

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-74406; File No. SR-OCC-2014-21)

March 2, 2015

Self-Regulatory Organizations; The Options Clearing Corporation; Order Instituting Proceedings to Determine Whether to Approve or Disapprove a Proposed Rule Change in Order to Permit OCC to Adjust the Size of its Clearing Fund on an Intra-Month Basis

I. Introduction

On November 13, 2014, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-OCC-2014-21 (“Proposed Rule Change”) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4 thereunder.² In the Proposed Rule Change, OCC proposes to amend its Rule 1001(a) to delete the requirement that OCC readjust the size of its clearing fund on a monthly basis.³ On December 2, 2014, the proposed rule change was published in the Federal Register.⁴ The Commission received no comments to the Proposed Rule Change.⁵ This order institutes proceedings under Section 19(b)(2)(B) of the Exchange Act⁶ to determine whether to approve or disapprove the Proposed Rule Change.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 204.19b-4. On October 15, 2014, OCC also filed an emergency notice with the Commission to suspend the effectiveness of the second sentence of Rule 1001(a). See infra note 10 and accompanying discussion.

³ Exchange Act Release No. 73685 (November 25, 2014) 78 FR 71479 (December 2, 2014) (SR-OCC-2014-21).

⁴ Id.

⁵ On January 5, 2015, pursuant to Section 19(b)(2)(A)(ii)(II) of the Exchange Act, as amended, OCC consented to an extension until March 2, 2015, for the Commission to approve the proposed rule change, disapprove the Proposed Rule Change, or institute proceedings to determine whether to disapprove the Proposed Rule Change. 15 U.S.C. 78s(b)(2)(A)(ii)(II).

⁶ 15 U.S.C. 78s(b)(2)(B).

II. Description of the Proposed Rule Change

OCC proposed this Proposed Rule Change to permit OCC to collect additional financial resources from its clearing members by increasing the size of its clearing fund on an intra-month basis when OCC determines that such action should be taken to ensure the clearing fund has sufficient resources to protect OCC against potential losses under simulated default scenarios. Specifically, OCC's Proposed Rule Change proposes to amend Rule 1001(a) to delete the second sentence, which states, "[s]uch [clearing fund resizing calculations] shall be made on a daily basis, and the size of the Clearing Fund shall be readjusted monthly based upon the average of such daily calculations performed during the preceding month."⁷

A. Background

In emergency circumstances and subject to certain conditions, Article IX, Section 14, of OCC's By-Laws permit OCC's Board of Directors, Executive Chairman, or President to waive or suspend its by-laws, rules, policies and procedures, or any other rules issued by OCC, or extend the time fixed thereby for the doing of any act or acts for up to thirty calendar days. To extend such a waiver or suspension for more than thirty calendar days, OCC's by-laws require it to submit a proposed rule change to the Commission seeking approval of such waiver.⁸ Upon submission of a rule filing, the waiver may continue in effect until the Commission approves or disapproves the proposed rule change.⁹

Although OCC monitors the sufficiency of its clearing fund on a daily basis, OCC Rule 1001(a) provides that it may only readjust the size of the clearing fund on a monthly basis.

⁷ OCC Rule 1001(a).

⁸ See OCC By-Laws, Article IX, Section 14(c).

⁹ Id.

On October 15, 2014, in order to address certain unanticipated intra-month market volatility OCC's Executive Chairman, pursuant to emergency authority, temporarily waived the OCC Rule 1001(a) requirement that OCC readjust the size of its clearing fund on a monthly basis, allowing OCC to resize the clearing fund intra-month. OCC was concerned that its current financial resources might not meet the total financial resources required to cover the default of its largest participant family. The waiver permitted OCC to increase the size of the clearing fund for the remainder of October 2014, prior to the next monthly resizing scheduled for the first business day of November 2014. As a result of the emergency action, OCC's clearing fund for October 2014 was increased by \$1.8 billion to a total amount of \$5.8 billion.

