



November 19, 2019

VIA ELECTRONIC MAIL

Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Rule Filing SR-OCC-2019-010 Rule Certification

Dear Secretary Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and Commodity Futures Trading Commission (“CFTC”) Regulation 40.6, enclosed is a copy of the above-referenced rule filing submitted by The Options Clearing Corporation (“OCC”). The date of implementation of the rule is at least 10 business days following receipt of the rule filing by the CFTC or the date the proposed rule is approved by the Securities and Exchange Commission (“SEC”) or otherwise becomes effective under the Securities Exchange Act of 1934 (the “Exchange Act”). This rule filing has been submitted to the SEC under the Exchange Act.

OCC has requested confidential treatment for Exhibits 3 and 5B – 5E to SR-OCC-2019-010 (contained in pages 57-68 and 71-160 of SR-OCC-2019-010, respectively).

In conformity with the requirements of Regulation 40.6(a)(7), OCC states the following:

Explanation and Analysis

The proposed rule change by OCC concerns enhancements to OCC’s Rules, margin policy and methodology, Clearing Fund policy, and Clearing Fund and stress testing methodology to adopt new margin charges and other risk measures to address the specific wrong-way risk presented by certain cleared positions.

The proposed amendments to OCC’s Rules are attached in Exhibit 5A. The proposed amendments to OCC’s Margin Policy and Margins Methodology are attached in Exhibits 5B and 5C, respectively. The proposed amendments to OCC’s Clearing Fund Methodology Policy (“CFM Policy”) and Stress Testing and Clearing Fund Methodology Description (“Methodology Description”) are attached in Exhibits 5D and 5E, respectively. Material proposed to be added to the Rules, Margin Policy and Margins Methodology as currently in effect is marked by underlining, and material proposed to be deleted is marked in strikethrough text; however, the proposed Specific Wrong-Way Risk Add-On chapter of the Margins Methodology is presented without marking to

improve readability as the entire chapter is newly proposed rule text. Material proposed to be added to the CFM Policy and Methodology Description is marked by double underlining, and material proposed to be deleted is marked in double strikethrough text.¹

All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.²

Background

As a central counterparty ("CCP"), OCC is exposed to wrong-way risk, which is the risk that arises when exposure to a counterparty is adversely correlated with the credit quality and probability of default of that counterparty. Specific wrong-way risk ("SWWR") arises when an exposure to a participant is highly likely to increase when the creditworthiness of that participant is deteriorating.³ For example, SWWR arises where a Clearing Member's cleared positions contain equity securities issued by the Clearing Member or its affiliates (*i.e.*, the Clearing Member Group) (such positions are referred to herein as "SWWR Equity positions") as the equity issued by the Clearing Member Group may be assumed to have a price at or near zero in a default or bankruptcy scenario, and those positions (*e.g.*, equity used as a hedge, stock loans, options on equity, single-stock futures) may experience substantial losses. In addition, SWWR may arise where uncollateralized exchange-traded notes ("ETNs") issued by a Clearing Member or its affiliates ("SWWR ETN positions") are part of the Clearing Member's cleared positions (these positions, collectively with "SWWR Equity positions," are hereinafter referred to as "SWWR positions"). SWWR may also arise when a Clearing Member posts equity securities or ETNs issued by it or of its affiliates as margin collateral.

OCC currently accounts for SWWR as it relates to margin collateral by generally prohibiting a Clearing Member from pledging equities issued by it or one of its affiliates as margin collateral unless this pledge provides a hedge against a cleared position in the same account.⁴ OCC does not, however, currently account for SWWR as it relates to cleared positions. As a result, OCC is

¹ OCC also submitted a proposed rule change concerning enhancements to its CFM Policy and Methodology Description, which are currently pending regulatory review. See SR-OCC-2019-009. OCC has marked proposed changes to the CFM Policy and Methodology Description described herein in double marking to clearly differentiate those changes from other changes currently pending review.

² OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>.

³ See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786, 70816, n. 317 (October 13, 2016) (S7-03-14) ("Standards for Covered Clearing Agencies"). See also Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

⁴ See OCC Rule 604, Interpretation and Policy .16.

proposing a new “add-on” charge⁵ for its margin methodology, the System for Theoretical Analysis and Numerical Simulations (“STANS”),⁶ and new stress test scenarios that may result in intra-day margin calls and, in more extreme cases, intra-month increases in the size of OCC’s Clearing Fund⁷ to address the wrong-way risk of OCC’s cleared positions involving Clearing Member-issued securities. In addition, OCC proposes to introduce certain restrictions on stock lending activity related to SWWR positions.

Proposed Changes

OCC proposes to enhance its management of SWWR by: (1) imposing certain restrictions on stock lending activity at OCC; (2) adopting a new SWWR margin add-on for STANS (“SWWR Add-on”); (3) introducing new stress test scenarios to capture the SWWR of cleared positions involving Clearing Member-issued ETNs beyond certain pre-defined thresholds; and (4) making other clarifying and conforming changes to the CFM Policy and Methodology Description. The proposed changes are intended to address the credit risks arising from SWWR positions at OCC. The proposed changes are described in detail below.

1. Prohibition on Lending Clearing Member/Affiliate-Issued Securities

OCC operates two programs for stock loan transactions: (1) the Stock Loan/Hedge Program and (2) the Market Loan Program (collectively, the “Stock Loan Programs”). In the Stock Loan/Hedge Program, prospective Lending and Borrowing Clearing Members identify each other (independent of OCC), agree to bilaterally negotiated terms of the stock loan (in this case, a “Hedge

⁵ Under OCC’s Margin Policy, OCC may collateralize certain exposures through the use of add-on charges.

⁶ See Securities Exchange Act Release No. 53322 (February 15, 2006), 71 FR 9403 (February 23, 2006) (SR-OCC-2004-20). A detailed description of the STANS methodology is available at <http://optionsclearing.com/risk-management/margins/>.

⁷ Under OCC’s existing stress testing and Clearing Fund methodology, OCC runs on a daily basis a set of stress test scenarios designed to 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 so that OCC continues to maintain sufficient financial resources to guard against potential losses under a wide range of stress scenarios, including extreme but plausible market conditions (“Sufficiency Scenarios,” and such scenarios collectively constituting “Sufficiency Stress Tests”). See Securities Exchange Act Release No. 83714 (July 26, 2018), 83 FR 37570 (August 1, 2018) (SR-OCC-2018-803) and Securities Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (August 2, 2018) (SR-OCC-2018-008). Under OCC Rule 609, the CFM Policy, and the Methodology Description, if a Sufficiency Stress Test identifies exposures that exceed 75% of the current Clearing Fund requirement less deficits (the “75% threshold” or “Sufficiency Stress Test Threshold 1”), OCC may require additional margin deposits from the Clearing Member Group(s) driving the breach. If a Sufficiency Stress Test identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. Id.

Loan”), and then send the details of the stock loan to the Depository Trust Company (“DTC”) designating the stock loan as a Hedge Loan for guaranty and clearance at OCC. The Lending Clearing Member then instructs DTC to transfer a specified number of shares of Eligible Stock⁸ to the account of the Borrowing Clearing Member, and the Borrowing Clearing Member instructs DTC to transfer the appropriate amount of cash collateral to the account of the Lending Clearing Member. In the Market Loan Program, stock loans are initiated through the matching of bids and offers that are either agreed upon by the Market Loan Clearing Members or matched anonymously through a Loan Market (such stock loans being “Market Loans”). In order to initiate a Market Loan, the Loan Market sends a matched transaction to OCC, which in turn sends two separate but linked settlement instructions to DTC to effect the movement of Eligible Stock and cash collateral between the accounts of the Market Loan Clearing Members through OCC’s account at DTC.

Regardless of whether a transaction is initiated under the Stock Loan/Hedge Program or Market Loan Program, OCC novates the transaction and becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member. As the principal counterparty to the Borrowing and Lending Clearing Members, OCC guarantees the return of the full value of cash collateral to a Borrowing Clearing Member and guarantees the return of the Loaned Stock (or value of that Loaned Stock) to the Lending Clearing Member.⁹ As noted above, OCC may be exposed to SWWR in its Stock Loan Programs where Clearing Members lend equity securities or ETNs issued by the Clearing Member or its affiliates. Specifically, the lending of Clearing Member or Member Affiliate-issued equity or ETNs creates a long exposure and liability in the case when a Clearing Member defaults and its own or affiliated equity or ETN declines.

OCC proposes to mitigate SWWR in its Stock Loan Programs by prohibiting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. The proposed restriction would apply to both SWWR Equity positions and SWWR ETN positions. OCC does not believe that the proposed restriction on lending SWWR Equity positions would have a material impact on Clearing Members in the Stock Loan Programs as Clearing Members do not typically engage in lending of their own equity securities and borrowers typically do not accept equity securities issued by their lending counterparty.¹⁰ The proposed restrictions on lending SWWR ETN positions would, however, impact a very small segment of

⁸ OCC’s By-Laws define “Eligible Stock” to mean, in part, any security that is eligible for lending in the Stock Loan/Hedge Program and the Market Loan Program. See Article I, Section 1.E(3) of the OCC By-Laws. Eligible Stock may include ETNs issued by OCC’s Clearing Members.

⁹ Under the Market Loan Program, OCC also provides a limited guaranty of dividend and rebate payments.

¹⁰ As of the start of September 2019, OCC had 107 Clearing Members, of which 64 have member or affiliate-issued securities eligible for lending in the Stock Loan Programs. OCC analyzed SWWR Equity lending activity for its Clearing Members from January 2018 through the beginning of September 2019. During this period, less than 10 Clearing Members had stock lending activity in SWWR Equity positions, and loans of SWWR Equity positions constituted less than three percent of each of those Clearing Members’ average notional stock lending activity for the period.

Clearing Members that lend SWWR ETNs.¹¹ OCC believes that the impact of the proposed changes would be limited by the fact that, unlike listed options, Clearing Members are able to lend SWWR positions on an uncleared basis outside of OCC. The proposed restrictions on lending activity in the Stock Loan Programs would not prevent Clearing Members from lending equities or ETNs issued by the Clearing Member or any affiliate of such Clearing Member on a bilateral basis if members wish to do so.

The proposed prohibition on lending Clearing Member or Member Affiliate-issued Eligible Stock would be included in new OCC Rules 2202(f) and 2202A(f) for the Stock Loan/Hedge Program and Market Loan Program, respectively. OCC would also make conforming changes to its Margin Policy and Margins Methodology to reflect the newly proposed restrictions in stock lending activity.

The proposed rule change would only apply to stock lending activity as of the time of implementation of the proposed rule change. The proposed rule change would not be applied retroactively to existing open positions, and Clearing Members with open stock loans involving Clearing Member or Member Affiliate-issued Eligible Stock would not be forced to terminate those existing positions. Any SWWR stock lending positions in existence as of the implementation of the proposed rule change would be subject to the SWWR charges described below until such positions are closed out through the normal course stock loan termination process.

2. *SWWR Add-on*

OCC proposes to adopt a new margin add-on (i.e., the SWWR Add-on) to address SWWR from cleared positions involving Clearing Member and affiliate issued equities and ETNs. The SWWR Add-on would be calculated for each margin tier account of a Clearing Member Group having positions related to either publicly traded equities or ETNs issued by the Clearing Member Group and would cover all types of positions (equity used as collateral, equity and ETN options, single-stock futures). The proposed SWWR Add-on is comprised of three main components: (1) “SWWR Equity Charge,” (2) “SWWR ETN Charge,” and (3) “SWWR Residual.” Each of these components is discussed below.

a. SWWR Equity Charge

¹¹ OCC analyzed SWWR ETN lending activity for its Clearing Members from January 2018 through the beginning of September 2019. Only 11 of OCC’s 107 Clearing Members have member or affiliate issued ETNs. During this period, less than 10 Clearing Members had stock lending activity for SWWR ETN positions. For the majority of these Clearing Members, lending in SWWR ETN positions constituted approximately 13 percent or less of each of those Clearing Members’ average notional stock lending activity for the period. For Clearing Members that averaged higher notational lending activity, OCC has observed significant reductions in this activity over recent months.

Under the proposal, when a Clearing Member defaults, it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member's and its affiliates' equity securities would be priced at zero and value all cleared positions accordingly (*i.e.*, all stocks, single stock futures, call options, and put options would be valued at zero) to provide full protection for the risk of potential market exposure to products on a Clearing Member Group's own equity in a default or bankruptcy scenario. In each margin account, the profit and loss ("P&L") of SWWR Equity positions would be calculated as the difference of the theoretical value of such securities (*i.e.*, zero) and the closing price of the position multiplied by the net quantity.¹² Moreover, any potential gain from the SWWR positions would be excluded by flooring the SWWR Equity Charge at zero.¹³ As a result, OCC believes that the proposed SWWR Equity Charge would adequately cover the SWWR arising from a Clearing Member's SWWR Equity positions.

b. SWWR ETN Charge

In addition to SWWR that arises from equity securities issued by a Clearing Member or its affiliates, OCC is also exposed to SWWR from open positions related to the uncollateralized ETNs issued by a Clearing Member/Group, which are adversely correlated with the credit quality of that Clearing Member Group. These ETNs are generally equivalent to unsecured senior debt issued by the Clearing Member/Group. While a Clearing Member default can be triggered by its failure to meet other obligations, the firm may or may not default on its ETNs. Hence, the recovery rate for ETNs is uncertain and could be between 0% and 100%.

