

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-83799; File No. SR-OCC-2018-011)

August 8, 2018

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Make Clarifying and Conforming Changes to The Options Clearing Corporation's Margins Methodology and Margin Policy

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 July 24, 2018, 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 by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)<sup>3</sup> of the Act and Rule 19b-4(f)(1)<sup>4</sup> thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

OCC proposes to make clarifying and conforming changes to its Margin Policy and Margins Methodology related to enhancements to OCC's margin methodology that were recently approved by the Commission. The proposed changes to the Margin Policy and Margins Methodology are included as confidential Exhibits 5A and 5B, respectively. Material proposed to be added to the Margin Policy and Margins Methodology as currently in effect is underlined and material proposed to be deleted is marked in

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(1).

strikethrough text. All capitalized terms not defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>5</sup>

II. Clearing Agency'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.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

**Background**

OCC's margin methodology, the System for Theoretical Analysis and Numerical Simulations ("STANS"), is OCC's proprietary risk management system that calculates Clearing Member margin requirements.<sup>6</sup> STANS utilizes large-scale Monte Carlo simulations to forecast price and volatility movements in determining a Clearing Member's margin requirement.<sup>7</sup> The STANS margin requirement is calculated at the portfolio level of Clearing Member accounts with positions in marginable securities and

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<sup>5</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

<sup>6</sup> See Securities Exchange Act Release No. 53322 (February 15, 2006), 71 FR 9403 (February 23, 2006) (SR-OCC-2004-20).

<sup>7</sup> See OCC Rule 601.

consists of an estimate of a 99% expected shortfall<sup>8</sup> over a two-day time horizon and an add-on margin charge for model risk (the concentration / dependence stress test charge).<sup>9</sup> The STANS methodology is used to measure the exposure of portfolios of options and futures cleared by OCC and cash instruments in margin collateral.

On May 23, 2018, the Commission issued a Notice of No Objection to OCC's advance notice filing concerning a number of enhancements to OCC's margin methodology.<sup>10</sup> The proposed changes were designed to enable OCC to: (1) obtain daily price data for equity products for use in the daily estimation of econometric model parameters; (2) enhance OCC's econometric model for updating statistical parameters for all risk factors that reflect the most recent data obtained; (3) improve the sensitivity and stability of correlation estimates across risk factors by using de-volatized returns; and (4) improve OCC's methodology related to the treatment of defaulting securities. On May 24, 2018, the Commission approved a proposed rule changed by OCC concerning these same enhancements (collectively with the advance notice filing, the "Initial Filings").<sup>11</sup> The purpose of this proposed rule change is to make clarifying and conforming changes to OCC's Margin Policy and Margins Methodology related to the implementation of the

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<sup>8</sup> The expected shortfall component is established as the estimated average of potential losses higher than the 99% value at risk threshold. The term "value at risk" or "VaR" refers to a statistical technique that, generally speaking, is used in risk management to measure the potential risk of loss for a given set of assets over a particular time horizon.

<sup>9</sup> A detailed description of the STANS methodology is available at <http://optionsclearing.com/risk-management/margins/>.

<sup>10</sup> See Securities Exchange Act Release No. 83305 (May 23, 2018), 83 FR 24536 (May 29, 2018) (SR-OCC-2017-811).

<sup>11</sup> See Securities Exchange Act Release No. 83326 (May 24, 2018), 83 FR 25081 (May 31, 2018) (SR-OCC-2017-022).

methodology enhancements in the Initial Filings. The proposed changes are described in detail below.

### **Proposed Changes**

OCC proposes to revise its Margin Policy to reflect the use of daily price data in its margin models. Under the Initial Filings, the statistical parameters for OCC's econometric model would be updated on a daily basis using the new daily price data obtained by OCC.<sup>12</sup> As a result, OCC would no longer need to rely on scale factors to approximate day-to-day market volatility for equity-based products.<sup>13</sup> Instead, statistical parameters would be calibrated on a daily basis, allowing OCC to calculate more accurate margin requirements that are representative of the most recent market data. OCC therefore proposes to make conforming changes to its Margin Policy to remove references to scale factors and to provide that market data would be recalibrated on an at least weekly-basis with a daily recalibration performed where possible (as opposed to recalibrating on a monthly-basis).

