



#43212

TO: ALL CLEARING MEMBERS

DATE: JUNE 12, 2018

SUBJECT: RULE FILING AFFECTING CLEARING FUND METHODOLOGY

On May 30, 2018, OCC filed [SR-OCC-2018-008¹](#) with the Securities and Exchange Commission proposing changes to its By-laws, Rules, and Clearing Fund and stress testing methodology, which would, among other things, modify OCC's methodology for calculating the size and testing the sufficiency of the Clearing Fund. The filing reflects the results of OCC's comprehensive review of its Clearing Fund Methodology, which identified matters, including a disconnect between the index stress shocks and the constituent single name stress shocks, that required changes. Furthermore, OCC's analysis identified that the current methodology results in Clearing Fund levels which may be disproportionate with the level of risk presented by Clearing Members and that OCC is potentially imposing financial requirements that may be above those required by prudent risk management. The proposed changes are designed to enhance OCC's overall resiliency, particularly with respect to the level of OCC's pre-funded financial resources.

The proposal would modify OCC's Clearing Fund sizing requirement to require that OCC cover the simultaneous default of its two largest Clearing Member Groups in extreme but plausible market conditions ("Cover 2") and introduce a new inventory of stress tests designed to assess the adequacy and sufficiency of OCC's pre-funded financial resources under a wide range of hypothetical and historical scenarios. While supporting Cover 2, OCC's proposed methodology also includes a "Cover 1" scenario using the extreme conditions of October 1987 against the potential default of OCC's largest Clearing Member Group as a sufficiency test of the Clearing Fund.

To further align the characteristics of the Clearing Fund with its purpose, the proposal also modifies OCC's methodology for calculating Clearing Members' *pro rata* allocation of the Clearing Fund to be more heavily weighted by the risk component of each Clearing Member's portfolio. The proposed allocation weightings are: 70% total risk (as a function of margin risk), 15% cleared volume, and 15% open interest (as opposed to the current weighting of 35% total risk, 50% open interest, and 15% volume). This change will be phased in over a three-month period, commencing one month after the first sizing of the Clearing Fund, following the introduction of the enhanced methodology. The proposed phase-in will gradually shift 35% of the weighting to total risk from open interest by 10% in months one and two and 15% in month three to arrive at the 70% weighting. Other significant components to the rule change are as follows:

- An anti-procyclical reduction cap, which will limit the maximum reduction in the Clearing Fund to 5% month-over-month.
- The size of the minimum contribution to the Clearing Fund will increase from \$150,000 to \$500,000.

¹ OCC also submitted an advance notice filing in connection with the proposed changes (SR-OCC-2018-803).

- Clearing Members will now be required to fund deficits related to a monthly resizing of the Clearing Fund within two business days of notification.
- The volume component used in the allocation calculations will be cleared volume for all firms.
- OCC will retain its authority to call an individual member for additional margin resources, or resize the Clearing Fund intra-month, when stress test exposures breach certain thresholds, and will introduce a new suite of stress test scenarios for these purposes.

Contingent upon regulatory approval, the anticipated implementation date for the rule change is September 1, 2018, which will coincide with the September 2018 sizing of the Clearing Fund. Consequently, the anticipated start of phase-in of the change in the allocation calculation will coincide with the October 2018 sizing. Prior to implementation, OCC will begin distributing *pro forma* Clearing Fund reporting to Members. The anticipated distribution is July and will be made available to the membership for analysis through the ENCORE system. OCC will publish additional information on that process closer to that date.

As of June 1, 2018, the size of the Clearing Fund would have been \$9.9 Billion utilizing the new methodology, versus \$14.8 Billion using the present methodology. OCC will be conducting direct outreach with any member that will experience a material increase in their requirement. Clearing Members interested in more information can contact OCC's Stress Testing and Liquidity Risk Management Group or their Member Services Representatives. OCC encourages its membership and Clearing Members' customers to review the [full proposal](#) for more detailed information.

Questions regarding this memo can be addressed to Member Services at 800-544-6091. Within Canada, call 800-424-7320.

Additional contact information:

Member Services - memberservices@theocc.com

Stress Testing and Liquidity Risk Management – stlrmgroup@theocc.com