SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68438; File No. AN-OCC-2012-04)

December 14, 2012

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing to Revise the Method for Determining the Minimum Clearing Fund Size to Include Consideration of the Amount Necessary to Draw on Secured Credit Facilities

I. Introduction

On October 18, 2012, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") an advance notice concerning a proposed rule change AN-OCC-2012-04 pursuant to Section 806(e) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"),[1] entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Title VIII" or "Clearing Supervision Act") and Rule 19b-4 under the Securities Exchange Act of 1934 ("Exchange Act").[2] The advance notice was published in the Federal Register on November 20, 2012.[3] The Commission did not receive comments on the advance notice publication. This publication serves as a notice of no objection to the proposed rule change discussed in the advance notice.

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1 Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 68225 (November 14, 2012), 77 FR 69668 (November 20, 2012). OCC also filed a proposed rule change under Section 19(b)(1) of the Exchange Act relating to these changes. See Securities Exchange Act Release No. 68130 (November 1, 2012), 77 FR 66900 (November 7, 2012)(Proposing Release). The Commission did not receive comments on the proposed rule change.

II. Description of Proposed Rule Change

A. Background

On September 23, 2011, the Commission approved a proposed rule change by OCC to establish the size of OCC's clearing fund as the amount that is required, within a confidence level selected by OCC, to sustain the maximum anticipated loss under a defined set of scenarios as determined by OCC, subject to a minimum clearing fund size of $1 billion.[4] OCC implemented this change in May 2012. Until that time, the size of OCC's clearing fund was calculated each month as a fixed percentage of the average total daily margin requirement for the preceding month, provided that the calculation resulted in a clearing fund of $1 billion or more.[5]

Under the formula that is implemented for determining the size of the clearing fund as a result of the May 2012 change, OCC's Rule 1001 provides that the amount of the fund is 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"[6] 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 with a

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4 Securities Exchange Act Release No. 65386 (September 23, 2011), 76 FR 60572 (September 29, 2011) (SR-OCC-2011-10).

5 If the calculation did not result in a clearing fund size of $1 billion or more, then the percentage of the average total daily margin requirement for the preceding month that resulted in a fund level of at least $1 billion would be applied. However, in no event was the percentage permitted to exceed 7%. With the rule change approved in September 2011, this 7% limiting factor on the minimum clearing fund size was eliminated.

6 The term "clearing member group" is defined in Article I of OCC's By-Laws to mean a clearing member and any member affiliates of the clearing member.

confidence level selected by OCC.[7] The size of the clearing fund continues to be recalculated monthly, based on a monthly averaging of daily calculations for the previous month, and it is subject to a requirement that its minimum size may not be less than $1 billion.

B. Proposed Change

The proposed rule change will implement a minimum clearing fund size equal to 110% of the amount of committed credit facilities secured by the clearing fund so that the amount of the clearing fund likely will exceed the required collateral value that would be necessary for OCC to be able to draw in full on such credit facilities. OCC's clearing fund is primarily intended to provide a high degree of assurance that market integrity will be maintained in the event that one or more clearing members, settlement banks, or banks that issue letters of credit on behalf of clearing members as a form of margin fails to meet its obligations.[8] This includes the potential use of the clearing fund as a source of liquidity should it ever be the case that OCC is unable to

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[7] 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" were approved by the Commission at 99% and 99.9%, respectively. However, the Commission approval order notes that OCC retains discretion to employ different confidence levels in these calculations provided that OCC will not employ confidence levels of less than 99% without first filing a proposed rule change.

[8] Under Article VIII, Section 1 of OCC's By-Laws, the clearing fund may be used to pay losses suffered by OCC: (1) as a result of the failure of a clearing member to perform its obligations with regard to any exchange transaction accepted by OCC; (2) as a result of a clearing member's failure to perform its obligations in respect of an exchange transaction or an exercised/assigned options contract, or any other contract or obligations in respect of which OCC is liable; (3) as a result of the failure of a clearing member to perform its obligations in respect of stock loan or borrow positions; (4) as a result of a liquidation of a suspended clearing member's open positions; (5) in connection with protective transactions of a suspended clearing member; (6) as a result of a failure of any clearing member to make any other required payment or to render any other required performance; or (7) as a result of a failure of any bank or securities or commodities clearing organization to perform its obligations to OCC.

obtain prompt delivery of, or convert promptly to cash, any asset credited to the account of a suspended clearing member.

OCC's committed credit facilities are secured by assets in the clearing fund and certain margin deposits of the suspended clearing member. In light of the uncertainty regarding the amount of margin assets of a suspended clearing member that might be eligible at any given point to support borrowing under the secured credit facilities, OCC has considered the availability of funds based on a consideration of the amount of the clearing fund deposits available as collateral. As an example, for OCC to draw on the full amount of its current credit facilities secured by the clearing fund, the size of the clearing fund likely would need to be approximately $2.2 billion. The $2.2 billion figure reflects a 10% increase above the total size of such credit facilities, which is meant to account for the percentage discount applied to collateral pledged by OCC in determining the amount available for borrowing.