To address SWWR presented by ETNs issued by a Clearing Member/Group, OCC proposes to calculate an SWWR ETN Charge as part of the SWWR Add-on. OCC notes that, unlike SWWR Equity positions, for which it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero, the recovery rate for ETNs would not necessarily fall to zero. As a result, the proposed SWWR ETN Charge would utilize an industry standard recovery rate assumption designed to reflect the credit risk associated with such ETN positions.¹⁴ OCC would also adopt additional stress test scenarios to monitor and measure SWWR ETN position exposures and

¹² Because SWWR of equity-related positions would be fully covered as part of margins, these positions would be removed from Clearing Fund shortfall calculations under OCC's stress testing and Clearing Fund methodology. Accordingly, OCC proposes to revise its Methodology Description to reflect the exclusion of SWWR Equity positions from the synthetic accounts used in OCC's stress testing.

¹³ For example, suppose the P&L from the SWWR equity price going to 0 for all SWWR equity-related positions were a loss of \$1 million. The SWWR Equity Charge in this case would be \$1 million. If the P&L were a gain of \$1 million, the SWWR Equity Charge would be \$0.

¹⁴ ETNs issued by a Clearing Member Group would still be stressed in OCC's Clearing Fund as only a part of the credit risk is covered by the SWWR ETN Charge. Additionally, any credit from margin assets would be adjusted by the direct charges related to the risk of the equity and ETNs issued by each Clearing Member Group.

allow for OCC to call for additional financial resources from its Clearing Members when certain thresholds are breached. These SWWR stress test scenarios are discussed in further detail below.

c. SWWR Residual

To ensure that OCC appropriately calculates margins to capture SWWR Equity and SWWR ETN position exposures, OCC proposes to include an SWWR Residual component in SWWR Add-on. Under the proposal, OCC would continue to calculate base STANS margin requirements for Clearing Members with SWWR positions including SWWR Equity and SWWR ETN positions under its current methodology (*i.e.*, without assuming that all SWWR Equity positions fall to a value of zero and without assuming all SWWR ETN positions are valued at the recovery rate times their current price).¹⁵ OCC would then also calculate a residual STANS margin with the SWWR Equity and SWWR ETN positions removed since for SWWR their P&L would be captured through the SWWR Equity and SWWR ETN Charges. The SWWR Residual would then be the difference between the residual margin and the base margin. If the sum of the SWWR Equity Charge, SWWR ETN Charge and SWWR Residual would result in a net credit to the Clearing Member,¹⁶ then the SWWR Residual would be adjusted to ensure that OCC always uses a more conservative measure that captures the greater of either the base STANS margin or the residual STANS margin plus the SWWR Equity and SWWR ETN Charges.¹⁷

¹⁵ STANS margin requirements are comprised of the sum of several components, each reflecting a different aspect of risk. The base component of the STANS margin requirement for each account is obtained using a risk measure known as 99% Expected Shortfall. 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. This base component is then adjusted by the addition of a stress test component, which is obtained from consideration of the increases in 99% Expected Shortfall that would arise from market movements that are especially large and/or in which various kinds of risk factors exhibit perfect or zero correlations in place of their correlations estimated from historical data (“Dependence Add-on”), or from extreme adverse idiosyncratic movements in individual risk factors to which the account is particularly exposed (“Concentration Add-on”).

¹⁶ For example, where a customer of a Clearing Member has net short positions referencing that Clearing Member’s issued equities, such positions may actually present so-called “right-way risk” whereby the position would result in a gain or margin credit for that account as the credit quality of the Clearing Member deteriorates.

¹⁷ For example, suppose that there are no SWWR ETN positions and the Expected Shortfall of a portfolio including all positions was a \$10 million loss and the Expected Shortfall with the SWWR Equity-related positions removed was a greater loss of \$11 million. In this case, the SWWR Residual would be -\$1 million. If the Expected Shortfall with the SWWR Equity-related positions removed was reduced to a loss of \$9 million then the SWWR Residual would depend on the SWWR Equity Charge: if the SWWR Equity Charge was more negative than -\$1 million, then the SWWR Residual would be +\$1 million; if the SWWR Equity Charge was \$0, then SWWR Residual would be \$0; and if SWWR Equity Charge was between \$0 and -\$1 million (*e.g.*, -\$0.4 million), then SWWR Residual

3. Enhancements to Sufficiency Stress Test Scenarios for ETNs

OCC proposes to revise its CFM Policy and Methodology Description to introduce new stress test scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge and that exceed certain thresholds of OCC's Clearing Fund ("SWWR Sufficiency Scenarios").¹⁸ Under the proposal, certain Sufficiency Scenarios¹⁹ would be evaluated with Clearing Member-issued ETNs declining to zero within the respective Clearing Member's accounts. Such scenarios would include, but would not be limited to, the 1987 "Black Monday" market event on a Cover 1 basis and the two most extreme moves from the 2008 historical market event on a Cover 2 basis.

SWWR Sufficiency Scenarios would value Clearing Member-issued ETNs at a price of zero within their own accounts capturing impacts to any cleared positions tied to those ETNs. Calls, equities, and single-stock futures would all be valued at zero and puts would be valued at their strike price. For these scenarios, margin assets for shortfall calculations would not be adjusted by the SWWR ETN Charge. In addition, other scenarios may be created that embed the SWWR Equity risk by not excluding positions related to the Clearing Member Group's own equity but using an equity price of zero to value all related products.

In the event an SWWR Sufficiency Scenario 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. If an SWWR Sufficiency Stress Scenario identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. The proposed change would enable OCC to more accurately measure its credit risks as they relate to SWWR and better test the sufficiency of its overall financial resources and would allow OCC to call for additional financial resources when SWWR ETN position exposures exceed certain thresholds of OCC's Clearing Fund. As a result of these proposed enhancements, OCC believes it would have sufficient financial resources to cover the SWWR associated with SWWR ETN positions if such positions were to be liquidated for less than the assumed recovery rate.

OCC notes that, under its current CFM Policy, in the event results of a daily Sufficiency Stress Test over the final five business days preceding the monthly Clearing Fund sizing exceed 90% of the projected Clearing Fund size for the upcoming month, the Clearing Fund size is set such that the peak Sufficiency Stress Test draw is no greater than 90% of the Clearing Fund size. OCC

would be positive and the opposite value of SWWR Equity Charge (e.g., +\$0.4 million). Thus, the sum of the SWWR Equity Charge, SWWR ETN Charge, and SWWR Residual cannot be positive.

¹⁸ OCC notes that it may also develop additional Informational Scenarios to monitor SWWR; however, these Informational Scenarios would not be used to call for additional financial resources from Clearing Members.

¹⁹ See supra note 7.

proposes to revise the CFM Policy to provide that OCC generally does not intend to mutualize exposures resulting from the proposed SWWR Sufficiency Scenarios and therefore SWWR Sufficiency Scenarios would not be included for purposes of this anti-procyclicality measure. The proposed change is generally aligned with OCC's intention to appropriately charge individual Clearing Members based on the SWWR they bring to OCC.

4. Other Clarifying and Conforming Changes to CFM Policy and Methodology Description

In addition to the proposed changes described above, OCC would revise the CFM Policy and Methodology Description to provide that, with respect to stress test portfolio construction, SWWR single-name equity positions would be removed from stress test portfolios as they are fully collateralized in margins. Additionally, the Methodology Description would be revised to provide that when adding STANS margin asset amounts to scenario gains and losses, the SWWR Equity Charge, SWWR ETN Charge, and certain other Add-ons from STANS margin asset amounts are excluded.

Finally, OCC would revise its Methodology Description to clarify that for Idiosyncratic Scenarios,²⁰ the four riskiest names used to calculate idiosyncratic stress test exposures would exclude any equity issued by the Clearing Member's own firms and make other clarifying, non-substantive changes to the Methodology Description concerning stress testing price shocks for products with multiple risk factors and Idiosyncratic Scenarios that are unrelated to the proposal described herein.

Clearing Member Outreach

To inform Clearing Members of the proposed changes, OCC has provided an overview of the proposed changes to the Financial Risk Advisory Council ("FRAC"), a working group comprised of exchanges, Clearing Members and indirect participants of OCC. OCC has also performed direct outreach to Clearing Members that would be most impacted by the proposed changes. To-date, OCC has not received any material objections or concerns in response to this outreach.

Implementation Timing

OCC expects to implement the proposed changes within sixty (60) days after the date that OCC receives all necessary regulatory approvals for the proposed changes. OCC will announce the implementation date of the proposed change by an Information Memorandum posted to its public website at least two (2) weeks prior to implementation.

²⁰ OCC has proposed in a separate proposed rule change filing to adopt a new set of stress scenarios to be used in the monthly sizing of OCC's Clearing Fund that are designed to capture the risks of extreme moves in individual or small subsets of securities ("Idiosyncratic Scenarios"). These Idiosyncratic Scenarios would consider the four single-name securities with the worst P&L in a Clearing Member's portfolio. See supra note 1.

OCC reviewed the derivatives clearing organization (“DCO”) Core Principles as set forth in the Act. During this review, OCC identified the following Core Principles as potentially being impacted:

Risk management. OCC believes that implementing the proposed rule change will be aligned with the requirements of Core Principle D.²¹ Core Principle D requires, in part, that each DCO limit, through the use of margin and other risk control mechanisms, its potential losses from defaults by members and participants of the DCO to ensure that its operations would not be disrupted and that its non-defaulting members or participants are not exposed to losses they cannot anticipate or control.²² Core Principle D further requires that each DCO have margin requirements sufficient to cover potential exposures in normal market conditions and that such margin requirements be set using risk-based models and parameters.²³

The proposed changes to OCC’s margin and Clearing Fund policies and methodologies to adopt the SWWR Add-on would utilize a risk-based model designed to limit OCC’s credit exposures to Clearing Members that present SWWR exposure to OCC through the clearing of Clearing Member-issued equity and ETN positions. OCC believes the proposed SWWR Add-on is reasonably designed to produce margin levels commensurate with the risks and particular attributes of SWWR Equity and ETN positions and would use an appropriate method for measuring credit exposure that accounts for relevant product risk factors such as SWWR. The SWWR Equity Charge assumes that when a Clearing Member defaults the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member’s and its affiliates’ equity securities would be priced at zero and value all cleared positions accordingly to provide full protection for the risk of potential market exposure to products on a Clearing Member Group’s own equity in a default or bankruptcy scenario. Moreover, the SWWR Add-on charge would include an SWWR Residual component to ensure that OCC takes the more conservative of the base STANS margin requirement or margin requirements including the SWWR Equity Charge (particularly in circumstances where using the SWWR Equity Charge would result in a net credit to the Clearing Member).

In addition, OCC would adopt an SWWR ETN Charge to address the SWWR presented by Clearing Member-issued ETNs. ETNs have different characteristics than equity securities and more closely reflect those characteristics of other unsecured debt obligations. For example, if a Clearing Member defaults that does not necessarily imply that it will automatically default on its ETNs. Therefore, ETNs are not necessarily valued at 0 and in fact may retain 100% of their value and be exposed to normal market risk. OCC therefore proposes to measure the risk of these positions using

²¹ 7 U.S.C. 7a-1(c)(2)(D).

²² 7 U.S.C. 7a-1(c)(2)(D)(iii).

²³ 7 U.S.C. 7a-1(c)(2)(D)(iv) - (v). CFTC Regulation 39.13(g)(2)(i) further implements Core Principle D by requiring, in part, that each DCO establish initial margin requirements that are commensurate with the risks of each product and portfolio, including any unusual characteristics of, or risks associated with, particular products or portfolios. See 17 CFR 39.13(g)(2)(i).

an industry standard recovery rate assumption designed to calculate a margin charge that reflects the expected credit risk associated with such ETN positions.

