Thank you for the opportunity to comment on SR-OCC-2024-001 34-99393 entitled "Proposed Rule Change by The Options Clearing Corporation Concerning Its Process for Adjusting Certain Parameters in Its Proprietary System for Calculating Margin Requirements During Periods When the Products It Clears and the Markets It Serves Experience High Volatility" (PDF, Federal Register) as a so-called "retail investor."

I have several concerns about the OCC rule proposal.

I do not support its approval and appreciate the opportunity to comment.

I am concerned about our financial system's lack of transparency, as evidenced by this rule proposal, amongst others. The details of this proposal in Exhibit 5 along with supporting information (see, e.g., Exhibit 3) are significantly redacted which prevents public review, making it impossible for the public to meaningfully review and comment on this proposal. Without opportunity for a full public review, this proposal should, in principle, be rejected on that basis alone.

Public review is of particular importance as the OCC's Proposed Rule blames U.S. regulators for failing to require the OCC to adopt prescriptive procyclicality controls ("U.S. regulators chose not to adopt the types of prescriptive procyclicality controls codified by financial regulators in other jurisdictions" [1]). As "procyclicality may be evidenced by increasing margin in times of stressed market conditions" [2], an "increase in margin requirements could stress a Clearing Member's ability to obtain liquidity to meet its obligations to OCC" [Id.] which "could expose OCC to financial risks if a Clearing Member fails to fulfil its obligations" [3] that "could threaten the stability of its members during periods of heightened volatility" [2].

With the OCC designated as a SIFMU whose failure or disruption could threaten the stability of the US financial system, everyone dependent on the US financial system is entitled to transparency. As the OCC is classified as a self-regulatory organization, the OCC blaming U.S. regulators for not requiring the SRO adopt regulations to protect itself makes it apparent that the public cannot fully rely upon the SRO to safeguard our financial markets.

This particular OCC Rule Proposal appears designed to protect Clearing Members from realizing the losses associated with extreme risk scenarios by rubber stamping reductions in margin requirements as required by Clearing Members; margin requirements that exist specifically to ensure adequate collateral is available to cover high-risk trades. Per the OCC rule proposal:

The OCC collects margin collateral from Clearing Members to address the market risk associated with a Clearing Member's positions [3].

OCC uses a proprietary system, STANS ("System for Theoretical Analysis and Numerical Simulation"), to calculate each Clearing Member's margin requirements with various models. One of the margin models may produce "procyclical" results where margin requirements are

correlated with volatility which “could threaten the stability of its members during periods of heightened volatility” [2].

An increase in margin requirements could make it difficult for a Clearing Member to obtain liquidity to meet its obligations to OCC. If the Clearing Member defaults, liquidating the Clearing Member positions could result in losses chargeable to the Clearing Fund, which could create liquidity issues for non-defaulting Clearing Members [2].

In summary: a systemic risk exists because Clearing Members are either insufficiently capitalized or over-leveraged (or both) such that a single Clearing Member failure (e.g., from insufficiently managing risks arising from high volatility) could cause a cascade of Clearing Member failures. To put it in layman’s terms: a Clearing Member who makes especially bad bets on Wall Street could trigger a systemic financial crisis because Clearing Members do not have the capital to cover the associated losses; as a whole, Clearing Members are all risking more than they can afford to lose.

The OCC’s rule proposal attempts to avoid triggering a systemic financial crisis by reducing margin requirements using “idiosyncratic” and “global” control settings; highlighting one instance for one individual risk factor that “after implementing idiosyncratic control settings for that risk factor, aggregate margin requirements decreased $2.6 billion” [4]. The OCC chose to avoid margin calling one or more Clearing Members at risk of default by implementing “idiosyncratic” control settings for a risk factor. According to footnote 35 [5], the OCC has made this “idiosyncratic” choice over 200 times in less than 4 years (from December 2019 to August 2023) of varying durations up to 190 days (with a median duration of 10 days). The OCC is choosing to waive away margin calls for Clearing Members over 50 times a year, which is much too often to be classified as “idiosyncratic.”

In addition to waiving away margin calls for 50 idiosyncratic risks a year, the OCC has also chosen to implement “global” control settings in connection with long tail [6] events, including the onset of the COVID-19 pandemic and the so-called “meme-stock” episode on January 27, 2021 [7]. One might suspect that the term “idiosyncratic” is simply being used to describe any scenario where a Clearing Member is unable to provide the collateral required to address the margin requirements of the market.