B. Proposed Rule Change SR-OCC-2014-21

OCC submitted the Proposed Rule Change, which amends its Rule 1001(a) by deleting the provision that requires OCC to readjust the size of its clearing fund on a monthly basis, allowing OCC to continue to collect additional financial resources from its clearing membership by increasing the size of its clearing fund on an intra-month basis when OCC determines such action should be taken so that the clearing fund is sufficient to protect OCC against potential loss under simulated default scenarios.¹⁰ OCC stated that it took this action to respond to the potential risk under prevailing market conditions that the clearing fund could be underfunded, which could have affected OCC's ability to provide services in a safe and sound manner. As noted, OCC's waiver of the provisions of the second sentence of Rule 1001(a) is permitted to continue for no more than thirty calendar days unless OCC submits a proposed rule change under

¹⁰ On October 15, 2014, OCC also filed an emergency notice with the Commission pursuant to Section 806(e)(2) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act"). 12 U.S.C. 5465(e)(2). See Securities Exchange Act Release No. 73579 (November 12, 2014), 79 FR 68747 (November 18, 2014) (SR-OCC-2014-807).

Section 19 of the Exchange Act seeking approval of such waiver.¹¹ By filing this proposed rule change, OCC preserved the suspended effectiveness of the second sentence of Rule 1001(a) beyond thirty calendar days.

OCC stated in its filing that it believes that the proposed rule change is appropriate: (i) to permit OCC to resize the clearing fund more frequently than monthly; and (ii) to determine the clearing fund's size in an amount sufficient to protect OCC from loss by relying on a broader range of sound risk management practices than only the average daily calculations under Rule 1001(a) that are performed during the preceding calendar month. OCC stated that it would use this authority to adjust the size of its clearing fund on an intra-month basis only to increase the size of the Clearing Fund where appropriate, not to decrease the size of the Clearing Fund. In continued reliance on the emergency rule waiver and the emergency notice, OCC set the November 2014 clearing fund size at \$7.8 billion, which included an amount determined by OCC to be sufficient to protect OCC against loss under simulated default scenarios (i.e., \$6 billion), plus a prudential margin of safety (the additional \$1.8 billion collected in October).¹²

C. Subsequent OCC Filings

On December 1, 2014, OCC filed an Advance Notice pursuant to Section 806(e)(1) of the Clearing Supervision Act and Exchange Act Rule 19b-4(n)(1)(i) and a corresponding proposed rule change, to establish procedures regarding the monthly resizing of the clearing fund and the addition of financial resources through intra-day margin calls and/or an intra-month increase of

¹¹ See supra note 8.

¹² See Information Memorandum #35507, dated October 31, 2014, <http://www.theocc.com/clearing/clearing-infomemos/infomemos1.jsp>.

the clearing fund to ensure adequate financial resources.¹³ The monthly clearing fund sizing procedures set forth in the advance notice and proposed rule change are based on broader risk management practices and establish the procedures that OCC would use to determine the size of the clearing fund on a monthly basis. These filings, however, do not provide OCC with authority to resize the clearing fund intra-month. Both filings are pending consideration by the Commission.¹⁴ By their terms, the proposals as identified in this advanced notice and proposed rule change will not take effect until all regulatory actions required with respect to the proposed rule change presently at issue are completed.

III. Proceedings to Determine Whether to Approve or Disapprove SR-OCC-2014-21 and Grounds for Disapproval Under Consideration

The Commission is instituting proceedings pursuant to Section 19(b)(2)(B) of the Act¹⁵ to determine whether the proposed rule change should be approved or disapproved. Institution of proceedings is appropriate at this time in view of the legal and policy issues raised by the Proposed Rule Change. As noted above, institution of proceedings does not indicate that the Commission has reached any conclusions with respect to any of the issues involved. Rather, the Commission seeks and encourages interested persons to comment on the Proposed Rule Change,

¹³ See Exchange Release No. 74091 (January 20, 2015), 80 FR 4001 (January 26, 2015) (SR-OCC-2014-811, as modified by Amendment No. 1); Exchange Act Release No. 73853 (December 16, 2014), 79 FR 76417 (December 22, 2014) (SR-OCC-2014-22, as modified by Amendment No. 1).

¹⁴ On January 27, 2015, the Commission requested additional information regarding Advance Notice SR-OCC-2014-811, which tolled the review period pursuant to Section 806(e)(1) of the Clearing Supervision Act. 12 U.S.C. 5465(e)(1). OCC has also voluntarily extended the statutory review period for the review pursuant to Exchange Act Section 19(b)(2)(A)(ii)(II). 15 U.S.C. 78s(B)(2)(A)(ii)(II).

¹⁵ 15 U.S.C. 78s(b)(2)(B).

and provide the Commission with arguments to support the Commission's analysis as to whether to approve or disapprove the Proposed Rule Change, as amended.

