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January 16, 2024

Via E-Mail (regs.comments@federalreserve.gov)
Ann E. Misback, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington, D.C. 20551
RIN 7100–AG64 [Docket R–1813]

Via Federal eRulemaking Portal (https://regulations.gov/)
Chief Counsel's Office
Office of the Comptroller of the Currency
400 7th Street SW, Suite 3E–218
Washington, D.C. 20219
Docket OCC–2023–0008

Via E-Mail (comments@fdic.gov)
Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street NW
Washington, D.C. 20429
Attention: Comments
RIN 3064–AF29

RE: Regulatory Capital Rule: Amendments Applicable to Large Banking Organizations and to Banking Organizations with Significant Trading Activity – Notice of Proposed Rulemaking

Ladies and Gentlemen:

The Options Clearing Corporation ("OCC") appreciates the opportunity to comment on the rule proposal set forth in the above-referenced notice of proposed rulemaking (the "Proposal")[1] published jointly by the Board of Governors of the Federal Reserve System (the "Board"), the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency (together, the "Agencies"). The Proposal sets forth revisions to large bank capital requirements that would implement policy that the Agencies believe would be consistent with the latest recommendations of the Basel Committee on Banking Supervision ("BCBS"), which are commonly referred to as the "Basel III Endgame." According to the Proposal, its objective is to improve risk-based

[1] Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity – Notice of Proposed Rulemaking, 88 Fed. Reg. 64028 (September 18, 2023).

capital requirements for large banks to better reflect underlying risks and to increase the consistency of how banks measure these risks.[2]

OCC generally supports these objectives and the efforts by the Agencies to set appropriate capital requirements for large banking organizations to increase the strength and resilience of the banking system. However, while it is not the intent of the Proposal, OCC believes that certain aspects of the Proposal would discourage use of central clearing for derivatives that OCC clears and settles. As a result of the resilience demonstrated by central counterparties ("CCPs"), like OCC, before and during the 2008 financial crisis, the G-20 committed in 2009 to promote central clearing to reduce systemic risks and bolster market stability. The G20 and lawmakers that implemented the post-crisis reforms recognized central clearing's numerous benefits, such as improved risk management, reduced counterparty risk, and centralized default management. In fact, one of the objectives of Basel III was to promote central clearing of standardized derivatives contracts to mitigate systemic risk and make derivatives markets safer.[3] Board Chair Jerome H. Powell has also stated that global regulators "have a responsibility to ensure that bank capital standards and other policies do not unnecessarily discourage central clearing."[4] Accordingly, OCC believes that certain aspects of the Proposal that would disincentivize clearing should be modified, as described below.

I. About OCC and the Markets It Serves

OCC, founded in 1973, is the world's largest equity derivatives clearing organization. In addition to serving as the only CCP for U.S. exchange-listed securities options ("Listed Options"), OCC acts as a CCP for certain stock loan transactions, futures contracts and options contracts on futures ("OCC Cleared Contracts"). CCP clearinghouses generally promote robust risk management and safety and soundness to reduce systemic risks by providing novation, netting and settlement guarantee services to their members. In OCC's case, it provides these services under the jurisdiction of both the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"). In July 2012, the Financial Stability Oversight Council ("FSOC") designated OCC as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer

[2] Proposal at 64031.

[3] Basel Committee on Banking Supervision, Basel III: A global regulatory framework for more resilient banks and banking systems at 4 (December 2010 (rev June 2011)) (noting an intent to create strong incentives for banks to move exposures to CCPs), available at https://www.bis.org/publ/bcbs189.pdf.

[4] Federal Reserve Board Governor Jerome H. Powell, Central Clearing and Liquidity, Speech at the Federal Reserve Bank of Chicago Symposium on Central Clearing, Chicago, Illinois (June 23, 2017), available at https://www.federalreserve.gov/newsevents/speech/powell20170623a.htm.

