scenarios designed to test the sufficiency of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing infra note 4, 85 Fed. Reg. at 80829.

⁴ Securities Exchange Act Release No. 90603 (Dec. 8, 2020), 85 Fed. Reg. 80829 (Dec. 14, 2020) (File No. SR-OCC-2020-015) (“Notice of Filing”).

OCC's prefunded financial resources. The proposed changes are to OCC's Comprehensive Stress Testing & Clearing Fund Methodology, and to its Liquidity Risk Management Description ("Methodology Description").

In 2018, OCC established its current clearing fund methodology, using a stress testing framework to measure its credit exposure at a level sufficient to cover potential losses under extreme but plausible market conditions.⁵ OCC performs daily stress testing using a wide range of scenarios, both hypothetical and historical. Its stress testing scenario inventory includes four different categories: (1) scenarios that determine whether the financial resources collected from all Clearing Members collectively are adequate to cover OCC's risk tolerance ("Adequacy Scenarios"); (2) scenarios that establish the monthly size of the Clearing Fund at an amount necessary to cover losses arising from the default of the two Clearing Member Groups that would potentially cause the largest aggregate credit exposure as a result of a 1-in-80 year hypothetical market event ("Sizing Scenarios"); (3) scenarios that measure the exposure of the 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 to guard against potential losses under a wide range of stress scenarios, including extreme but plausible market conditions ("Sufficiency Scenarios");⁶ and (4) scenarios that monitor and assess

⁵ Securities Exchange Act Release No. 83735 (Jul. 27, 2018), 83 Fed. Reg. 37855 (Aug. 2, 2018) (File No. SR-OCC-2018-008).

⁶ Pursuant to OCC Rule 609 and OCC's Clearing Fund Methodology Policy, if any of OCC's Sufficiency Scenarios identifies exposures that exceed 75% of the current Clearing Fund requirement less deficits, OCC may require additional margin deposits from the Clearing Member Group(s) driving the breach. Additionally, pursuant to Rule 1001(c) and the Clearing Fund Methodology Policy, if a Sufficiency Scenario identifies a Clearing Fund draw for any one or two Clearing Member Groups that exceeds 90% of the current Clearing Fund size (after subtracting any monies deposited as a result of a margin call in accordance with a breach of the 75% threshold), OCC has the authority to reset the

the size of OCC’s prefunded financial resources against a wide range of stress scenarios that may include newly developed stress scenarios for evaluation as well as extreme but implausible scenarios (“Informational Scenarios”). Adequacy and Informational Scenarios are not used directly to size the Clearing Fund or drive calls for additional financial resources from OCC’s Clearing Members.

As described in the Notice of Filing, OCC proposes to elevate four of its current Informational Scenarios to Sufficiency Scenarios. These Informational Scenarios are historical scenarios designed to represent recent market events from March 2020. The proposed Sufficiency Scenarios would include price shocks representing the most extreme market decline and rally moves in March 2020, and would include variations of these scenarios designed to account for specific wrong-way risk exposures arising from cleared positions on issued exchange traded notes (“ETNs”).⁷

These four scenarios, as Informational Scenarios, currently do not drive the size of the Clearing Fund or calls for additional resources. Once elevated to Sufficiency Scenarios, they would be used to measure OCC’s Clearing Fund exposure to the portfolios of individual Clearing Member Groups and determine whether any such exposure is sufficiently large where it would necessitate OCC calling for additional resources in the form of margin or an intra-month resizing of the Clearing Fund. OCC asserts that by adding these four Sufficiency Scenarios, it would be able to test the sufficiency of its financial resources under a wider range of relevant stress

size of the Clearing Fund on an intra-month basis to ensure that it continues to maintain sufficient prefunded financial resources. See Notice of Filing supra note 4, 85 Fed. Reg. at 80829-30.

⁷ See Notice of Filing supra note 4, 85 Fed. Reg. at 80830.

scenarios and respond quickly when OCC believes additional financial resources are necessary.⁸

III. COMMISSION’S FINDINGS AND ORDER GRANTING ACCELERATED APPROVAL OF THE PROPOSED RULE CHANGE

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.⁹ After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act,¹⁰ and Rule 17Ad-22(e)(4)¹¹ thereunder, as described in detail below.

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

Section 17A(b)(3)(F) of the Exchange Act requires that the rules of a clearing agency be designed to, among other things, promote the prompt and accurate clearance and settlement of securities transactions, and assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.¹² In 2018, the Commission approved a Proposed Rule Change to formalize OCC’s current Clearing Fund Methodology Policy, including OCC’s current stress testing methodology, and the Commission’s

⁸ Id.

⁹ 15 U.S.C. 78s(b)(2)(C).