For the reasons set forth above, OCC believes the proposed SWWR Add-on would enhance OCC's margin system in a manner consistent with the requirements of Core Principle D.²⁴

In addition, OCC believes restricting the lending of SWWR positions is the most prudent way to manage SWWR in the Stock Loan Programs because it is the simplest and most effective way to mitigate this risk from an operational and default management perspective. By restricting lending activity for SWWR positions, large changes in margin requirements associated with the initiation of these types of positions would be avoided. The proposed change would also simplify the potential closeout activities associated with a default. Moreover, OCC believes the proposed limitation on lending SWWR positions is the most effective way to address the potential liquidity demands driven by the lending of SWWR positions, the costs of which are borne by all of OCC's Clearing Members and not just those members lending SWWR positions. OCC believes the proposed change would enhance OCC's ability to manage the credit risks presented by SWWR positions in the Stock Loan Programs and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default. For these reasons, OCC believes the proposed rule change promotes compliance with Core Principle D.²⁵

Financial resources. OCC believes that implementing the proposed rule change would also be consistent with the Core Principle B,²⁶ which requires, in part, that each DCO possesses financial resources that, at a minimum, exceed the total amount that would enable it to meet its financial obligations to its members and participants notwithstanding a default by the member or participant creating the largest financial exposure for that organization in extreme but plausible market conditions.²⁷ CFTC Regulation 39.11(c)(1)²⁸ further requires, in part, that a DCO shall, on a monthly basis, perform stress testing that will allow it to make a reasonable calculation of such financial resources using a methodology that takes into account both historical data and hypothetical scenarios.

OCC believes that introducing new SWWR Sufficiency Scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge would enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources, particularly in stressed market conditions. The proposed change

²⁴ 7 U.S.C. 7a-1(c)(2)(D).

²⁵ 7 U.S.C. 7a-1(c)(2)(D).

²⁶ 7 U.S.C. 7a-1(c)(2)(B).

²⁷ CFTC Regulation 39.11(a)(1) provides that if a clearing member controls another clearing member or is under common control with another clearing member, the affiliated clearing members shall be deemed to be a single clearing member for purposes of this provision. 17 CFR 39.11(a)(1).

²⁸ 17 CFR 39.11(c)(1).

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would also allow OCC to call for additional financial resources when those exposures exceed certain thresholds of OCC's Clearing Fund. The proposed rule change is therefore designed to 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 in extreme but plausible market conditions. In this regard, the proposed changes would further OCC's compliance with Core Principle B.

Opposing Views

No opposing views were expressed related to the rule amendments.

Notice of Pending Rule Certification

OCC hereby certifies that notice of this rule filing has been given to Clearing Members of OCC in compliance with Regulation 40.6(a)(2) by posting a copy of the submission on OCC's website concurrently with the filing of this submission.

Certification

OCC hereby certifies that the rule set forth at Item 1 of the enclosed filing complies with the Act and the CFTC's regulations thereunder.

Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,



Justin W. Byrne
Vice President, Regulatory Filings

Enclosure

Required fields are shown with yellow backgrounds and asterisks.

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Filing by Options Clearing Corporation
Pursuant to Rule 19b-4 under the Securities Exchange Act of 1934

Initial *	Amendment *	Withdrawal	Section 19(b)(2) *	Section 19(b)(3)(A) *	Section 19(b)(3)(B) *
<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input checked="" type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Pilot <input type="checkbox"/> Extension of Time Period for Commission Action * <input type="checkbox"/> Date Expires * <input type="text"/>			Rule		
			<input type="checkbox"/> 19b-4(f)(1)	<input type="checkbox"/> 19b-4(f)(4)	
			<input type="checkbox"/> 19b-4(f)(2)	<input type="checkbox"/> 19b-4(f)(5)	
			<input type="checkbox"/> 19b-4(f)(3)	<input type="checkbox"/> 19b-4(f)(6)	

Notice of proposed change pursuant to the Payment, Clearing, and Settlement Act of 2010 Section 806(e)(1) * <input type="checkbox"/> Section 806(e)(2) * <input type="checkbox"/>	Security-Based Swap Submission pursuant to the Securities Exchange Act of 1934 Section 3C(b)(2) * <input type="checkbox"/>
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Exhibit 2 Sent As Paper Document <input type="checkbox"/>	Exhibit 3 Sent As Paper Document <input type="checkbox"/>
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Description
Provide a brief description of the action (limit 250 characters, required when Initial is checked *).

Proposed rule change concerning proposed changes to The Options Clearing Corporation's Rules, Margin Policy, Margin Methodology, Clearing Fund Methodology Policy, and Clearing Fund and Stress Testing Methodology to address Specific Wrong-Way Risk.

Contact Information
Provide the name, telephone number, and e-mail address of the person on the staff of the self-regulatory organization prepared to respond to questions and comments on the action.

First Name * Justin	Last Name * Byrne
Title * Vice President, Regulatory Filings	
E-mail * jbyrne@theocc.com	
Telephone * (202) 971-7238	Fax (312) 322-6280

Signature
Pursuant to the requirements of the Securities Exchange Act of 1934,
has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

(Title *)

Date 10/10/2019	Vice President, Regulatory Filings
By Justin W. Byrne	
(Name *)	

Justin Byrne, jbyrne@theocc.com

NOTE: Clicking the button at right will digitally sign and lock this form. A digital signature is as legally binding as a physical signature, and once signed, this form cannot be changed.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

For complete Form 19b-4 instructions please refer to the EFFS website.

Form 19b-4 Information *

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The self-regulatory organization must provide all required information, presented in a clear and comprehensible manner, to enable the public to provide meaningful comment on the proposal and for the Commission to determine whether the proposal is consistent with the Act and applicable rules and regulations under the Act.

Exhibit 1 - Notice of Proposed Rule Change *

Add Remove View

The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 1A- Notice of Proposed Rule Change, Security-Based Swap Submission, or Advance Notice by Clearing Agencies *

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The Notice section of this Form 19b-4 must comply with the guidelines for publication in the Federal Register as well as any requirements for electronic filing as published by the Commission (if applicable). The Office of the Federal Register (OFR) offers guidance on Federal Register publication requirements in the Federal Register Document Drafting Handbook, October 1998 Revision. For example, all references to the federal securities laws must include the corresponding cite to the United States Code in a footnote. All references to SEC rules must include the corresponding cite to the Code of Federal Regulations in a footnote. All references to Securities Exchange Act Releases must include the release number, release date, Federal Register cite, Federal Register date, and corresponding file number (e.g., SR-[SRO]-xx-xx). A material failure to comply with these guidelines will result in the proposed rule change, security-based swap submission, or advance notice being deemed not properly filed. See also Rule 0-3 under the Act (17 CFR 240.0-3)

Exhibit 2 - Notices, Written Comments, Transcripts, Other Communications

Add Remove View

Exhibit Sent As Paper Document

Copies of notices, written comments, transcripts, other communications. If such documents cannot be filed electronically in accordance with Instruction F, they shall be filed in accordance with Instruction G.

Exhibit 3 - Form, Report, or Questionnaire

Add Remove View

Exhibit Sent As Paper Document

Copies of any form, report, or questionnaire that the self-regulatory organization proposes to use to help implement or operate the proposed rule change, or that is referred to by the proposed rule change.

Exhibit 4 - Marked Copies

Add Remove View

The full text shall be marked, in any convenient manner, to indicate additions to and deletions from the immediately preceding filing. The purpose of Exhibit 4 is to permit the staff to identify immediately the changes made from the text of the rule with which it has been working.

Exhibit 5 - Proposed Rule Text

Add Remove View

The self-regulatory organization may choose to attach as Exhibit 5 proposed changes to rule text in place of providing it in Item I and which may otherwise be more easily readable if provided separately from Form 19b-4. Exhibit 5 shall be considered part of the proposed rule change.

Partial Amendment

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If the self-regulatory organization is amending only part of the text of a lengthy proposed rule change, it may, with the Commission's permission, file only those portions of the text of the proposed rule change in which changes are being made if the filing (i.e. partial amendment) is clearly understandable on its face. Such partial amendment shall be clearly identified and marked to show deletions and additions.

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change
by

THE OPTIONS CLEARING CORPORATION

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

Item 1. Text of the Proposed Rule Change

Pursuant to the provisions of Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act” or “Act”),¹ and Rule 19b-4 thereunder,² The Options Clearing Corporation (“OCC” or “Corporation”) is filing with the Securities and Exchange Commission (“SEC” or “Commission”) a proposed rule change in connection with proposed enhancements to OCC’s Rules, margin policy and methodology, Clearing Fund policy, and Clearing Fund and stress testing methodology to adopt new margin charges and other risk measures to address the specific wrong-way risk presented by certain cleared positions.

The proposed amendments to OCC’s Rules are attached in Exhibit 5A. The proposed amendments to OCC’s Margin Policy and Margins Methodology are attached in Exhibits 5B and 5C, respectively. The proposed amendments to OCC’s Clearing Fund Methodology Policy (“CFM Policy”) and Stress Testing and Clearing Fund Methodology Description (“Methodology Description”) are attached in Exhibits 5D and 5E, respectively. Material proposed to be added to the Rules, Margin Policy and Margins Methodology as currently in effect is marked by underlining, and material proposed to be deleted is marked in strikethrough text; however, the proposed Specific Wrong-Way Risk Add-On chapter of the Margins Methodology is presented without marking to improve readability as the entire chapter is newly proposed rule text.³ Material proposed to be added to the CFM Policy and Methodology Description is marked by double underlining, and material proposed to be deleted is marked in double strikethrough text.⁴

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ OCC also has filed an advance notice with the Commission in connection with the proposed changes. See SR-OCC-2019-807.

⁴ OCC also filed with the Commission proposed rule change and advance notice filings concerning enhancements to its CFM Policy and Methodology Description, which are

All terms with initial capitalization not defined herein have the same meaning as set forth in OCC's By-Laws and Rules.⁵

Item 2. Procedures of the Self-Regulatory Organization

The proposed changes were approved for filing with the Commission by the Risk Committee of the Board of Directors at a meeting held on October 2, 2018, pursuant to authority delegated by the Board of Directors at a meeting held on July 18, 2018. Additional amendments to the proposal were approved by the Risk Committee and the Board of Directors at meetings held on April 25, 2019, and July 17, 2019.

Questions should be addressed to Justin W. Byrne, Vice President, Regulatory Filings, at (202) 971-7238.

Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

A. Purpose

Background

As a central counterparty ("CCP"), OCC is exposed to wrong-way risk, which is the risk that arises when exposure to a counterparty is adversely correlated with the credit quality and probability of default of that counterparty. Specific wrong-way risk ("SWWR") arises when an exposure to a participant is highly likely to increase when the creditworthiness of that participant is deteriorating.⁶ For example, SWWR arises where a Clearing Member's cleared positions

currently pending Commission review. See SR-OCC-2019-009 and SR-OCC-2019-806. OCC has marked proposed changes to the CFM Policy and Methodology Description described herein in double marking to clearly differentiate those changes from other changes currently pending Commission review.

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

⁶ See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786,

contain equity securities issued by the Clearing Member or its affiliates (i.e., the Clearing Member Group) (such positions referred to herein as “SWWR Equity positions”) as the equity issued by the Clearing Member Group may be assumed to have a price at or near zero in a default or bankruptcy scenario, and those positions (e.g., equity used as a hedge, stock loans, options on equity, single-stock futures) may experience substantial losses. In addition, SWWR may arise where uncollateralized exchange-traded notes (“ETNs”) issued by a Clearing Member or its affiliates (“SWWR ETN positions”) are part of the Clearing Member’s cleared positions (these positions, collectively with “SWWR Equity positions,” are hereinafter referred to as “SWWR positions”). SWWR may also arise when a Clearing Member posts equity securities or ETNs issued by it or of its affiliates as margin collateral.

OCC currently accounts for SWWR as it relates to margin collateral by generally prohibiting a Clearing Member from pledging equities issued by it or one of its affiliates as margin collateral unless this pledge provides a hedge against a cleared position in the same account.⁷ OCC does not, however, currently account for SWWR as it relates to cleared positions. As a result, OCC is proposing a new “add-on” charge⁸ for its margin methodology, the System for Theoretical Analysis and Numerical Simulations (“STANS”),⁹ and new stress test

70816, n. 317 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”). See also Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

⁷ See OCC Rule 604, Interpretation and Policy .16.

⁸ Under OCC’s Margin Policy, OCC may collateralize certain exposures through the use of add-on charges.

⁹ See Securities Exchange Act Release No. 53322 (February 15, 2006), 71 FR 9403 (February 23, 2006) (SR-OCC-2004-20). A detailed description of the STANS methodology is available at <http://optionsclearing.com/risk-management/margins/>.

scenarios that may result in intra-day margin calls and, in more extreme cases, intra-month increases in the size of OCC's Clearing Fund¹⁰ to address the wrong-way risk of OCC's cleared positions involving Clearing Member-issued securities. In addition, OCC proposes to introduce certain restrictions on stock lending activity related to SWWR positions.

Proposed Changes

OCC proposes to enhance its management of SWWR by: (1) imposing certain restrictions on stock lending activity at OCC; (2) adopting a new SWWR margin add-on for STANS ("SWWR Add-on"); (3) introducing new stress test scenarios to capture the SWWR of cleared positions involving Clearing Member-issued ETNs beyond certain pre-defined thresholds; and (4) making other clarifying and conforming changes to the CFM Policy and Methodology Description. The proposed changes are intended to address the credit risks arising from SWWR positions at OCC. The proposed changes are described in detail below.