Protection Act of 2010 ("Dodd-Frank Act"). As a SIFMU, OCC is additionally subject to oversight by the Board, and the SEC is its primary regulator.

The vast majority of OCC's clearing members are broker-dealers regulated by the SEC and/or futures commission merchants regulated by the CFTC, and a number of the largest clearing members are bank-affiliated. The SEC also recently approved amendments to OCC's membership standards so that certain banking entities supervised by the Agencies are eligible to participate as clearing members.[5] As a CCP, OCC's ability to reduce risks in the markets it serves requires the participation and financial strength of its clearing members. Clearing members access OCC's clearing and settlement services for their own transactions in OCC Cleared Contracts as well as for those of their customers, posting collateral and margin relevant to both portfolios.

These aspects of OCC's clearing and settlement services are relevant to the Proposal because U.S. bank holding companies and US FDIC-insured banks, which may have bank and bank-affiliated clearing members, would be required to comply with the Agencies' new regulatory capital rules. OCC is concerned that certain aspects of the Proposal would impose material, additional capital costs on the banks that would cause them to either decrease or stop providing clearing services to customers altogether. This concern is particularly acute in the Listed Options market where it is already the case that only three bank-affiliated clearing members account for over half of the cleared volume in OCC Cleared Contracts. Providing clearing services for their customers is a capital intensive and low profit margin business for banks. As such, a significant increase in capital requirements under the Proposal would make the business even more costly, which may cause banks to exit or reduce its participation in the clearing business, further exacerbating concentration in the industry and related risks.

II. Summary of OCC Comments

As discussed above, capital requirements in the Proposal that would disincentivize and reduce access to central clearing would run directly counter to the goal of promoting central clearing in financial markets that has long been supported by leading global economies, Congress, and U.S. financial regulators. Accordingly, OCC believes that it is critically important that any new capital requirements implemented by the Agencies do not disrupt or undermine continued access to central clearing. In particular, there are three aspects of the Proposal, described below in Sections III.A., B. and C., that OCC requests that the Agencies modify in connection with any final rulemaking. In addition, OCC continues to have certain concerns related to netting under the standardized approach to counterparty credit risk ("SA-CCR") that the Agencies

[5] 88 FR 30373 (May 11, 2023), available at https://www.govinfo.gov/content/pkg/FR-2023-05-11/pdf/2023-10029.pdf.

adopted in 2020. Section III.D reiterates these concerns, and OCC requests that the Agencies reconsider those issues and make related modifications in connection with the Proposal.

A. Both Legs of Cleared Transactions Should be Exempt from the Credit Value Adjustment ("CVA") Capital Charges

The Proposal would exclude cleared transactions from the definition of CVA risk covered position and therefore from CVA risk-based capital charges for such transactions. However, the proposed definition of "cleared transaction" only includes the leg of the transaction that faces the CCP, and not the client leg (that is, the transaction between the CCP's clearing member and that member's customer) of the same transaction. By excluding the client leg from the definition of cleared transaction, the Proposal would subject the client leg to CVA risk-based capital charges. OCC requests that both legs of cleared transactions be automatically excluded from the definition of CVA risk covered position.

The Proposal recognizes that banking organizations do not calculate CVA for the CCP-facing leg of cleared transactions for financial reporting purposes under US GAAP and therefore, the Proposal would not consider the CCP-facing leg of a cleared transaction to be a CVA risk covered position. Notably, however, banking organizations also do not report any CVA for client-facing cleared transactions under US GAAP. Nevertheless, the Proposal states in a footnote that transactions, where a clearing member either is acting as a financial intermediary and enters into an offsetting transaction with a CCP or where it provides a guarantee on the performance of its client to a CCP, the exposures would be included in CVA risk covered positions. Given that the client-facing cleared transactions are off balance sheet, the only counterparty-related losses that a clearing member could incur in client clearing would be in the unlikely event of a client default. The risk of such a default is a credit risk that is already accounted for in the counterparty credit risk default charge under SA-CCR. Including the client leg in the definition of CVA risk covered position therefore creates redundant capital charges. This could further disincentivize clearing members from undertaking clearing activity on behalf of existing or potential clients, which could in turn increase systemic risk by reducing availability of clearing.