Pursuant to Section 19(b)(2)(B) of the Exchange Act,¹⁶ the Commission is providing notice of the grounds for disapproval under consideration. The Commission is instituting proceedings to allow for additional analysis of, and input from commenters with respect to, the Proposed Rule Change's consistency with Section 17A of the Exchange Act, and in particular, Section 17A(b)(3)(F) of the Exchange Act, which requires, among other things, that the rules of a clearing agency must: (i) assure the safeguarding of securities and funds which are in the custody or control of a clearing agency; and (ii) to protect investors and the public interest.¹⁷

Here, the Proposed Rule Change is proposing to eliminate the currently waived second sentence of Rule 1001(a), which would result in the elimination of the monthly resizing requirement. In the absence of an alternative, OCC's rules are devoid of any timeframes within which OCC would be required to resize its clearing fund. OCC's clearing fund reinforces OCC's ability to protect against a clearing member's default, and as such, OCC's clearing fund size (and calculation thereof) would correlate directly with OCC's ability to protect the clearing agency and its members against default.¹⁸ Without a robust framework and specific requirements in OCC's rules to resize the clearing fund on an expressed and periodic basis, it is not apparent that OCC will have sufficient financial resources to manage the risks associated with the default of one or more clearing members. Furthermore, without such a provision in OCC's rules, clearing members may not be sufficiently prepared to fund OCC's clearing fund calls when such calls are made.

¹⁶ 15 U.S.C. 78s(b)(2)(B).

¹⁷ See 15 U.S.C. 78q-1(b)(3)(F).

¹⁸ See http://optionsclearing.com/components/docs/about/occ_financial_guarantee.pdf.

With only pending proposals before the Commission for determining the clearing fund's size,¹⁹ the Proposed Rule Change raises concerns about how OCC will safeguard securities and funds that are in its custody or control, as well as how the Proposed Rule Change will protect investors and the public interest in the absence of any clearing fund resizing requirements. Consequently, the Commission believes that significant questions remain as to whether the Proposed Rule Change is consistent with the requirements of the Exchange Act, particularly when considered in combination with OCC's other proposed rule changes and advance notices currently pending before the Commission. Section 19(b)(2)(B) of the Exchange Act provides that proceedings to determine whether to approve or disapprove a proposed rule change must be concluded within 180 days of the date of publication of notice of the filing of the Proposed Rule Change. The time for conclusion of the proceedings may be extended for up to an additional 60 days if the Commission finds good cause for such extension and publishes its reasons for so finding or if the self-regulatory organization consents to the extension.

IV. Procedure: Request for Written Comments

The Commission requests that interested persons provide written submissions of their views, data, and arguments with respect to the concerns identified above, as well as any others they may have with the Proposed Rule Change. In particular, the Commission invites the written views of interested persons concerning whether the proposed rule change is inconsistent with Section 17A of the Exchange Act or any other provision of the Exchange Act, or the rules and regulations thereunder. Although there do not appear to be any issues relevant to approval or disapproval which would be facilitated by an oral presentation of views, data, and arguments, the Commission will consider, pursuant to Rule 19b-4, any request for an opportunity to make an

¹⁹ See supra note 13 and accompanying text.

oral presentation.²⁰

Interested persons are invited to submit written data, views, and arguments on or before [insert date 21 days from publication in the Federal Register]. Any person who wishes to file a rebuttal to any other person's submission must file that rebuttal on or before [insert 35 days from the date of publication in the Federal Register]. 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. Please include File Number SR-OCC-2014-21 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2014-21. 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

²⁰ Section 19(b)(2) of the Exchange Act, as amended by the Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 (1975), grants the Commission flexibility to determine what type of proceeding – either oral or notice and opportunity for written comments – is appropriate for consideration of a particular proposal by a self-regulatory organization. See Securities Acts Amendments of 1975, Report of the Senate Committee on Banking, Housing and Urban Affairs to Accompany S. 249, S. Rep. No. 75, 94th Cong., 1st Sess. 30 (1975).

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 filings also will be available for inspection and copying at the principal office of OCC and on OCC's website at

http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_14_21.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-2014-21 and should be submitted on or before [insert date 21 days from publication in the Federal Register]. If comments are received, any rebuttal comments should be submitted on or before [insert 35 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²¹

Brent J. Fields
Secretary

²¹ 17 CFR 200.30-3(a)(57).