1. Prohibition on Lending Clearing Member/Affiliate-Issued Securities

OCC operates two programs for stock loan transactions: (1) the Stock Loan/Hedge

¹⁰ Under OCC's existing stress testing and Clearing Fund methodology, OCC runs on a daily basis a set of stress test scenarios designed to 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 so that OCC continues to maintain sufficient financial resources to guard against potential losses under a wide range of stress scenarios, including extreme but plausible market conditions ("Sufficiency Scenarios," and such scenarios collectively constituting "Sufficiency Stress Tests"). See Securities Exchange Act Release No. 83714 (July 26, 2018), 83 FR 37570 (August 1, 2018) (SR-OCC-2018-803) and Securities Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (August 2, 2018) (SR-OCC-2018-008). Under OCC Rule 609, the CFM Policy, and the Methodology Description, if a Sufficiency Stress Test identifies exposures that exceed 75% of the current Clearing Fund requirement less deficits (the "75% threshold" or "Sufficiency Stress Test Threshold 1"), OCC may require additional margin deposits from the Clearing Member Group(s) driving the breach. If a Sufficiency Stress Test identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. Id.

Program and (2) the Market Loan Program (collectively, the “Stock Loan Programs”). In the Stock Loan/Hedge Program, prospective Lending and Borrowing Clearing Members identify each other (independent of OCC), agree to bilaterally negotiated terms of the stock loan (in this case, a “Hedge Loan”), and then send the details of the stock loan to the Depository Trust Company (“DTC”) designating the stock loan as a Hedge Loan for guaranty and clearance at OCC. The Lending Clearing Member then instructs DTC to transfer a specified number of shares of Eligible Stock¹¹ to the account of the Borrowing Clearing Member, and the Borrowing Clearing Member instructs DTC to transfer the appropriate amount of cash collateral to the account of the Lending Clearing Member. In the Market Loan Program, stock loans are initiated through the matching of bids and offers that are either agreed upon by the Market Loan Clearing Members or matched anonymously through a Loan Market (such stock loans being “Market Loans”). In order to initiate a Market Loan, the Loan Market sends a matched transaction to OCC, which in turn sends two separate but linked settlement instructions to DTC to effect the movement of Eligible Stock and cash collateral between the accounts of the Market Loan Clearing Members through OCC’s account at DTC.

Regardless of whether a transaction is initiated under the Stock Loan/Hedge Program or Market Loan Program, OCC novates the transaction and becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member. As the principal counterparty to the Borrowing and Lending Clearing Members, OCC guarantees the return of the full value of cash collateral to a Borrowing Clearing Member and guarantees the return of the

¹¹ OCC’s By-Laws define “Eligible Stock” to mean, in part, any security that is eligible for lending in the Stock Loan/Hedge Program and the Market Loan Program. See Article I, Section 1.E(3) of the OCC By-Laws. Eligible Stock may include ETNs issued by OCC’s Clearing Members.

Loaned Stock (or value of that Loaned Stock) to the Lending Clearing Member.¹² As noted above, OCC may be exposed to SWWR in its Stock Loan Programs where Clearing Members lend equity securities or ETNs issued by the Clearing Member or its affiliates. Specifically, the lending of Clearing Member or Member Affiliate-issued equity or ETNs creates a long exposure and liability in the case when a Clearing Member defaults and its own or affiliated equity or ETN declines.

OCC proposes to mitigate SWWR in its Stock Loan Programs by prohibiting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. The proposed restriction would apply to both SWWR Equity positions and SWWR ETN positions. OCC does not believe that the proposed restriction on lending SWWR Equity positions would have a material impact on Clearing Members in the Stock Loan Programs as Clearing Members do not typically engage in lending of their own equity securities and borrowers typically do not accept equity securities issued by their lending counterparty.¹³ The proposed restrictions on lending SWWR ETN positions would, however, impact a very small segment of Clearing Members that lend SWWR ETNs.¹⁴ OCC believes that the impact of

¹² Under the Market Loan Program, OCC also provides a limited guaranty of dividend and rebate payments.

¹³ As of the start of September 2019, OCC had 107 Clearing Members, of which 64 have member or affiliate-issued securities eligible for lending in the Stock Loan Programs. OCC analyzed SWWR Equity lending activity for its Clearing Members from January 2018 through the beginning of September 2019. During this period, less than 10 Clearing Members had stock lending activity in SWWR Equity positions, and loans of SWWR Equity positions constituted less than three percent of each of those Clearing Members' average notional stock lending activity for the period.

¹⁴ OCC analyzed SWWR ETN lending activity for its Clearing Members from January 2018 through the beginning of September 2019. Only 11 of OCC's 107 Clearing Members have member or affiliate issued ETNs. During this period, less than 10 Clearing Members had stock lending activity for SWWR ETN positions. For the majority of these Clearing Members, lending in SWWR ETN positions constituted

the proposed changes would be limited by the fact that, unlike listed options, Clearing Members are able to lend SWWR positions on an uncleared basis outside of OCC. The proposed restrictions on lending activity in the Stock Loan Programs would not prevent Clearing Members from lending equities or ETNs issued by the Clearing Member or any affiliate of such Clearing Member on a bilateral basis if members wish to do so.

The proposed prohibition on lending Clearing Member or Member Affiliate-issued Eligible Stock would be included in new OCC Rules 2202(f) and 2202A(f) for the Stock Loan/Hedge Program and Market Loan Program, respectively. OCC would also make conforming changes to its Margin Policy and Margins Methodology to reflect the newly proposed restrictions in stock lending activity.

The proposed rule change would only apply to stock lending activity as of the time of implementation of the proposed rule change. The proposed rule change would not be applied retroactively to existing open positions, and Clearing Members with open stock loans involving Clearing Member or Member Affiliate-issued Eligible Stock would not be forced to terminate those existing positions. Any SWWR stock lending positions in existence as of the implementation of the proposed rule change would be subject to the SWWR charges described below until such positions are closed out through the normal course stock loan termination process.

2. *SWWR Add-on*

OCC proposes to adopt a new margin add-on (i.e., the SWWR Add-on) to address SWWR from cleared positions involving Clearing Member and affiliate issued equities and

approximately 13 percent or less of each of those Clearing Members' average notional stock lending activity for the period. For Clearing Members that averaged higher notional lending activity, OCC has observed significant reductions in this activity over recent months.

ETNs. The SWWR Add-on would be calculated for each margin tier account of a Clearing Member Group having positions related to either publicly traded equities or ETNs issued by the Clearing Member Group and would cover all types of positions (equity used as collateral, equity and ETN options, single-stock futures). The proposed SWWR Add-on is comprised of three main components: (1) “SWWR Equity Charge,” (2) “SWWR ETN Charge,” and (3) “SWWR Residual.” Each of these components is discussed below.

a. SWWR Equity Charge

Under the proposal, when a Clearing Member defaults, it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member’s and its affiliates’ equity securities would be priced at zero and value all cleared positions accordingly (i.e., all stocks, single stock futures, call options, and put options would be valued at zero) to provide full protection for the risk of potential market exposure to products on a Clearing Member Group’s own equity in a default or bankruptcy scenario. In each margin account, the profit and loss (“P&L”) of SWWR Equity positions would be calculated as the difference of the theoretical value of such securities (i.e., zero) and the closing price of the position multiplied by the net quantity.¹⁵ Moreover, any potential gain from the SWWR positions would be excluded by flooring the SWWR Equity Charge at zero.¹⁶ As a result, OCC believes that the proposed

¹⁵ Because SWWR of equity-related positions would be fully covered as part of margins, these positions would be removed from Clearing Fund shortfall calculations under OCC’s stress testing and Clearing Fund methodology. Accordingly, OCC proposes to revise its Methodology Description to reflect the exclusion of SWWR Equity positions from the synthetic accounts used in OCC’s stress testing.

¹⁶ For example, suppose the P&L from the SWWR equity price going to 0 for all SWWR equity-related positions were a loss of \$1 million. The SWWR Equity Charge in this case would be \$1 million. If the P&L were a gain of \$1 million, the SWWR Equity Charge would be \$0.

SWWR Equity Charge would adequately cover the SWWR arising from a Clearing Member's SWWR Equity positions.

b. SWWR ETN Charge

In addition to SWWR that arises from equity securities issued by a Clearing Member or its affiliates, OCC is also exposed to SWWR from open positions related to the uncollateralized ETNs issued by a Clearing Member/Group, which are adversely correlated with the credit quality of that Clearing Member Group. These ETNs are generally equivalent to unsecured senior debt issued by the Clearing Member/Group. While a Clearing Member default can be triggered by its failure to meet other obligations, the firm may or may not default on its ETNs. Hence, the recovery rate for ETNs is uncertain and could be between 0% and 100%.

To address SWWR presented by ETNs issued by a Clearing Member/Group, OCC proposes to calculate an SWWR ETN Charge as part of the SWWR Add-on. OCC notes that, unlike SWWR Equity positions, for which it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero, the recovery rate for ETNs would not necessarily fall to zero. As a result, the proposed SWWR ETN Charge would utilize an industry standard recovery rate assumption designed to reflect the credit risk associated with such ETN positions.¹⁷ OCC would also adopt additional stress test scenarios to monitor and measure SWWR ETN position exposures and allow for OCC to call for additional financial resources from its Clearing Members when certain thresholds are breached. These SWWR stress test scenarios are discussed in further detail below.

c. SWWR Residual

¹⁷ ETNs issued by a Clearing Member Group would still be stressed in OCC's Clearing Fund as only a part of the credit risk is covered by the SWWR ETN Charge. Additionally, any credit from margin assets would be adjusted by the direct charges related to the risk of the equity and ETNs issued by each Clearing Member Group.

To ensure that OCC appropriately calculates margins to capture SWWR Equity and SWWR ETN position exposures, OCC proposes to include an SWWR Residual component in SWWR Add-on. Under the proposal, OCC would continue to calculate base STANS margin requirements for Clearing Members with SWWR positions including SWWR Equity and SWWR ETN positions under its current methodology (*i.e.*, without assuming that all SWWR Equity positions fall to a value of zero and without assuming all SWWR ETN positions are valued at the recovery rate times their current price).¹⁸ OCC would then also calculate a residual STANS margin with the SWWR Equity and SWWR ETN positions removed since for SWWR their P&L would be captured through the SWWR Equity and SWWR ETN Charges. The SWWR Residual would then be the difference between the residual margin and the base margin. If the sum of the SWWR Equity Charge, SWWR ETN Charge and SWWR Residual would result in a net credit to the Clearing Member,¹⁹ then the SWWR Residual would be adjusted to ensure that OCC always

¹⁸ STANS margin requirements are comprised of the sum of several components, each reflecting a different aspect of risk. The base component of the STANS margin requirement for each account is obtained using a risk measure known as 99% Expected Shortfall. 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. This base component is then adjusted by the addition of a stress test component, which is obtained from consideration of the increases in 99% Expected Shortfall that would arise from market movements that are especially large and/or in which various kinds of risk factors exhibit perfect or zero correlations in place of their correlations estimated from historical data (“Dependence Add-on”), or from extreme adverse idiosyncratic movements in individual risk factors to which the account is particularly exposed (“Concentration Add-on”).

¹⁹ For example, where a customer of a Clearing Member has net short positions referencing that Clearing Member’s issued equities, such positions may actually present so-called “right-way risk” whereby the position would result in a gain or margin credit for that account as the credit quality of the Clearing Member deteriorates.

uses a more conservative measure that captures the greater of either the base STANS margin or the residual STANS margin plus the SWWR Equity and SWWR ETN Charges.²⁰

3. *Enhancements to Sufficiency Stress Test Scenarios for ETNs*

OCC proposes to revise its CFM Policy and Methodology Description to introduce new stress test scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge and that exceed certain thresholds of OCC's Clearing Fund ("SWWR Sufficiency Scenarios").²¹ Under the proposal, certain Sufficiency Scenarios²² would be evaluated with Clearing Member-issued ETNs declining to zero within the respective Clearing Member's accounts. Such scenarios would include, but would not be limited to, the 1987 "Black Monday" market event on a Cover 1 basis and the two most extreme moves from the 2008 historical market event on a Cover 2 basis.

SWWR Sufficiency Scenarios would value Clearing Member-issued ETNs at a price of zero within their own accounts capturing impacts to any cleared positions tied to those ETNs. Calls, equities, and single-stock futures would all be valued at zero and puts would be valued at

²⁰ For example, suppose that there are no SWWR ETN positions and the Expected Shortfall of a portfolio including all positions was a \$10 million loss and the Expected Shortfall with the SWWR Equity-related positions removed was a greater loss of \$11 million. In this case, the SWWR Residual would be -\$1 million. If the Expected Shortfall with the SWWR Equity-related positions removed was reduced to a loss of \$9 million then the SWWR Residual would depend on the SWWR Equity Charge: if the SWWR Equity Charge was more negative than -\$1 million, then the SWWR Residual would be +\$1 million; if the SWWR Equity Charge was \$0, then SWWR Residual would be \$0; and if SWWR Equity Charge was between \$0 and -\$1 million (e.g., -\$0.4 million), then SWWR Residual would be positive and the opposite value of SWWR Equity Charge (e.g., +\$0.4 million). Thus, the sum of the SWWR Equity Charge, SWWR ETN Charge, and SWWR Residual cannot be positive.