The Proposal goes beyond the recommendations of the Basel Framework and its implementation in several other jurisdictions, including the UK and the European Union. In those jurisdictions, the capital rules typically recognize that the client leg of a cleared transaction is an essential component of the overall clearing activity and therefore exclude the client leg from CVA requirements, consistent with the economic reality of the trade and the need to avoid undermining the systemic value of clearing through

duplicative capital charges. If the Proposal's approach is adopted, it would create an uneven playing field and add to the potential for regulatory arbitrage in addition to undermining the stated policy goal of encouraging central clearing.

For the foregoing reasons, OCC requests that the Proposal be modified to exclude both legs of cleared transactions from the definition of CVA risk covered position.

B. The Operational Risk Charge Should Not Be Based on Gross Fees

The Proposal imposes a standardized approach for the calculation of operational risk. This approach replaces the existing internal model-based advanced measurement approaches for calculating risk weights used by Category I and II organizations. Question 74 in the Proposal asks for feedback regarding this structure. While OCC recognizes the benefits of standardization in reducing uncertainty in the capital planning process, OCC is concerned that the Proposal's formula for calculating the operational risk capital requirement may have the effect of disincentivizing the use of central clearing.

This concern is due to the fact that the services component of the operational risk capital requirement business indicator is based upon the larger of the institution's revenue (fees plus commission income) or expenses, on a gross basis. This is problematic, as many clearing members account for certain fees such as clearing and exchanges fees, which they pass through to their customers, as their own revenues and expenses under U.S. GAAP. By not allowing the netting out of these pass-through fees under the Proposal, clearing members' gross revenue would be artificially elevated. This means that banking organizations would effectively pay a capital surcharge under the operational risk capital requirement.

At sufficient transaction volumes, this additional capital surcharge could disincentivize the use of clearing. The corresponding increase in capital would also increase the amount clearing members charge customers, making clearing more expensive, further discouraging clearing. As such, we recommend that the Agencies allow clearing members to calculate the services component of the operational risk capital requirement, on a net basis.

C. Banking Organizations Should be Permitted to Decompose Non-linear Transactions on Certain Index Products to Calculate Exposures

OCC also believes that the Proposal inappropriately restricts offsets within hedging sets of OCC clearing clients – particularly Listed Option market makers. This is because the Proposal would prohibit banking organizations from decomposing non-linear transactions on indices when calculating the exposures associated with index products, such as Listed Options on securities indexes. According to the Agencies, this prohibition is because "it is not mathematically possible to calculate the supervisory delta for an

underlying component, as the delta associated with the non-linear index applies at the instrument level.[6]

Market makers are critical to the proper functioning of the Listed Options market, serving as the predominant source of liquidity. Inappropriately limiting offsets within their portfolios harms the overall Listed Options market. OCC previously raised this same concern in connection with its comments on SA-CCR.[7] An example best demonstrates OCC's concern. Market makers often engage in Listed Option transactions for which the underlying economic exposure is an equity index, but the form that the exposure takes may vary. Thus, for example, market makers trade (i) options ("SPY Options") on shares of the SPDR S&P Index exchange-traded fund ("SPDR Shares") and (ii) options ("SPX Options") on the S&P Index itself. In many cases, the positions that a market maker takes in the course of meeting market demand for one type of option (e.g., SPY Options) are hedged with the other type of option (e.g., SPX Options) and/or the underlying (e.g., SPY Shares), in an effort to maintain a risk neutral portfolio.