Based on monthly recalculation information, the size of OCC's clearing fund during the period from July 2011 to July 2012 was less than $2.2 billion on eight occasions. Therefore, to reduce the risk that the assets in the clearing fund might at any time be insufficient to enable OCC to meet potential liquidity needs by accessing the full amount of its committed credit facilities that are secured by the clearing fund, OCC is amending the current minimum clearing fund be size requirement of $1 billion by providing instead that the minimum clearing fund size is the greater of either $1 billion or 110% of the amount of such committed credit facilities. OCC is denoting the credit facility component of the minimum clearing fund requirement as a percentage of the total amount of the credit facilities that OCC actually secures with clearing fund assets because OCC negotiates these credit facility agreements, including size and other terms, on an annual basis and the total size is therefore subject to change.

III. Analysis of Advance Notice

Standard of Review

A registered clearing agency that has been designated as a systemically important financial market utility ("FMU") by the Financial Stability Oversight Council ("FSOC") must provide advance notice of all proposed changes to its rules, procedures, or operations that could, as defined in the rules of the supervisory agency, materially affect the nature or level of risks presented by the clearing agency.[9] Absent an extension or request for additional information, as discussed in greater detail below, the Commission is required to notify the clearing agency of any objection regarding the proposed change within the 60 day time frame established by Title VIII.[10] A designated clearing agency may not implement a change to which its supervisory agency has objected;[11] however, the clearing agency is explicitly permitted to implement a change if it has not received an objection from its supervisory agency within the same 60 day time period.[12]

Although Title VIII does not specify a standard that the Commission must apply to determine whether to object to an advance notice, the Commission believes that the purpose of

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9 12 U.S.C. 5465(e). See also Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations, Securities Exchange Act Release No. 67286 (June 28, 2012), 77 FR 41602 (July 13, 2012) (Adopting Release).

10 12 U.S.C. 5465(e)(1)(E).

11 12 U.S.C. 5465(e)(1)(F).

12 12 U.S.C. 5465(e)(1)(G).

Title VIII, as stated under Section 802(b),[13] is relevant to the review of advance notices.

The stated purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability, by (among other things) authorizing the Federal Reserve Board to promote uniform risk management standards for systemically important FMUs, and providing an enhanced role for the Federal Reserve Board in the supervising of risk management standards for systemically important FMUs.[14] Therefore, the Commission believes that when reviewing advance notices for FMUs, the consistency of an advance notice with Title VIII may be judged principally by reference to the consistency of the advance notice with applicable rules of the Federal Reserve Board governing payment, clearing, and settlement activity of the designated FMU.[15]

Section 805(a) requires the Federal Reserve Board and authorizes the Commission to prescribe standards for the payment, clearing, and settlement activities of FMUs designated as systemically important, in consultation with the supervisory agencies. Section 805(b) of the Clearing Supervision Act[16] requires that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- Promote robust risk management;
- Promote safety and soundness;
- Reduce systemic risks; and

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13 12 U.S.C. 5461(b).

14 12 U.S.C. 5461(b).

15 See Financial Market Utilities, 77 FR 45907 (Aug. 2, 2012).

16 12 U.S.C. 5464(b).

- Support the stability of the broader financial system.

The relevant rules of the Federal Reserve Board prescribing risk management standards for designated FMUs by their terms do not apply to designated FMUs that are clearing agencies registered with the Commission.[17] Therefore, the Commission believes that the objectives and principles by which the Federal Reserve Board is required and the Commission is authorized to promulgate such rules, as expressed in Section 805(b) of Title VIII,[18] are the appropriate standards at this time by which to evaluate advance notices.[19] Accordingly, the analysis set forth below is organized by reference to the stated objectives and principles in Section 805(b).

Discussion of Advance Notice

The proposed rule change is designed to allow OCC to take full advantage of its liquidity resources that are secured by the clearing fund by collecting an amount that is at least 10% above the total size of the credit facilities to account for any collateral haircut that may be applied. This should assist OCC in maintaining market integrity in the event that one or more clearing members, settlement banks, or banks that issue letters of credit on behalf of clearing members as a form of margin fails to meet its obligations. By increasing the likelihood that OCC can take full advantage of its liquidity resources that are secured by the clearing fund, the proposed rule

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17 12 CFR 234.1(b).

18 12 U.S.C. 5464(b).

19 The risk management standards that have been adopted by the Commission in Rule 17Ad-22 are substantially similar to those of the Federal Reserve Board applicable to designated FMUs other than those designated clearing organizations registered with the CFTC or clearing agencies registered with the Commission. See Clearing Agency Standards, Securities Exchange Act Release No. 68080 (Oct.22, 2012), 77 FR 66219 (Nov. 2, 2012). To the extent such Commission standards are in effect at the time advance notices are reviewed in the future, the standards would be relevant to the analysis. Moreover, the analysis of clearing agency rule filings under the Exchange Act would incorporate such standards directly.

change should promote robust risk management and safety and soundness, reduce systemic risks, and support the stability of the broader financial system. For these reasons, the Commission does not object to the advance notice.

IV. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,[20] that, the Commission DOES NOT OBJECT to proposed rule change (File No. AN-OCC-2012-04) and that OCC be and hereby is AUTHORIZED to implement proposed rule change (File No. AN-OCC-2012-04) as of the date of this notice or the date of the "Order Approving Proposed Rule Change to Revise the Method for Determining the Minimum Clearing Fund Size to Include Consideration of the Amount Necessary to Draw on Secured Credit Facilities" (File No. SR-OCC-2012-22), whichever is later.

By the Commission.

Kevin M. O'Neill
Deputy Secretary

[20] 12 U.S.C. 5465(e)(1)(I).