²¹ OCC notes that it may also develop additional Informational Scenarios to monitor SWWR; however, these Informational Scenarios would not be used to call for additional financial resources from Clearing Members.

²² See supra note 10.

their strike price. For these scenarios, margin assets for shortfall calculations would not be adjusted by the SWWR ETN Charge. In addition, other scenarios may be created that embed the SWWR Equity risk by not excluding positions related to the Clearing Member Group's own equity but using an equity price of zero to value all related products.

In the event an SWWR Sufficiency Scenario 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. If an SWWR Sufficiency Stress Scenario identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. The proposed change would enable OCC to more accurately measure its credit risks as they relate to SWWR and better test the sufficiency of its overall financial resources and would allow OCC to call for additional financial resources when SWWR ETN position exposures exceed certain thresholds of OCC's Clearing Fund. As a result of these proposed enhancements, OCC believes it would have sufficient financial resources to cover the SWWR associated with SWWR ETN positions if such positions were to be liquidated for less than the assumed recovery rate.

OCC notes that, under its current CFM Policy, in the event results of a daily Sufficiency Stress Test over the final five business days preceding the monthly Clearing Fund sizing exceed 90% of the projected Clearing Fund size for the upcoming month, the Clearing Fund size is set such that the peak Sufficiency Stress Test draw is no greater than 90% of the Clearing Fund size. OCC proposes to revise the CFM Policy to provide that OCC generally does not intend to mutualize exposures resulting from the proposed SWWR Sufficiency Scenarios and therefore SWWR Sufficiency Scenarios would not be included for purposes of this anti-procyclicality measure. The proposed change is generally aligned with OCC's intention to appropriately

charge individual Clearing Members based on the SWWR they bring to OCC.

4. *Other Clarifying and Conforming Changes to CFM Policy and Methodology Description*

In addition to the proposed changes described above, OCC would revise the CFM Policy and Methodology Description to provide that, with respect to stress test portfolio construction, SWWR single-name equity positions would be removed from stress test portfolios as they are fully collateralized in margins. Additionally, the Methodology Description would be revised to provide that when adding STANS margin asset amounts to scenario gains and losses, the SWWR Equity Charge, SWWR ETN Charge, and certain other Add-ons from STANS margin asset amounts are excluded.

Finally, OCC would revise its Methodology Description to clarify that for Idiosyncratic Scenarios,²³ the four riskiest names used to calculate idiosyncratic stress test exposures would exclude any equity issued by the Clearing Member's own firms and make other clarifying, non-substantive changes to the Methodology Description concerning stress testing price shocks for products with multiple risk factors and Idiosyncratic Scenarios that are unrelated to the proposal described herein.

Clearing Member Outreach

To inform Clearing Members of the proposed changes, OCC has provided an overview of the proposed changes to the Financial Risk Advisory Council ("FRAC"), a working group comprised of exchanges, Clearing Members and indirect participants of OCC. OCC has also

²³ OCC has proposed in separate proposed rule change and advance notice filings to adopt a new set of stress scenarios to be used in the monthly sizing of OCC's Clearing Fund that are designed to capture the risks of extreme moves in individual or small subsets of securities ("Idiosyncratic Scenarios"). These Idiosyncratic Scenarios would consider the four single-name securities with the worst P&L in a Clearing Member's portfolio. See supra note 4.

performed direct outreach to Clearing Members that would be most impacted by the proposed changes. To-date, OCC has not received any material objections or concerns in response to this outreach.

Implementation Timing

OCC expects to implement the proposed changes within sixty (60) days after the date that OCC receives all necessary regulatory approvals for the proposed changes. OCC will announce the implementation date of the proposed change by an Information Memorandum posted to its public website at least two (2) weeks prior to implementation.

B. Statutory Basis

OCC believes the proposed rule change is consistent with requirements of the Act and rules and regulations thereunder applicable to registered clearing agencies. Specifically, OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act²⁴ and Rule 17Ad-22(b)(2),²⁵ Rule 17Ad-22(e)(4),²⁶ and Rule 17Ad-22(e)(6)²⁷ thereunder, as described in further detail below.

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

Section 17A(b)(3)(F) of the Act²⁸ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, to protect investors and

²⁴ 15 U.S.C. 78q-1(b)(3)(F).

²⁵ 17 CFR 240.17Ad-22(b)(2).

²⁶ 17 CFR 240.17Ad-22(e)(4).

²⁷ 17 CFR 240.17Ad-22(e)(6).

²⁸ 15 U.S.C. 78q-1(b)(3)(F).

the public interest. OCC believes that prohibiting Clearing Members from lending their own or Member Affiliate-issued securities in the Stock Loan Programs and introducing the proposed SWWR Add-on charge would enhance OCC's ability to manage the credit risks presented by its Clearing Members' SWWR positions and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default. As a result, the proposed change is designed, in general, to enhance OCC's framework for measuring and managing its credit risks so that it can continue to provide prompt and accurate clearance and settlement of securities and derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.²⁹

In addition, OCC believes that introducing new SWWR Sufficiency Scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge would provide OCC with a more comprehensive approach to managing OCC's credit risks as they relate to SWWR ETN positions. The proposed change would enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources and would allow OCC to call for additional financial resources when those exposures exceed certain thresholds of OCC's Clearing Fund. The proposed rule change is therefore designed to 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. For these reasons, OCC believes the proposed change is designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to assure the safeguarding of securities and funds in the custody or control of the

²⁹Id.

clearing agency or for which it is responsible, and, in general, to protect investors and the public interest in accordance with Section 17A(b)(3)(F) of the Act.³⁰

OCC also proposes a number of other clarifying and conforming changes to its CFM Policy and Methodology Description required to implement the proposed SWWR Add-on and SWWR Sufficiency Scenarios described herein and to more clearly describe OCC's stress testing practices. OCC believes that these changes would enhance OCC's overall framework for measuring and managing its credit risks so that it can continue to provide prompt and accurate clearance and settlement of securities and derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.³¹

Consistency with Rule 17Ad-22 Under the Exchange Act

Rule 17Ad-22(b)(2)³² requires a registered clearing agency that performs CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to, in part, use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set such margin requirements. In addition, Rules 17Ad-22(e)(6)(i) and (v)³³ require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum: (1) considers and produces margin levels commensurate with

³⁰ Id.

³¹ Id.

³² 17 CFR 240.17Ad-22(b)(2).

³³ 17 CFR 240.17Ad-22(e)(6)(i) and (v).

the risks and particular attributes of each relevant product, portfolio, and market, and (2) uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.

The proposed changes to OCC's margin and Clearing Fund policies and methodologies to adopt the SWWR Add-on would utilize a risk-based model designed to limit OCC's credit exposures to Clearing Members that present SWWR exposure to OCC through the clearing of Clearing Member-issued equity and ETN positions. OCC believes the proposed SWWR Add-on is reasonably designed to produce margin levels commensurate with the risks and particular attributes SWWR Equity and ETN positions and would use an appropriate method for measuring credit exposure that accounts for relevant product risk factors such as SWWR.

The proposed SWWR Add-on would include both an SWWR Equity Charge and SWWR ETN Charge to address the SWWR attributes and exposures presented to OCC by each type of product. For example, the SWWR Equity Charge assumes that when a Clearing Member defaults the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member's and its affiliates' equity securities would be priced at zero and value all cleared positions accordingly to provide full protection for the risk of potential market exposure to products on a Clearing Member Group's own equity in a default or bankruptcy scenario. Moreover, the SWWR Add-on charge would include an SWWR Residual component to ensure that OCC takes the more conservative of the base STANS margin requirement or margin requirements including the SWWR Equity Charge (particularly in circumstances where using the SWWR Equity Charge would result in a net credit to the Clearing Member).

In addition, OCC would adopt an SWWR ETN Charge to address the SWWR presented

by Clearing Member-issued ETNs. ETNs have different characteristics than equity securities and more closely reflect those characteristics of other unsecured debt obligations. For example, if a Clearing Member defaults that does not necessarily imply that it will automatically default on its ETNs. Therefore, ETNs are not necessarily valued at 0 and in fact may retain 100% of their value and be exposed to normal market risk. OCC proposes to measure the risk of these positions using an industry standard recovery rate assumption designed to calculate a margin charge that reflects the expected credit risk associated with such ETN positions. The potential market risk of the ETNs would still be covered by including ETNs in regular margin calculations, whereas the SWWR Equity positions are assumed to be heading towards bankruptcy and necessarily valued near 0 in a default situation.

For these reasons, OCC believes the proposed SWWR Add-on would enhance OCC's margin system by providing for a risk-based model that: (1) sets margin requirements designed to limit OCC's SWWR exposures to its participant; (2) considers and produces margin levels commensurate with the risks and particular attributes SWWR positions cleared by OCC; and (3) uses an appropriate method for measuring such SWWR exposures consistent with the requirements of Rules 17Ad-22(b)(2), (e)(6)(i) and (e)(6)(v).³⁴

Rules 17Ad-22(e)(4)(iii) and (vi)³⁵ 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 additional financial resources at the minimum to enable it to cover a wide range of foreseeable

³⁴ 17 CFR 240.17Ad-22(b)(2), (e)(6)(i), and (e)(6)(v).

³⁵ 17 CFR 240.17Ad-22(e)(4)(iii) and (vi).

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 (2) testing the sufficiency of its total financial resources available to meet these minimum financial resource requirements. OCC believes that introducing new SWWR Sufficiency Scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge would enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources, particularly in stressed market conditions. The proposed change would also allow OCC to call for additional financial resources when those exposures exceed certain thresholds of OCC's Clearing Fund. The proposed rule change is therefore designed to 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)(iii) and (vi).³⁶

Rule 17Ad-22(e)(4)³⁷ generally requires 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. By prohibiting Clearing Members from lending Eligible Stock issued by the Clearing Member or any affiliate of such Clearing Member, OCC would mitigate the SWWR that currently exists in its Stock Loan Programs and thereby reduce the risk that OCC's financial resources would be insufficient in the event such a Clearing Member would default. OCC believes the proposed change is therefore reasonably

³⁶ Id.

³⁷ 17 CFR 240.17Ad-22(e)(4).

designed to help OCC manage the credit risks associated with SWWR Equity and SWWR ETN positions in the Stock Loan Programs and is therefore consistent with Rule 17Ad-22(e)(4).³⁸

For the reasons set forth above, OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act³⁹ and the rules promulgated thereunder.

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act⁴⁰ 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 notes that while the proposed SWWR Add-on and SWWR Sufficiency Scenario margin charges may impact or impose a burden on competition for those Clearing Members with SWWR exposures in their cleared positions when compared to Clearing Members without SWWR positions, any burden on competition would be necessary or appropriate in furtherance of the purposes of the Act. The proposed margin charges would be imposed on all Clearing Members that bring SWWR exposure to OCC on an individualized basis in an amount reasonably calculated to mitigate the risks posed to OCC by such Clearing Members' SWWR positions. The proposed rule change is necessary for OCC to limit its credit exposures posed by these securities. Moreover, OCC believes that the proposed rule change would appropriately charge individual Clearing Members based on the SWWR they bring to OCC. The Clearing Members most likely to be impacted by the proposed changes primarily consist of larger Clearing Members or Clearing Members that are affiliated with, larger holding companies, banks, and financial services firms that issue publicly traded equity or issued ETNs. OCC notes, however, that the proposed changes could impact any Clearing Member that has publicly traded

³⁸ Id.

³⁹ 15 U.S.C. 78q-1(b)(3)(F)

⁴⁰ 15 U.S.C. 78q-1(b)(3)(I).

equity or issued ETNs and that clears positions in such securities through OCC, regardless of the respective size of that member. The proposed rule change would enable OCC to calculate and collect margin that more accurately reflects the risk characteristics of these securities and to help limit potential losses from defaults by Clearing Members with SWWR exposures. In this way, OCC believes the proposed change would promote the prompt and accurate clearance and settlement of securities transactions and protect investors and the public interest. As such, OCC believes any burden on competition imposed by the new SWWR Add-on and SWWR Sufficiency Stress Test margin charges would be necessary and appropriate in furtherance of the Act and would therefore be consistent with Section 17A(b)(3)(I) of the Act.⁴¹

OCC also proposes to mitigate SWWR in its Stock Loan Programs by prohibiting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. As discussed above, OCC does not believe that the proposed restriction on lending SWWR Equity positions would have a material impact on Clearing Members in the Stock Loan Programs. The vast majority of OCC's Clearing Members do not lend their own or affiliate-issued equity securities in the Stock Loan Programs, and to the extent Clearing Members do engage in such activity, it is minimal when compared to their overall stock lending activity.⁴² The proposed restrictions on lending SWWR ETN positions would, however, impact a very small segment of Clearing Members that lend SWWR ETNs.⁴³ OCC believes that it is necessary and appropriate to mitigate the SWWR associated with this stock lending activity by restricting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. OCC believes restricting the lending of

⁴¹ Id.