The economic profiles of SPY Options and SPX Options are, for all practical purposes, the same, as are the economic profiles of SPDR Shares and the S&P Index itself. Indeed, they have historically tracked one another with close correlation.[8] However, the SA-CCR Final Rule permits full offset within an equity hedging set only for positions with respect to the same "reference entity" within the hedging set. For positions with different reference entities, only a partial offset is permitted. Given the practical economic equivalence of SPY Options and SPX Options, permitting only a partial offset is unnecessarily punitive for OCC clearing members when they calculate the capital that they must hold against the credit risk of their clearing clients. In practical effect, there is no significant credit risk to a Listed Options market maker with respect to offsetting positions in the instruments described above, because of how closely both positions track the same underlying index. A partial offset between different equity indexes is reasonable, as is a partial offset where single name entities represent different economic exposures. However, partial offsets are unnecessarily conservative with respect to options on different instruments that are designed to closely track, and have historically closely tracked, the same index.

To address this problem, OCC restates its request, which was raised previously in connection with its comments on SA-CCR,[9] that the Agencies permit banking

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[6] Proposal at 64058

[7] See supra note 11.

[8] For instance, the SPDR Shares traded at a .04% discount to the net asset value of the SPDR Shares exchange-traded fund in the fourth quarter of 2018. *See* State Street Global Advisors, *SPDR S&P 500 ETF* (https://us.spdrs.com/en/etf/spdr-sp-500-etf-SPY).

[9] See supra note 11

organizations to calculate exposures to positions such as SPY Options and SPX Options by reference to the positions' components. Thus, both a SPY Option and a SPX Option would be decomposed for calculation purposes, with exposures then determined based on their components (i.e., the equities that compose the S&P Index). Such an approach would ensure that economically equivalent positions are treated equivalently for exposure calculation purposes, and not inappropriately subject to partial offsets.

D. Clearing Members Should Be Permitted to Net a Clearing Client's Listed Options Positions and Cleared Futures Positions in Calculating Potential Future Exposure

Prior to the Proposal, the Agencies proposed and adopted a standardized approach for calculating the exposure of derivative contracts as part of SA-CCR.[10] OCC commented on the SA-CCR Proposal because it imposes capital requirements on bank-affiliated clearing members with respect to OCC Cleared Contracts.[11] The SA-CCR Final Rule became effective on April 1, 2020 with a mandatory compliance date of January 1, 2022.

OCC continues to have concerns about the SA-CCR Final Rule related to the ability of clearing members to net clients' Listed Options positions and cleared futures positions in calculating Potential Future Exposure ("PFE"). OCC previously commented on this issue in connection with the SA-CCR Proposal and believes the Agencies should address it in connection with the Proposal. Specifically, we request that the Agencies permit netting across settled-to-market ("STM") and collateralized-to-market ("CTM") derivatives.

The SA-CCR Final Rule's treatment of "hybrid netting sets" limits the ability of banking organizations to net across such netting sets for purposes of calculating Potential Future Exposure ("PFE"). This limitation results in OCC clearing members' not being permitted to net Listed Options (collateralized-to-market ("CTM")) and cleared futures (settled-to-market ("STM")) when calculating their PFE with respect to clearing clients. The SA-CCR Proposal stated the rational for this as follows:

> [M]argined derivative contracts cannot offset unmargined derivative contracts in the PFE component calculation [with respect to a hybrid netting set] because of

[10] See 83 Fed. Reg. 64660 (December 17, 2018) ("SA-CCR Proposal"), available at https://www.govinfo.gov/content/pkg/FR-2018-12-17/pdf/2018-24924.pdf ; 85 Fed. Reg. 4362 (January 24, 2020) ("SA-CCR Final Rule"), available at https://www.fdic.gov/news/board-matters/2019/2019-11-19-notice-dis-a-fr.pdf.

[11] See OCC Comment Letter re: Standardized Approach for Calculating the Exposure Amount of Derivative Contracts (February 15, 2019), available at https://www.fdic.gov/resources/regulations/federal-register-publications/2018/2018-exposure-amount-derivative-contracts-3064-ae80-c-008.pdf.

