

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65119; File No. SR-OCC-2011-10)

August 12, 2011

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Revise its By-Laws and Rules to Establish a Clearing Fund Amount Intended to Support Losses under a Defined Set of Default Scenarios

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 August 3, 2011, 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 primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change would change the method by which the size of OCC’s clearing fund is determined.

II. Self-Regulatory Organization’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.<sup>3</sup>

---

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

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

<sup>3</sup> The Commission has modified the text of the summaries prepared by OCC.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

This proposed rule change would revise OCC's By-Laws and Rules to establish the size of OCC's clearing fund as the amount that is required within a confidence level selected by OCC to sustain possible loss under a defined set of scenarios as determined by OCC. The proposed rule change replaces a previously proposed rule change which was withdrawn by OCC.<sup>4</sup> Currently the size of the clearing fund is calculated each month and is equal to a fixed percentage of the average total daily margin requirement for the preceding month provided that this calculation results in a clearing fund of \$1 billion or more.<sup>5</sup>

Under the proposed formula for determining the size of the clearing fund, the amount of the fund would be equal to the larger of the amount of the charge to the fund that would result from (i) a default by the single "clearing member group" whose default would be likely to result in the largest draw against the clearing fund or (ii) an event involving the near-simultaneous default of two randomly-selected "clearing member groups," in each case as calculated by OCC

---

<sup>4</sup> Securities Exchange Act Release 34-62371 (June 24, 2010), 75 FR 37864 (June 30, 2010) (SR-OCC-2010-04). OCC withdrew its proposed rule change regarding clearing fund sizing in order to submit this proposed rule change which: incorporates the amendments that were proposed to the previous proposed rule change; discusses the adaptation of the methodology underlying the formula change made to incorporate the effects of implementing the rule changes described in Securities Exchange Act Release No. 34-58158 (July 15, 2008), 73 FR 42646 (July 22, 2008) (SR-OCC-2007-20) ("Collateral in Margins Filing"); provides updated comparative data about the impact of the proposed clearing fund sizing formula; and makes additional changes to improve the overall readability of certain proposed rule text.

<sup>5</sup> If the calculation does not result in a clearing fund of \$1 billion or more, the percentage that results in a fund level of at least \$1 billion is applied provided that in no event will the percentage exceed 7%.

with a specified confidence level. Initially, the confidence levels employed by OCC in calculating the charge likely to result from a default by OCC's largest "clearing member group" and the default of two randomly-selected "clearing member groups" would be 99% and 99.9%, respectively.<sup>6</sup> However, OCC would have the discretion to employ different confidence levels in these calculations in the future provided that OCC would not employ confidence levels of less than 99% without filing a rule change with the Commission.<sup>7</sup> The size of the clearing fund would continue to be recalculated monthly based on a monthly averaging of daily calculations for the previous month and subject to a requirement that the total clearing fund be not less than \$1 billion.<sup>8</sup>

The new formula is designed to more directly take into account anticipated losses resulting from the clearing member default scenarios described above and thereby establish the clearing fund at a size that is sufficient to cover such losses without relying on any rights of OCC to require clearing members to replenish the clearing fund. The formula is generally consistent with the current "Recommendations for Central Counterparties" published by the Bank for International Settlements and the International Organization of Securities Commissioners. Among the recommendations in the publication are that a clearing organization "maintain sufficient financial resources to withstand, at a minimum, a default by the clearing member to which it has the largest exposure in extreme but plausible market conditions." The publication

---

<sup>6</sup> "Clearing member group" will be defined in Article I ("Definitions") of OCC's By-Laws to mean "a Clearing Member and any Member Affiliates of such Clearing Member."

<sup>7</sup> Proposed Interpretation and Policy .02 to OCC Rule 1001.

<sup>8</sup> Proposed Interpretation and Policy .01 to OCC Rule 1001.

further advises clearing organizations to plan for the possibility of a default by two or more clearing members in a short time frame.<sup>9</sup>

In considering whether to revise the formula for determining the size of the clearing fund, OCC compared the size of the clearing fund that would have resulted from application of the revised formula to the actual size of the clearing fund for each month from February 2008 through September 2009. This analysis revealed that for this time period the size of the clearing fund under the revised formula would have been on average 10% larger than under the current formula. In September and October 2008, which were two months of extreme volatility in the U.S. securities markets, the revised formula would have resulted in a clearing fund size of approximately 31% and 27% greater than under the current formula. The average monthly change in the size of the clearing fund and the standard deviation of clearing fund size from month to month for this time period under the two formulas were broadly similar.<sup>10</sup>