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹¹ 17 CFR 240.17Ad-22(e)(4).

¹² 15 U.S.C. 78q-1(b)(3)(F).

approval was based in part on the same Section 17A(b)(3)(F) requirements above.¹³ Based on its review of the record, and for the reasons described below, the Commission believes that the proposed addition of more stress test scenarios designed to test the sufficiency of OCC's prefunded financial resources as described above is consistent with the promotion of prompt and accurate clearance and settlement of securities transactions, and the assurance of the safeguarding of securities and funds which are in OCC's custody or control or for which OCC is responsible.

First, the proposal to elevate four Informational Scenarios to Sufficiency Scenarios would expand upon the scope of stress scenarios against which OCC monitors its financial resources. The Commission continues to believe that the historical scenarios replicating the 1987 market crash and financial crisis provide additional depth to the monitoring of OCC's financial resources.¹⁴ Similarly, for the present proposal, the Commission believes that the introduction of new historical scenarios replicating the market events of March 2020 would provide stress exposure estimates that would be meaningful for the monitoring of OCC's total financial resources. Elevating these Informational Scenarios to become Sufficiency Scenarios would increase the likelihood that OCC will have sufficient financial resources in excess of margin to address credit losses that could arise from the default of a Clearing Member, and this would in turn enhance OCC's ability to continue to promptly and accurately clear and settle securities transactions for participants in the options markets during periods of market stress. Therefore, the Commission believes that the proposal is consistent with promoting the prompt and accurate clearance and settlement of securities transactions.

¹³ See supra note 5, 83 Fed. Reg. at 37861-62.

¹⁴ See supra note 5, 83 Fed. Reg. at 37861.

Second, adding the proposed Sufficiency Scenarios would be consistent with assuring the safeguarding of securities and funds currently in OCC's custody and control by creating a wider range of stress scenarios that would improve the likelihood of the Clearing Fund having sufficient resources to cover potential credit losses under adverse market conditions. As noted above, Sufficiency Scenarios are used to determine whether any exposure of the Clearing Fund to the portfolios of individual Clearing Member Groups is sufficiently large as to necessitate OCC calling for additional resources in the form of margin to guard against potential losses. Collecting this additional margin reduces the likelihood that OCC must mutualize the risk associated with these potential losses through the use of surviving Clearing Members' contributions to the Clearing Fund. The Commission continues to believe that reducing the potentiality of loss mutualization during periods of market stress, while unavoidable in certain circumstances, could reduce the potential knock-on effects to non-defaulting Clearing Members, their customers and the broader options market.¹⁵ The addition of the four scenarios representing recent market events, previously uncaptured in OCC's Sufficiency stress testing, would widen the set of Sufficiency Scenarios to include such events, and further reduce the likelihood of drawing upon surviving Clearing Members' Clearing Fund collateral in the event that similar market scenarios occur. Therefore, the Commission believes that the proposal is consistent with assuring the safeguarding of securities and funds which are in OCC's custody or control.

¹⁵ See e.g., Securities Exchange Act Release No. 86119 (Jun. 17, 2019), 84 Fed. Reg. 29267, 29269 (Jun. 21, 2019) (File No. SR-OCC-2019-004) (noting a new liquidation cost model's impact on reducing potential loss mutualization).

The Commission believes, therefore, that the proposal to elevate the four Informational Scenarios to Sufficiency Scenarios is consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.¹⁶

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

Rule 17Ad-22(e)(4)(vi) under the Exchange Act requires OCC to establish, implement, maintain, and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes by testing the sufficiency of its total financial resources available to meet the minimum financial resource requirements under paragraphs Rules 17Ad-22(e)(4)(i) through (iii).¹⁷ Such testing must include, among other things, conducting stress testing of OCC's total financial resources once each day using standard predetermined parameters and assumptions.¹⁸

After reviewing and assessing the proposal, the Commission believes that the proposed changes described above are consistent with Rule 17Ad-22(e)(4)(vi) under the Exchange Act. As it stated in 2018, the Commission believes that expanding the scope of stress scenarios against which OCC monitors its financial resources would increase the likelihood that OCC maintains sufficient financial resources at all times.¹⁹ Similarly, the Commission believes that the elevation of the four Informational Scenarios to Sufficiency Scenarios is consistent with Rule 17Ad-22(e)(4)(vi) because the addition of the four Sufficiency Scenarios would enhance OCC's

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

¹⁷ 17 CFR 240.17Ad-22(e)(4)(vi) (citing 17 CFR 240.17Ad-22(e)(4)(i)-(iii)).

¹⁸ 17 CFR 240.17Ad-22(e)(4)(vi)(A).