⁴² See supra note 13 and associated text.

⁴³ See supra note 14 and associated text.

SWWR positions is the most prudent way to manage SWWR in the Stock Loan Programs because it is the simplest and most effective way to mitigate this risk from an operational and default management perspective. By restricting lending activity for SWWR positions, large changes in margin requirements associated with the initiation of these types of positions would be avoided. The proposed change would also simplify the potential closeout activities associated with a default. Moreover, OCC believes the proposed limitation on lending SWWR positions is the most effective way to address the potential liquidity demands driven by the lending of SWWR positions, the costs of which are borne by all of OCC's Clearing Members and not just those members lending SWWR positions. OCC also believes that the high rate of collateralization of these positions that would otherwise be imposed through the newly proposed SWWR charges would create an incentive for members to not use the OCC Stock Loan Programs for these transactions. OCC further notes that, unlike listed options, OCC's Stock Loan Programs only constitute a portion of the overall securities lending markets and therefore Clearing Members would still be able to lend these securities on an uncleared basis outside of OCC. As a result, the proposed restrictions on lending activity in the Stock Loan Programs would not prevent Clearing Members from lending those securities on a bilateral basis if they choose to do so, thereby limiting the potential competitive impact or burden of the proposed rule change. OCC believes the proposed change would enhance OCC's ability to manage the credit risks presented by SWWR positions in the Stock Loan Programs and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default, thereby promoting the prompt and accurate clearance and settlement of securities transactions and the protection of investors and the public interest. As such, OCC believes any burden on competition imposed by the proposed restrictions would be necessary and appropriate in

furtherance of the Act and would therefore be consistent with Section 17A(b)(3)(I) of the Act.⁴⁴

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none have been received. OCC will notify the Commission of any written comments received by OCC.

Item 6. Extension of Time Period for Commission Action

Not applicable.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2) or Section 19(b)(7)(D)

Not applicable.

Item 8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

Not applicable.

Item 9. Security-Based Swap Submissions Filed Pursuant to Section 3C of the Act

Not applicable.

Item 10. Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

Not applicable.

Item 11. Exhibits

Exhibit 1A. Completed Notice of Proposed Rule Change for publication in the Federal Register.

Exhibit 3. Confidential Data and Analysis.

Exhibit 5A. OCC Rules.

⁴⁴

Id.

Exhibit 5B. Margin Policy.

Exhibit 5C. Margins Methodology.

Exhibit 5D. Clearing Fund Methodology Policy.

Exhibit 5E. Stress Testing and Clearing Fund Methodology Description.

Exhibit 3 and Exhibits 5B-5E have been omitted and filed separately with the Commission. Confidential treatment of Exhibit 3 and Exhibits 5B-5E is requested pursuant to SEC Rule 24b-2 (17 CFR 240.24b-2).

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

THE OPTIONS CLEARING CORPORATION

By:

Justin W. Byrne
Vice President, Regulatory Filings

EXHIBIT 1A

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-[_____]; File No. SR-OCC-2019-010)

October __, 2019

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Related to Proposed Changes to The Options Clearing Corporation's Rules, Margin Policy, Margin Methodology, Clearing Fund Methodology Policy, and Clearing Fund and Stress Testing Methodology to Address Specific Wrong-Way Risk

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 10, 2019, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("SEC" or "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. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change is filed in connection with proposed enhancements to OCC's Rules, margin policy and methodology, Clearing Fund policy, and Clearing Fund and stress testing methodology to adopt new margin charges and other risk measures to address the specific wrong-way risk presented by certain cleared positions.

The proposed amendments to OCC's Rules are included in Exhibit 5A of the filing. The proposed amendments to OCC's Margin Policy and Margins Methodology

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

are included in Exhibits 5B and 5C, respectively. The proposed amendments to OCC's Clearing Fund Methodology Policy ("CFM Policy") and Stress Testing and Clearing Fund Methodology Description ("Methodology Description") are included in Exhibits 5D and 5E, respectively. Material proposed to be added to the Rules, Margin Policy and Margins Methodology as currently in effect is marked by underlining, and material proposed to be deleted is marked in strikethrough text; however, the proposed Specific Wrong-Way Risk Add-On chapter of the Margins Methodology is presented without marking to improve readability as the entire chapter is newly proposed rule text.³ Material proposed to be added to the CFM Policy and Methodology Description is marked by double underlining, and material proposed to be deleted is marked in double strikethrough text.⁴ The proposed changes are described in detail in Item II below.

The proposed rule change is available on OCC's website at <https://www.theocc.com/about/publications/bylaws.jsp>. All terms with initial capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.⁵

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

³ OCC also has filed an advance notice with the Commission in connection with the proposed changes. See SR-OCC-2019-807.

⁴ OCC also filed with the Commission proposed rule change and advance notice filings concerning enhancements to its CFM Policy and Methodology Description, which are currently pending Commission review. See SR-OCC-2019-009 and SR-OCC-2019-806. OCC has marked proposed changes to the CFM Policy and Methodology Description described herein in double marking to clearly differentiate those changes from other changes currently pending Commission review.

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

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

As a central counterparty (“CCP”), OCC is exposed to wrong-way risk, which is the risk that arises when exposure to a counterparty is adversely correlated with the credit quality and probability of default of that counterparty. Specific wrong-way risk (“SWWR”) arises when an exposure to a participant is highly likely to increase when the creditworthiness of that participant is deteriorating.⁶ For example, SWWR arises where a Clearing Member’s cleared positions contain equity securities issued by the Clearing Member or its affiliates (i.e., the Clearing Member Group) (such positions referred to herein as “SWWR Equity positions”) as the equity issued by the Clearing Member Group may be assumed to have a price at or near zero in a default or bankruptcy scenario, and those positions (e.g., equity used as a hedge, stock loans, options on equity, single-stock futures) may experience substantial losses. In addition, SWWR may arise where

⁶ See Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786, 70816, n. 317 (October 13, 2016) (S7-03-14) (“Standards for Covered Clearing Agencies”). See also Committee on Payment and Settlement Systems and Technical Committee of the International Organization of Securities Commissions, *Principles for financial market infrastructures* (Apr. 16, 2012), available at <http://www.bis.org/publ/cpss101a.pdf>.

uncollateralized exchange-traded notes (“ETNs”) issued by a Clearing Member or its affiliates (“SWWR ETN positions”) are part of the Clearing Member’s cleared positions (these positions, collectively with “SWWR Equity positions,” are hereinafter referred to as “SWWR positions”). SWWR may also arise when a Clearing Member posts equity securities or ETNs issued by it or of its affiliates as margin collateral.

OCC currently accounts for SWWR as it relates to margin collateral by generally prohibiting a Clearing Member from pledging equities issued by it or one of its affiliates as margin collateral unless this pledge provides a hedge against a cleared position in the same account.⁷ OCC does not, however, currently account for SWWR as it relates to cleared positions. As a result, OCC is proposing a new “add-on” charge⁸ for its margin methodology, the System for Theoretical Analysis and Numerical Simulations (“STANS”),⁹ and new stress test scenarios that may result in intra-day margin calls and, in more extreme cases, intra-month increases in the size of OCC’s Clearing Fund¹⁰ to

⁷ See OCC Rule 604, Interpretation and Policy .16.

⁸ Under OCC’s Margin Policy, OCC may collateralize certain exposures through the use of add-on charges.

⁹ See Securities Exchange Act Release No. 53322 (February 15, 2006), 71 FR 9403 (February 23, 2006) (SR-OCC-2004-20). A detailed description of the STANS methodology is available at <http://optionsclearing.com/risk-management/margins/>.

¹⁰ Under OCC’s existing stress testing and Clearing Fund methodology, OCC runs on a daily basis a set of stress test scenarios designed to 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 so that OCC continues to maintain sufficient financial resources to guard against potential losses under a wide range of stress scenarios, including extreme but plausible market conditions (“Sufficiency Scenarios,” and such scenarios collectively constituting “Sufficiency Stress Tests”). See Securities Exchange Act Release No. 83714 (July 26, 2018), 83 FR 37570 (August 1, 2018) (SR-OCC-2018-803) and Securities Exchange Act Release No. 83735 (July 27, 2018), 83 FR 37855 (August 2, 2018) (SR-OCC-

address the wrong-way risk of OCC's cleared positions involving Clearing Member-issued securities. In addition, OCC proposes to introduce certain restrictions on stock lending activity related to SWWR positions.

Proposed Changes

OCC proposes to enhance its management of SWWR by: (1) imposing certain restrictions on stock lending activity at OCC; (2) adopting a new SWWR margin add-on for STANS ("SWWR Add-on"); (3) introducing new stress test scenarios to capture the SWWR of cleared positions involving Clearing Member-issued ETNs beyond certain pre-defined thresholds; and (4) making other clarifying and conforming changes to the CFM Policy and Methodology Description. The proposed changes are intended to address the credit risks arising from SWWR positions at OCC. The proposed changes are described in detail below.

1. Prohibition on Lending Clearing Member/Affiliate-Issued Securities

OCC operates two programs for stock loan transactions: (1) the Stock Loan/Hedge Program and (2) the Market Loan Program (collectively, the "Stock Loan Programs"). In the Stock Loan/Hedge Program, prospective Lending and Borrowing Clearing Members identify each other (independent of OCC), agree to bilaterally negotiated terms of the stock loan (in this case, a "Hedge Loan"), and then send the details of the stock loan to the Depository Trust Company ("DTC") designating the stock

2018-008). Under OCC Rule 609, the CFM Policy, and the Methodology Description, if a Sufficiency Stress Test identifies exposures that exceed 75% of the current Clearing Fund requirement less deficits (the "75% threshold" or "Sufficiency Stress Test Threshold 1"), OCC may require additional margin deposits from the Clearing Member Group(s) driving the breach. If a Sufficiency Stress Test identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. Id.

loan as a Hedge Loan for guaranty and clearance at OCC. The Lending Clearing Member then instructs DTC to transfer a specified number of shares of Eligible Stock¹¹ to the account of the Borrowing Clearing Member, and the Borrowing Clearing Member instructs DTC to transfer the appropriate amount of cash collateral to the account of the Lending Clearing Member. In the Market Loan Program, stock loans are initiated through the matching of bids and offers that are either agreed upon by the Market Loan Clearing Members or matched anonymously through a Loan Market (such stock loans being “Market Loans”). In order to initiate a Market Loan, the Loan Market sends a matched transaction to OCC, which in turn sends two separate but linked settlement instructions to DTC to effect the movement of Eligible Stock and cash collateral between the accounts of the Market Loan Clearing Members through OCC’s account at DTC.

Regardless of whether a transaction is initiated under the Stock Loan/Hedge Program or Market Loan Program, OCC novates the transaction and becomes the lender to the Borrowing Clearing Member and the borrower to the Lending Clearing Member. As the principal counterparty to the Borrowing and Lending Clearing Members, OCC guarantees the return of the full value of cash collateral to a Borrowing Clearing Member and guarantees the return of the Loaned Stock (or value of that Loaned Stock) to the Lending Clearing Member.¹² As noted above, OCC may be exposed to SWWR in its Stock Loan Programs where Clearing Members lend equity securities or ETNs issued by

¹¹ OCC’s By-Laws define “Eligible Stock” to mean, in part, any security that is eligible for lending in the Stock Loan/Hedge Program and the Market Loan Program. See Article I, Section 1.E(3) of the OCC By-Laws. Eligible Stock may include ETNs issued by OCC’s Clearing Members.

¹² Under the Market Loan Program, OCC also provides a limited guaranty of dividend and rebate payments.

the Clearing Member or its affiliates. Specifically, the lending of Clearing Member or Member Affiliate-issued equity or ETNs creates a long exposure and liability in the case when a Clearing Member defaults and its own or affiliated equity or ETN declines.

OCC proposes to mitigate SWWR in its Stock Loan Programs by prohibiting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. The proposed restriction would apply to both SWWR Equity positions and SWWR ETN positions. OCC does not believe that the proposed restriction on lending SWWR Equity positions would have a material impact on Clearing Members in the Stock Loan Programs as Clearing Members do not typically engage in lending of their own equity securities and borrowers typically do not accept equity securities issued by their lending counterparty.¹³ The proposed restrictions on lending SWWR ETN positions would, however, impact a very small segment of Clearing Members that lend SWWR ETNs.¹⁴ OCC believes that the impact of the proposed

¹³ As of the start of September 2019, OCC had 107 Clearing Members, of which 64 have member or affiliate-issued securities eligible for lending in the Stock Loan Programs. OCC analyzed SWWR Equity lending activity for its Clearing Members from January 2018 through the beginning of September 2019. During this period, less than 10 Clearing Members had stock lending activity in SWWR Equity positions, and loans of SWWR Equity positions constituted less than three percent of each of those Clearing Members' average notional stock lending activity for the period.