> different applicable risk horizons. Similarly, derivative contracts with different [minimum periods of risk] cannot offset each other.[12]

It should be noted that in the context of cleared transactions (defined in the Proposal as only the CCP-facing leg of the transaction) the final SA-CCR rule allows banking organizations to treat STM proprietary transactions as CTM and apply netting. However, this treatment does not extend to the client-leg of the cleared transactions. This limitation on netting may be appropriate in the case of most hybrid netting sets. However, the rationale for the limitation does not apply to OCC clearing members for OCC cleared Listed Options and futures positions. This is because the "applicable risk horizon" of Listed Options and cleared futures is the same. Moreover, not only is the risk horizon the same, it is a single day. Although the rationale stated above makes sense for a typical hybrid portfolio—where unmargined derivatives have risk horizons that accord with their remaining terms rather than any related margining requirements—it does not make sense where the unmargined derivatives, like cleared futures, are subject to daily settlement.

An OCC clearing member should not be required to hold different amounts of capital for two market maker clearing clients having portfolios with identical risk profiles where the only difference is that one market maker hedges its Listed Options solely with other Listed Options while the second market maker hedges its Listed Options with cleared futures transactions. Clearing clients, particularly market makers, often have portfolios that include cleared futures positions that offset the risk of Listed Option positions. Such futures positions represent an important means by which market makers maintain hedged (risk-neutral) portfolios. For instance, market makers in options on the S&P Index use futures on the S&P Index to hedge their exposures to such options. In this respect, the risk-reducing nature of offsetting futures and options positions (on the same underlying) has long been recognized in the Listed Options market through the cross-margining program that OCC and the Chicago Mercantile Exchange ("CME") have implemented.[13] The OCC/CME program recognizes margin offsets between futures and options positions on the same underlying product. In Q3 2023 such offsetting provided average daily efficiencies of more than $5 billion for members participating in the OCC/CME cross margining program.

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[12] See SA-CCR Proposal at 64672.

[13] OCC and CME first implemented their cross-margining program in 1989 to facilitate the cross-margining of positions in options cleared by OCC with positions in futures and commodity options cleared by CME. The program addressed the fact that clearing members may have been required to meet higher margin requirements at each clearinghouse than were warranted by the risk of combined positions, because each portfolio was margined separately without regard to positions held in the other portfolio. *See* Securities Exchange Act Release Nos. 26607 (March 7, 1989), 48 FR 10608 (March 14, 1989) (SR-OCC-89-1); 27296 (September 26, 1989) (SR-OCC-89-11).

OCC respectfully requests that the Agencies' use the Proposal as an opportunity to remove the limitation in the SA-CCR Final Rule and to permit clearing members to net Listed Options and cleared futures when calculating their PFE with respect to clearing clients.

III. Conclusion

OCC urges the Agencies to make the changes described above in connection with finalizing the Proposal. Without these important modifications, OCC believes that the final rules will unnecessarily discourage central clearing – which would be inconsistent with long stated policy objectives and related efforts that are meant to promote central clearing. Moreover, a failure to include these modifications will likely result in even fewer firms being willing to provide client clearing services, which will exacerbate concentration in the industry and systemic risk.

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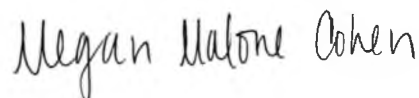
We appreciate the opportunity to submit these comments and would be pleased to discuss them in detail with the Agencies as the Proposal is further considered. We also urge the Agencies to make the changes described above in connection with finalizing the Proposal.

If you have any questions, please do not hesitate to contact me at 312.322.4467, or mcohen@theocc.com. We would be pleased to provide the Commission with any additional information or analyses that might be useful in determining the content of the final rules.

Respectfully submitted,



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