---

<sup>9</sup> See Bank for International Settlements and International Organization of Securities Commissions, Recommendations for Central Counterparties (November 2004), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD176.pdf> (the “2004 Recommendations”). OCC notes that in December 2009 the Committee on Payment and Settlement Systems of the Bank for International Settlements (“CPSS”) and the Technical Committee of the International Organization of Securities Commissions (“IOSCO”) began a comprehensive review of the 2004 Recommendations in order to strengthen and clarify such recommendations based on experience and lessons learned from the recent financial crisis. In March 2011, the CPSS and IOSCO published for comment the results of such review with comments requested by July 29, 2011. See Bank for International Settlements and International Organization of Securities Commissions, Principles for financial market infrastructures (March 2011), available at <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD350.pdf>

<sup>10</sup> Note the comparative data described in this paragraph was obtained using confidence levels set at 99% and above. OCC estimates that using only a 99% confidence level for the months referenced would have lowered by an average of approximately ½% the total size of the clearing fund as determined by the proposed methodology.

Since deciding in September 2009 that it wished to adopt the revised formula, OCC has continued to compare the size of the clearing fund under the revised formula with the size under the current formula. During 2010 the methodology underlying the revised formula was adapted to incorporate the effects of the implementation of the rule changes described in the Collateral in Margins Filing.<sup>11</sup> Under those changes, certain types of securities accepted as collateral are analyzed for margin purposes together with positions in cleared products as a single portfolio, affording a more accurate measurement of risk. During the period February 2008 through January 2010 (*i.e.*, prior to the implementation of the Collateral in Margins Filing) for which comparative data is available, the size of the clearing fund under the revised formula would have been on average 3% larger than under the current formula. Including also the further months of July, 2010 through June, 2011 (*i.e.*, since the implementation of the Collateral in Margins Filing) for which comparative data is available, the corresponding percentage increase is 2%.

The existing formula for determining the size of the clearing fund was intended to establish the fund at a level reasonably designed to cover losses resulting from one or more clearing member defaults, and OCC believes that it has served that purpose adequately. Nevertheless, OCC believes that the proposed amended formula is a better predictor of the actual losses that would be likely to result from such defaults. The existing formula takes potential losses into account only indirectly by setting the size of the clearing fund as a percentage of average margin requirements. The revised formula would directly take into account various types of default scenarios and therefore in OCC's view would be more likely to result in a level for the clearing fund that is adequate in the event such scenarios occur. The new formula would

---

<sup>11</sup> Securities Exchange Act Release No. 34-58158 (July 15, 2008), 73 FR 42646 (July 22, 2008) (SR-OCC-2007-20). See supra note 4.

therefore more closely align the size of the clearing fund with its intended purpose of absorbing losses resulting from clearing member defaults and would thereby avoid a disruption of the clearance process even during extreme market conditions.

Article VIII, Section 6 of OCC's By-Laws, which obligates clearing members to make good deficiencies in their clearing fund deposits resulting from pro rata charges or otherwise (subject to a cap equal to 100% of a clearing member's then required deposit if it promptly withdraws from membership and closes out or transfers its open positions) would remain unchanged.

The specific amendments proposed to OCC's By-Laws and Rules to facilitate the proposed changes to its clearing fund calculation can be found at

[http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_11\\_10.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_11_10.pdf)

If approved by the Commission, OCC would implement the revised formula for determining the size of its clearing fund sixty days after notice to its clearing members.

## 2. Statutory Basis

OCC believes the proposed rule changes are consistent with the requirements of Section 17A of the Act<sup>12</sup> and the rules and regulations thereunder because the proposed rule changes would facilitate prompt and accurate clearance and settlement of securities transactions by creating a more direct correlation between the clearing fund size and estimated losses from a defined set of default scenarios.

### (B) Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impose any burden on competition.

---

<sup>12</sup> 15 U.S.C. 78q-1.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments relating to the proposed rule change have not been solicited or received. OCC will notify the Commission of any written comments received by OCC.

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-2011-10 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2011-10. 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 Section, 100 F Street, N.E., Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of OCC and on OCC's website at [http://www.optionsclearing.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_11\\_03.pdf](http://www.optionsclearing.com/components/docs/legal/rules_and_bylaws/sr_occ_11_03.pdf).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to



make available publicly. All submissions should refer to File Number SR-OCC-2011-10 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>13</sup>

Elizabeth M. Murphy  
Secretary

---

<sup>13</sup> 17 CFR 200.30-3(a)(12).