¹⁴ OCC analyzed SWWR ETN lending activity for its Clearing Members from January 2018 through the beginning of September 2019. Only 11 of OCC's 107 Clearing Members have member or affiliate issued ETNs. During this period, less than 10 Clearing Members had stock lending activity for SWWR ETN positions. For the majority of these Clearing Members, lending in SWWR ETN positions constituted approximately 13 percent or less of each of those Clearing Members' average notional stock lending activity for the period. For Clearing Members that averaged higher notational lending activity, OCC has observed significant reductions in this activity over recent months.

changes would be limited by the fact that, unlike listed options, Clearing Members are able to lend SWWR positions on an uncleared basis outside of OCC. The proposed restrictions on lending activity in the Stock Loan Programs would not prevent Clearing Members from lending equities or ETNs issued by the Clearing Member or any affiliate of such Clearing Member on a bilateral basis if members wish to do so.

The proposed prohibition on lending Clearing Member or Member Affiliate-issued Eligible Stock would be included in new OCC Rules 2202(f) and 2202A(f) for the Stock Loan/Hedge Program and Market Loan Program, respectively. OCC would also make conforming changes to its Margin Policy and Margins Methodology to reflect the newly proposed restrictions in stock lending activity.

The proposed rule change would only apply to stock lending activity as of the time of implementation of the proposed rule change. The proposed rule change would not be applied retroactively to existing open positions, and Clearing Members with open stock loans involving Clearing Member or Member Affiliate-issued Eligible Stock would not be forced to terminate those existing positions. Any SWWR stock lending positions in existence as of the implementation of the proposed rule change would be subject to the SWWR charges described below until such positions are closed out through the normal course stock loan termination process.

2. *SWWR Add-on*

OCC proposes to adopt a new margin add-on (i.e., the SWWR Add-on) to address SWWR from cleared positions involving Clearing Member and affiliate issued equities and ETNs. The SWWR Add-on would be calculated for each margin tier account of a

Clearing Member Group having positions related to either publicly traded equities or ETNs issued by the Clearing Member Group and would cover all types of positions (equity used as collateral, equity and ETN options, single-stock futures). The proposed SWWR Add-on is comprised of three main components: (1) “SWWR Equity Charge,” (2) “SWWR ETN Charge,” and (3) “SWWR Residual.” Each of these components is discussed below.

a. SWWR Equity Charge

Under the proposal, when a Clearing Member defaults, it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member’s and its affiliates’ equity securities would be priced at zero and value all cleared positions accordingly (i.e., all stocks, single stock futures, call options, and put options would be valued at zero) to provide full protection for the risk of potential market exposure to products on a Clearing Member Group’s own equity in a default or bankruptcy scenario. In each margin account, the profit and loss (“P&L”) of SWWR Equity positions would be calculated as the difference of the theoretical value of such securities (i.e., zero) and the closing price of the position multiplied by the net quantity.¹⁵ Moreover, any potential gain from the SWWR positions would be excluded by flooring

¹⁵ Because SWWR of equity-related positions would be fully covered as part of margins, these positions would be removed from Clearing Fund shortfall calculations under OCC’s stress testing and Clearing Fund methodology. Accordingly, OCC proposes to revise its Methodology Description to reflect the exclusion of SWWR Equity positions from the synthetic accounts used in OCC’s stress testing.

the SWWR Equity Charge at zero.¹⁶ As a result, OCC believes that the proposed SWWR Equity Charge would adequately cover the SWWR arising from a Clearing Member's SWWR Equity positions.

b. SWWR ETN Charge

In addition to SWWR that arises from equity securities issued by a Clearing Member or its affiliates, OCC is also exposed to SWWR from open positions related to the uncollateralized ETNs issued by a Clearing Member/Group, which are adversely correlated with the credit quality of that Clearing Member Group. These ETNs are generally equivalent to unsecured senior debt issued by the Clearing Member/Group. While a Clearing Member default can be triggered by its failure to meet other obligations, the firm may or may not default on its ETNs. Hence, the recovery rate for ETNs is uncertain and could be between 0% and 100%.

To address SWWR presented by ETNs issued by a Clearing Member/Group, OCC proposes to calculate an SWWR ETN Charge as part of the SWWR Add-on. OCC notes that, unlike SWWR Equity positions, for which it is assumed that the price of any equity security issued by the Clearing Member Group would fall to zero, the recovery rate for ETNs would not necessarily fall to zero. As a result, the proposed SWWR ETN Charge would utilize an industry standard recovery rate assumption designed to reflect the credit risk associated with such ETN positions.¹⁷ OCC would also adopt additional

¹⁶ For example, suppose the P&L from the SWWR equity price going to 0 for all SWWR equity-related positions were a loss of \$1 million. The SWWR Equity Charge in this case would be \$1 million. If the P&L were a gain of \$1 million, the SWWR Equity Charge would be \$0.

¹⁷ ETNs issued by a Clearing Member Group would still be stressed in OCC's Clearing Fund as only a part of the credit risk is covered by the SWWR ETN Charge. Additionally, any credit from margin assets would be adjusted by the

stress test scenarios to monitor and measure SWWR ETN position exposures and allow for OCC to call for additional financial resources from its Clearing Members when certain thresholds are breached. These SWWR stress test scenarios are discussed in further detail below.

c. SWWR Residual

To ensure that OCC appropriately calculates margins to capture SWWR Equity and SWWR ETN position exposures, OCC proposes to include an SWWR Residual component in SWWR Add-on. Under the proposal, OCC would continue to calculate base STANS margin requirements for Clearing Members with SWWR positions including SWWR Equity and SWWR ETN positions under its current methodology (*i.e.*, without assuming that all SWWR Equity positions fall to a value of zero and without assuming all SWWR ETN positions are valued at the recovery rate times their current price).¹⁸ OCC would then also calculate a residual STANS margin with the SWWR Equity and SWWR ETN positions removed since for SWWR their P&L would be

direct charges related to the risk of the equity and ETNs issued by each Clearing Member Group.

¹⁸ STANS margin requirements are comprised of the sum of several components, each reflecting a different aspect of risk. The base component of the STANS margin requirement for each account is obtained using a risk measure known as 99% Expected Shortfall. 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. This base component is then adjusted by the addition of a stress test component, which is obtained from consideration of the increases in 99% Expected Shortfall that would arise from market movements that are especially large and/or in which various kinds of risk factors exhibit perfect or zero correlations in place of their correlations estimated from historical data (“Dependence Add-on”), or from extreme adverse idiosyncratic movements in individual risk factors to which the account is particularly exposed (“Concentration Add-on”).

captured through the SWWR Equity and SWWR ETN Charges. The SWWR Residual would then be the difference between the residual margin and the base margin. If the sum of the SWWR Equity Charge, SWWR ETN Charge and SWWR Residual would result in a net credit to the Clearing Member,¹⁹ then the SWWR Residual would be adjusted to ensure that OCC always uses a more conservative measure that captures the greater of either the base STANS margin or the residual STANS margin plus the SWWR Equity and SWWR ETN Charges.²⁰

3. Enhancements to Sufficiency Stress Test Scenarios for ETNs

OCC proposes to revise its CFM Policy and Methodology Description to introduce new stress test scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge and that

¹⁹ For example, where a customer of a Clearing Member has net short positions referencing that Clearing Member's issued equities, such positions may actually present so-called "right-way risk" whereby the position would result in a gain or margin credit for that account as the credit quality of the Clearing Member deteriorates.

²⁰ For example, suppose that there are no SWWR ETN positions and the Expected Shortfall of a portfolio including all positions was a \$10 million loss and the Expected Shortfall with the SWWR Equity-related positions removed was a greater loss of \$11 million. In this case, the SWWR Residual would be -\$1 million. If the Expected Shortfall with the SWWR Equity-related positions removed was reduced to a loss of \$9 million then the SWWR Residual would depend on the SWWR Equity Charge: if the SWWR Equity Charge was more negative than -\$1 million, then the SWWR Residual would be +\$1 million; if the SWWR Equity Charge was \$0, then SWWR Residual would be \$0; and if SWWR Equity Charge was between \$0 and -\$1 million (e.g., -\$0.4 million), then SWWR Residual would be positive and the opposite value of SWWR Equity Charge (e.g., +\$0.4 million). Thus, the sum of the SWWR Equity Charge, SWWR ETN Charge, and SWWR Residual cannot be positive.

exceed certain thresholds of OCC's Clearing Fund ("SWWR Sufficiency Scenarios").²¹ Under the proposal, certain Sufficiency Scenarios²² would be evaluated with Clearing Member-issued ETNs declining to zero within the respective Clearing Member's accounts. Such scenarios would include, but would not be limited to, the 1987 "Black Monday" market event on a Cover 1 basis and the two most extreme moves from the 2008 historical market event on a Cover 2 basis.

SWWR Sufficiency Scenarios would value Clearing Member-issued ETNs at a price of zero within their own accounts capturing impacts to any cleared positions tied to those ETNs. Calls, equities, and single-stock futures would all be valued at zero and puts would be valued at their strike price. For these scenarios, margin assets for shortfall calculations would not be adjusted by the SWWR ETN Charge. In addition, other scenarios may be created that embed the SWWR Equity risk by not excluding positions related to the Clearing Member Group's own equity but using an equity price of zero to value all related products.

In the event an SWWR Sufficiency Scenario 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. If an SWWR Sufficiency Stress Scenario identifies exposures that exceed 90% of the current Clearing Fund, OCC would perform an intra-month resizing of the Clearing Fund. The proposed change would enable OCC to more accurately measure its credit risks as they relate to

²¹ OCC notes that it may also develop additional Informational Scenarios to monitor SWWR; however, these Informational Scenarios would not be used to call for additional financial resources from Clearing Members.

²² See supra note 10.

SWWR and better test the sufficiency of its overall financial resources and would allow OCC to call for additional financial resources when SWWR ETN position exposures exceed certain thresholds of OCC's Clearing Fund. As a result of these proposed enhancements, OCC believes it would have sufficient financial resources to cover the SWWR associated with SWWR ETN positions if such positions were to be liquidated for less than the assumed recovery rate.

OCC notes that, under its current CFM Policy, in the event results of a daily Sufficiency Stress Test over the final five business days preceding the monthly Clearing Fund sizing exceed 90% of the projected Clearing Fund size for the upcoming month, the Clearing Fund size is set such that the peak Sufficiency Stress Test draw is no greater than 90% of the Clearing Fund size. OCC proposes to revise the CFM Policy to provide that OCC generally does not intend to mutualize exposures resulting from the proposed SWWR Sufficiency Scenarios and therefore SWWR Sufficiency Scenarios would not be included for purposes of this anti-procyclicality measure. The proposed change is generally aligned with OCC's intention to appropriately charge individual Clearing Members based on the SWWR they bring to OCC.

4. Other Clarifying and Conforming Changes to CFM Policy and Methodology Description

In addition to the proposed changes described above, OCC would revise the CFM Policy and Methodology Description to provide that, with respect to stress test portfolio construction, SWWR single-name equity positions would be removed from stress test portfolios as they are fully collateralized in margins. Additionally, the Methodology Description would be revised to provide that when adding STANS margin asset amounts

to scenario gains and losses, the SWWR Equity Charge, SWWR ETN Charge, and certain other Add-ons from STANS margin asset amounts are excluded.

Finally, OCC would revise its Methodology Description to clarify that for Idiosyncratic Scenarios,²³ the four riskiest names used to calculate idiosyncratic stress test exposures would exclude any equity issued by the Clearing Member's own firms and make other clarifying, non-substantive changes to the Methodology Description concerning stress testing price shocks for products with multiple risk factors and Idiosyncratic Scenarios that are unrelated to the proposal described herein.

Clearing Member Outreach

To inform Clearing Members of the proposed changes, OCC has provided an overview of the proposed changes to the Financial Risk Advisory Council ("FRAC"), a working group comprised of exchanges, Clearing Members and indirect participants of OCC. OCC has also performed direct outreach to Clearing Members that would be most impacted by the proposed changes. To-date, OCC has not received any material objections or concerns in response to this outreach.

Implementation Timing

OCC expects to implement the proposed changes within sixty (60) days after the date that OCC receives all necessary regulatory approvals for the proposed changes. OCC will announce the implementation date of the proposed change by an Information Memorandum posted to its public website at least two (2) weeks prior to implementation.

²³ OCC has proposed in separate proposed rule change and advance notice filings to adopt a new set of stress scenarios to be used in the monthly sizing of OCC's Clearing Fund that are designed to capture the risks of extreme moves in individual or small subsets of securities ("Idiosyncratic Scenarios"). These Idiosyncratic Scenarios would consider the four single-name securities with the worst P&L in a Clearing Member's portfolio. See supra note 4.