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<sup>12</sup> See supra notes 10 and 11.

<sup>13</sup> Prior to the implementation of daily updates, OCC would continue to employ an approach where one or many identified market proxies (or "scale-factors") are used to incorporate day-to-day market volatility across all associated asset classes throughout. In 2017, the Commission approved a proposed rule change and issued a Notice of No Objection to an advance notice filing by OCC which, among other things: (1) expanded the number of scale factors used for equity-based products to more accurately measure the relationship between current and long-run market volatility with proxies that correlate more closely to certain products carried within the equity asset class, and (2) applied relevant scale factors to the greater of (i) the estimated variance of 1-day return scenarios or (ii) the historical variance of the daily return scenarios of a particular instrument, as a floor to mitigate procyclicality. See Securities Exchange Act Release No. 80147 (March 3, 2017), 82 FR 13163 (March 9, 2017) (SR-OCC-2017-001) and Securities Exchange Act Release No. 80143 (March 2, 2017), 82 FR 13036 (March 8, 2017) (SR-OCC-2017-801).

OCC also proposes to revise its Margins Methodology to clarify certain constraints on first and second day conditional variance estimates that would be imposed as part of the implementation of the methodology enhancements in the Initial Filings. As part of the Initial Filings, OCC introduced a second-day forecast for volatility into the model to estimate the two-day scenario distributions for risk factors.<sup>14</sup> OCC proposes to clarify in its Margins Methodology that OCC would impose an upper-bound limitation on the second-day conditional variance estimate in order to ensure that the expected shortfall is finite. Specifically, in the implementation of the new methodology, OCC would floor the day ahead and second day conditional variance for STANS at 100% every day.

Finally, OCC proposes to revise its Margins Methodology to clarify that the proposed changes from the Initial Filings and the proposed changes described herein would not be implemented until October 1, 2018.

(2) Statutory Basis

Section 17A(b)(3)(F) of the Act, requires, among other things, that the rules of a clearing agency be designed, in general, to protect investors and the public interest.<sup>15</sup> The proposed rule change would make a number of clarifying and conforming changes to OCC's Margin Policy and Margins Methodology related to enhancements to OCC's margin methodology that were recently approved by the Commission.<sup>16</sup> Specifically, the proposed rule change is designed to improve OCC's policy and methodology documentation by clarifying certain implementation details of the methodology changes in the Initial Filings, ensuring that OCC's Margin Policy is properly aligned with the

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<sup>14</sup> See supra notes 10 and 11.

<sup>15</sup> 17 U.S.C. 78q-1(b)(3)(F).

<sup>16</sup> See supra notes 10 and 11 and associated text.

methodology enhancements upon their implementation, and clarifying the implementation date for these changes. OCC believes that the proposed rule change is therefore designed, in general, to protect investors and the public interest in accordance with Section 17A(b)(3)(F) of the Act.<sup>17</sup>

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act<sup>18</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. OCC does not believe that the proposed rule change would have any impact or impose a burden on competition. The proposed rule change is intended to make clarifying and conforming changes to OCC's Margin Policy and Margins Methodology in connection with the implementation of a proposed rule change that was previously approved by the Commission. Accordingly, OCC does not believe that the proposed rule change would have any impact or impose a burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>19</sup> and Rule 19b-4(f)(1)<sup>20</sup> thereunder because it constitutes a stated policy,

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<sup>17</sup> 17 U.S.C. 78q-1(b)(3)(F).

<sup>18</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>19</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>20</sup> 17 CFR 240.19b-4(f)(1).

practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule.

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>21</sup>

#### 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-2018-011 on the subject line.

##### Paper Comments:

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

All submissions should refer to File Number SR-OCC-2018-011. 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

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<sup>21</sup> Notwithstanding its immediate effectiveness, implementation of this rule change will be delayed until (1) this change is deemed certified under CFTC Regulation 40.6 and (2) the implementation of the related methodology enhancements on October 1, 2018.

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 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 filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at [https://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_18\\_011.pdf](https://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_18_011.pdf).

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.



All submissions should refer to File Number SR-OCC-2018-011 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>22</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>22</sup> 17 CFR 200.30-3(a)(12).