¹⁹ See supra note 5, 83 Fed. Reg. at 37863.

financial resources testing, and the broader scope of stress scenarios would increase the chances that OCC maintains sufficient financial resources. The Commission also believes that the daily testing of OCC's financial resources against the Sufficiency Scenarios, including the four proposed Sufficiency Scenarios based on the March 2020 market events, would be consistent with the daily stress testing requirements of Rule 17Ad-22(e)(4)(vi)(A), as described above.

The Commission also believes that the proposed introduction of stress scenario variations accounting for specific wrong-way risk exposures arising from cleared positions on issued ETNs would be consistent with the requirements of Rules 17Ad-22(e)(4)(i), (iii), and (vi).²⁰ These Rules require that a covered clearing agency establish, implement, maintain and enforce written policies and procedures reasonably designed to effectively identify, measure, monitor, and manage its credit exposures to participants and those arising from its payment, clearing, and settlement processes, including by: (1) maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence; (2) maintaining additional financial resources at the minimum to enable it to cover a wide range of foreseeable stress scenarios that include, but are not limited to, the default of the participant family that would potentially cause the largest aggregate credit exposure for the covered clearing agency in extreme but plausible market conditions; and (3) testing the sufficiency of its total financial resources available to meet these minimum financial resource requirements. In its 2019 approval of enhancements to OCC's Clearing Fund and stress testing methodology, the Commission noted that OCC's introduction of new stress test scenarios designed to capture single wrong-way risk exposures for Clearing Member-issued ETNs would be consistent with the requirements of Rules 17Ad-22(e)(4)(i), (iii), and (vi), because it would enable OCC to test its total financial resources

²⁰ 17 CFR 240.17Ad-22(e)(4)(i), (iii), and (vi).

and to call for additional resources as necessary to ensure the resources it holds would be sufficient to enable OCC to cover exposures arising under the relevant stress scenarios.²¹

Likewise, for the current proposal, the Commission believes that OCC's introduction of four Sufficiency Scenarios reflecting the market events of March 2020, including its specific wrong-way risk exposure variations, would also enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources. The proposed rule change would thus enhance OCC's overall framework for measuring and managing its credit risks and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default consistent with Rules 17Ad-22(e)(4)(i), (iii), and (vi).

The Commission believes, therefore, that the proposal to elevate the four Informational Scenarios to Sufficiency Scenarios is consistent with the requirements of Rule 17Ad-22(e)(4) under the Exchange Act.²²

C. Accelerated Approval of the Proposed Rule Change

In its filing, OCC requests that the Commission grant accelerated approval of the Proposed Rule Change pursuant to Section 19(b)(C)(iii) of the Exchange Act.²³ Under Section 19(b)(2)(C)(iii) of the Exchange Act, the Commission may grant accelerated approval of a proposed rule change if the Commission finds good cause for doing so.²⁴ OCC believes that there is good cause for the Commission to accelerate effectiveness because the proposed changes

²¹ Securities Exchange Act Release No. 87718 (Dec. 11, 2019), 84 Fed. Reg. 68992, 68995 (Dec. 17, 2019) (File No. SR-OCC-2019-010).

²² 17 CFR 240.17Ad-22(e)(4).

²³ 15 U.S.C. 78s(b)(2)(C)(iii).

²⁴ Id.

are designed to improve OCC's ability to measure, monitor and manage its credit exposures to its participants.²⁵ Further, OCC believes that implementation of the proposed Sufficiency Scenarios would promote the protection of investors and the public interest by enabling OCC to test the sufficiency of its prefunded financial resources against a recent and significant period of market volatility and enhancing OCC's ability to manage the risks it faces as a systemically important financial market utility.²⁶

The Commission finds good cause, pursuant to Section 19(b)(2)(C)(iii) of the Exchange Act,²⁷ for approving the Proposed Rule Change on an accelerated basis, prior to the 30th day after the date of publication of notice in the Federal Register, because accelerated approval of this proposed rule change will facilitate the prompt and accurate clearance and settlement of options contracts by ensuring that OCC has expanded the range of stress scenarios to measure, monitor, and manage its credit exposures to its participants in a timely fashion, thereby immediately putting OCC in a better position to manage the risks it faces as a systemically important financial market utility.

²⁵ See Notice of Filing, 85 Fed. Reg. at 80830.

²⁶ Id.

²⁷ 15 U.S.C. 78s(b)(2)(C)(iii).

IV. CONCLUSION

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act, and in particular, the requirements of Section 17A of the Exchange Act²⁸ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,²⁹ that the Proposed Rule Change (SR-OCC-2020-015) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.³⁰

J. Matthew DeLesDernier
Assistant Secretary

²⁸ In approving this Proposed Rule Change, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁹ 15 U.S.C. 78s(b)(2).

³⁰ 17 CFR 200.30-3(a)(12).