(2) Statutory Basis

OCC believes the proposed rule change is consistent with requirements of the Act and rules and regulations thereunder applicable to registered clearing agencies.

Specifically, OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act²⁴ and Rule 17Ad-22(b)(2),²⁵ Rule 17Ad-22(e)(4),²⁶ and Rule 17Ad-22(e)(6)²⁷ thereunder, as described in further detail below.

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

Section 17A(b)(3)(F) of the Act²⁸ requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, to protect investors and the public interest. OCC believes that prohibiting Clearing Members from lending their own or Member Affiliate-issued securities in the Stock Loan Programs and introducing the proposed SWWR Add-on charge would enhance OCC's ability to manage the credit risks presented by its Clearing Members' SWWR positions and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default. As a result, the proposed change is designed, in general, to enhance OCC's framework for measuring and managing its credit risks so that it can continue to provide prompt and accurate clearance and settlement of securities and

²⁴ 15 U.S.C. 78q-1(b)(3)(F).

²⁵ 17 CFR 240.17Ad-22(b)(2).

²⁶ 17 CFR 240.17Ad-22(e)(4).

²⁷ 17 CFR 240.17Ad-22(e)(6).

²⁸ 15 U.S.C. 78q-1(b)(3)(F).

derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.²⁹

In addition, OCC believes that introducing new SWWR Sufficiency Scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge would provide OCC with a more comprehensive approach to managing OCC's credit risks as they relate to SWWR ETN positions. The proposed change would enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources and would allow OCC to call for additional financial resources when those exposures exceed certain thresholds of OCC's Clearing Fund. The proposed rule change is therefore designed to 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. For these reasons, OCC believes the proposed change is designed to promote the prompt and accurate clearance and settlement of securities and derivatives transactions, to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible, and, in general, to protect investors and the public interest in accordance with Section 17A(b)(3)(F) of the Act.³⁰

OCC also proposes a number of other clarifying and conforming changes to its CFM Policy and Methodology Description required to implement the proposed SWWR Add-on and SWWR Sufficiency Scenarios described herein and to more clearly describe

²⁹ Id.

³⁰ Id.

OCC's stress testing practices. OCC believes that these changes would enhance OCC's overall framework for measuring and managing its credit risks so that it can continue to provide prompt and accurate clearance and settlement of securities and derivatives transactions, assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible, and, in general, protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Act.³¹

Consistency with Rule 17Ad-22 Under the Exchange Act

Rule 17Ad-22(b)(2)³² requires a registered clearing agency that performs CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to, in part, use margin requirements to limit its credit exposures to participants under normal market conditions and use risk-based models and parameters to set such margin requirements. In addition, Rules 17Ad-22(e)(6)(i) and (v)³³ require a covered clearing agency that provides CCP services to establish, implement, maintain and enforce written policies and procedures reasonably designed to cover its credit exposures to its participants by establishing a risk-based margin system that, at a minimum: (1) considers and produces margin levels commensurate with the risks and particular attributes of each relevant product, portfolio, and market, and (2) uses an appropriate method for measuring credit exposure that accounts for relevant product risk factors and portfolio effects across products.

The proposed changes to OCC's margin and Clearing Fund policies and methodologies to adopt the SWWR Add-on would utilize a risk-based model designed to

³¹ Id.

³² 17 CFR 240.17Ad-22(b)(2).

³³ 17 CFR 240.17Ad-22(e)(6)(i) and (v).

limit OCC's credit exposures to Clearing Members that present SWWR exposure to OCC through the clearing of Clearing Member-issued equity and ETN positions. OCC believes the proposed SWWR Add-on is reasonably designed to produce margin levels commensurate with the risks and particular attributes SWWR Equity and ETN positions and would use an appropriate method for measuring credit exposure that accounts for relevant product risk factors such as SWWR.

The proposed SWWR Add-on would include both an SWWR Equity Charge and SWWR ETN Charge to address the SWWR attributes and exposures presented to OCC by each type of product. For example, the SWWR Equity Charge assumes that when a Clearing Member defaults the price of any equity security issued by the Clearing Member Group would fall to zero. As a result, OCC would calculate the SWWR Equity Charge by assuming that a Clearing Member's and its affiliates' equity securities would be priced at zero and value all cleared positions accordingly to provide full protection for the risk of potential market exposure to products on a Clearing Member Group's own equity in a default or bankruptcy scenario. Moreover, the SWWR Add-on charge would include an SWWR Residual component to ensure that OCC takes the more conservative of the base STANS margin requirement or margin requirements including the SWWR Equity Charge (particularly in circumstances where using the SWWR Equity Charge would result in a net credit to the Clearing Member).

In addition, OCC would adopt an SWWR ETN Charge to address the SWWR presented by Clearing Member-issued ETNs. ETNs have different characteristics than equity securities and more closely reflect those characteristics of other unsecured debt obligations. For example, if a Clearing Member defaults that does not necessarily imply

that it will automatically default on its ETNs. Therefore, ETNs are not necessarily valued at 0 and in fact may retain 100% of their value and be exposed to normal market risk.

OCC proposes to measure the risk of these positions using an industry standard recovery rate assumption designed to calculate a margin charge that reflects the expected credit risk associated with such ETN positions. The potential market risk of the ETNs would still be covered by including ETNs in regular margin calculations, whereas the SWWR Equity positions are assumed to be heading towards bankruptcy and necessarily valued near 0 in a default situation.

For these reasons, OCC believes the proposed SWWR Add-on would enhance OCC's margin system by providing for a risk-based model that: (1) sets margin requirements designed to limit OCC's SWWR exposures to its participant; (2) considers and produces margin levels commensurate with the risks and particular attributes SWWR positions cleared by OCC; and (3) uses an appropriate method for measuring such SWWR exposures consistent with the requirements of Rules 17Ad-22(b)(2), (e)(6)(i) and (e)(6)(v).³⁴

Rules 17Ad-22(e)(4)(iii) and (vi)³⁵ 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 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,

³⁴ 17 CFR 240.17Ad-22(b)(2), (e)(6)(i), and (e)(6)(v).

³⁵ 17 CFR 240.17Ad-22(e)(4)(iii) and (vi).

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 (2) testing the sufficiency of its total financial resources available to meet these minimum financial resource requirements. OCC believes that introducing new SWWR Sufficiency Scenarios designed to capture SWWR exposures for Clearing Member-issued ETNs that are not accounted for in the SWWR ETN Charge would enable OCC to more accurately measure its credit risks and better test the sufficiency of its overall financial resources, particularly in stressed market conditions. The proposed change would also allow OCC to call for additional financial resources when those exposures exceed certain thresholds of OCC's Clearing Fund. The proposed rule change is therefore designed to 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)(iii) and (vi).³⁶

Rule 17Ad-22(e)(4)³⁷ generally requires 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. By prohibiting Clearing Members from lending Eligible Stock issued by the Clearing Member or any affiliate of such Clearing Member, OCC would mitigate the SWWR that currently exists in its Stock Loan Programs and thereby reduce the risk that OCC's financial resources

³⁶ Id.

³⁷ 17 CFR 240.17Ad-22(e)(4).

would be insufficient in the event such a Clearing Member would default. OCC believes the proposed change is therefore reasonably designed to help OCC manage the credit risks associated with SWWR Equity and SWWR ETN positions in the Stock Loan Programs and is therefore consistent with Rule 17Ad-22(e)(4).³⁸

For the reasons set forth above, OCC believes the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act³⁹ and the rules promulgated thereunder.

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

Section 17A(b)(3)(I) of the Act⁴⁰ 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 notes that while the proposed SWWR Add-on and SWWR Sufficiency Scenario margin charges may impact or impose a burden on competition for those Clearing Members with SWWR exposures in their cleared positions when compared to Clearing Members without SWWR positions, any burden on competition would be necessary or appropriate in furtherance of the purposes of the Act. The proposed margin charges would be imposed on all Clearing Members that bring SWWR exposure to OCC on an individualized basis in an amount reasonably calculated to mitigate the risks posed to OCC by such Clearing Members' SWWR positions. The proposed rule change is necessary for OCC to limit its credit exposures posed by these securities. Moreover, OCC believes that the proposed rule change would appropriately charge individual Clearing Members based on the SWWR they bring to OCC. The Clearing Members most likely to be impacted by the proposed changes primarily consist

³⁸ Id.

³⁹ 15 U.S.C. 78q-1(b)(3)(F)

⁴⁰ 15 U.S.C. 78q-1(b)(3)(I).

of larger Clearing Members or Clearing Members that are affiliated with, larger holding companies, banks, and financial services firms that issue publicly traded equity or issued ETNs. OCC notes, however, that the proposed changes could impact any Clearing Member that has publicly traded equity or issued ETNs and that clears positions in such securities through OCC, regardless of the respective size of that member. The proposed rule change would enable OCC to calculate and collect margin that more accurately reflects the risk characteristics of these securities and to help limit potential losses from defaults by Clearing Members with SWWR exposures. In this way, OCC believes the proposed change would promote the prompt and accurate clearance and settlement of securities transactions and protect investors and the public interest. As such, OCC believes any burden on competition imposed by the new SWWR Add-on and SWWR Sufficiency Stress Test margin charges would be necessary and appropriate in furtherance of the Act and would therefore be consistent with Section 17A(b)(3)(I) of the Act.⁴¹

OCC also proposes to mitigate SWWR in its Stock Loan Programs by prohibiting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. As discussed above, OCC does not believe that the proposed restriction on lending SWWR Equity positions would have a material impact on Clearing Members in the Stock Loan Programs. The vast majority of OCC's Clearing Members do not lend their own or affiliate-issued equity securities in the Stock Loan Programs, and to the extent Clearing Members do engage in such activity, it is

⁴¹ Id.

minimal when compared to their overall stock lending activity.⁴² The proposed restrictions on lending SWWR ETN positions would, however, impact a very small segment of Clearing Members that lend SWWR ETNs.⁴³ OCC believes that it is necessary and appropriate to mitigate the SWWR associated with this stock lending activity by restricting Clearing Members from lending any Eligible Stock issued by such Clearing Member or any affiliate of such Clearing Member. OCC believes restricting the lending of SWWR positions is the most prudent way to manage SWWR in the Stock Loan Programs because it is the simplest and most effective way to mitigate this risk from an operational and default management perspective. By restricting lending activity for SWWR positions, large changes in margin requirements associated with the initiation of these types of positions would be avoided. The proposed change would also simplify the potential closeout activities associated with a default. Moreover, OCC believes the proposed limitation on lending SWWR positions is the most effective way to address the potential liquidity demands driven by the lending of SWWR positions, the costs of which are borne by all of OCC's Clearing Members and not just those members lending SWWR positions. OCC also believes that the high rate of collateralization of these positions that would otherwise be imposed through the newly proposed SWWR charges would create an incentive for members to not use the OCC Stock Loan Programs for these transactions. OCC further notes that, unlike listed options, OCC's Stock Loan Programs only constitute a portion of the overall securities lending markets and therefore Clearing Members would still be able to lend these securities on an uncleared basis outside of

⁴² See supra note 13 and associated text.

⁴³ See supra note 14 and associated text.

OCC. As a result, the proposed restrictions on lending activity in the Stock Loan Programs would not prevent Clearing Members from lending those securities on a bilateral basis if they choose to do so, thereby limiting the potential competitive impact or burden of the proposed rule change. OCC believes the proposed change would enhance OCC's ability to manage the credit risks presented by SWWR positions in the Stock Loan Programs and would reduce the risk that OCC's financial resources would be insufficient in the event of a Clearing Member default, thereby promoting the prompt and accurate clearance and settlement of securities transactions and the protection of investors and the public interest. As such, OCC believes any burden on competition imposed by the proposed restrictions would be necessary and appropriate in furtherance of the Act and would therefore be consistent with Section 17A(b)(3)(I) of the Act.⁴⁴

(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

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

⁴⁴ Id.

(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. Please include File Number SR-OCC-2019-010 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-2019-010. 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 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/about/publications/bylaws.jsp>.

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-2019-010 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.⁴⁵

Secretary

⁴⁵ 17 CFR 200.30-3(a)(12).

EXHIBIT 5A



OCC Rules

Underlined text indicates new text

~~Strikethrough~~ text indicates deleted text

Chapter XXII - Stock Loan/Hedge Program

* * *

RULE 2202 - Initiation of Stock Loans

(a) – (e) [No change]

(f) Hedge Clearing Members shall be prohibited from initiating stock loans intended for inclusion in the Stock Loan/Hedge Program that involve the lending of any Eligible Stock issued by such Hedge Clearing Member or any Member Affiliate of such Hedge Clearing Member.

* * *

Chapter XXIIA – Market Loan Program

* * *

RULE 2202A - Initiation of Market Loans

(a) – (f) [No change]

(g) Market Loan Clearing Members shall be prohibited from initiating stock loans intended for inclusion in the Market Loan Program that involve the lending of any Eligible Stock issued by such Market Loan Clearing Member or any Member Affiliate of such Market Loan Clearing Member.