Fundamentally, these rules create an unfair marketplace for other market participants, including retail investors, who have no alternative but to face the consequences of long-tail risks, while the OCC can simply elect to waive margin calls for Clearing Members by repeatedly reducing their margin requirements at their discretion.

For this reason, this rule proposal should be rejected, and Clearing Members should be subject to strictly defined margin requirements, as other investors are; that is only fair.

Per the OCC, this rule proposal and these special margin reduction procedures exist because a single Clearing Member defaulting could result in a cascade of Clearing Member defaults

potentially exposing the OCC to financial risk [8]. But Clearing Members should not feel entitled to simply propose new rules to protect themselves from the financial liabilities they create; Clearing Members who fail to responsibly manage their portfolio risk against long-tail events must be prepared to handle the consequential outcomes of these failures; if this means increased capitalization to address margin requirements, then so be it. Clearing Member failure is a natural disincentive against excessive leverage and insufficient capitalization as others in the market will not cover their loss.

For this reason, this rule proposal should be rejected, and Clearing Members should face the consequences of failing to responsibly manage their portfolio risk, including against long-tail events.

Additionally, this rule proposal codifies an inherent conflict of interest for the Financial Risk Management (FRM) Officer. While the FRM Officer's position is allegedly to protect OCC's interests, the situation outlined by the OCC proposal where a Clearing Member failure exposes the OCC to financial risk necessarily requires the FRM Officer to protect the Clearing Member from failure to protect the OCC. Thus, the FRM Officer is no more than an administrative rubber stamp to reduce margin requirements for Clearing Members at risk of failure.

Rubber stamping margin requirement reductions for Clearing Members at risk of failure vitiates the protection from market risks associated with Clearing Member's positions that would otherwise be provided by the margin collateral collected by the OCC. For this reason, this rule proposal should be rejected, and the OCC should enforce sufficient margin requirements to protect itself and minimize the size of any bailouts that may already be required.

As the OCC's Clearing Member Default Rules and Procedures [9] Loss Allocation waterfall allocates losses to "3. OCC's own pre-funded financial resources" (OCC 's "skin-in-the-game" per SR-OCC-2021-801 34-91491 [10]) before "4. Clearing fund deposits of non-defaulting firms," any sufficiently large Clearing Member default which exhausts both "1. The margin deposits of the suspended firm" and "2. Clearing fund deposits of the suspended firm" automatically poses a financial risk to the OCC.

As this rule proposal is concerned with potential liquidity issues for non-defaulting Clearing Members as a result of charges to the Clearing Fund, it is clear that the OCC is concerned about risk which exhausts OCC's own pre-funded financial resources. With the primary line of protection for the OCC being "1. The margin deposits of the suspended firm," this rule proposal to reduce margin requirements for at-risk Clearing Members via "idiosyncratic" control settings is completely illogical at best, and transparently self-serving at worst.

According to the OCC's own description of the potential scale of the financial risk posed by a single defaulting Clearing Member, the OCC *should increase the amount of margin collateral required from the at-risk Clearing Member(s)* to increase their protection from market risks

associated with Clearing Members' positions and promote responsible risk management practices among Clearing Members.

Curiously, increasing margin requirements is exactly what the OCC admits is predicted by the allegedly "procyclical" STANS model [2] that the OCC alleges is an overestimation and seeks to mitigate [11]. If this rule proposal is approved, mitigating the procyclical margin requirements directly *reduces* the first line of protection for the OCC, margin collateral from at-risk Clearing Members.

For this reason, this rule proposal should be rejected, and made fully available for public review.

Additionally, I would suggest the following: margin requirements for Clearing Members should be *increased,* commensurate with the risks associated with Clearing Member positions, instead of reducing margin requirements in scenarios where Clearing Members would be unable to meet them.

Clearing Members should be encouraged to position their portfolios to account for stressed market conditions and long-tail risks. Instead, the current proposal encourages Clearing Members to behave as if they are "too big to fail," and are therefore entitled to carry excessively risky and leveraged positions, which they can conveniently manage by implementing "idiosyncratic controls" to reduce any associated margin requirements.

External auditing and supervision as a "fourth line of defense," similar to that described in The "four lines of defence model" for financial institutions [12], with enhanced public reporting to ensure that risks are identified and managed before they become systemically significant, is also recommended.

Finally, the OCC's Loss Allocation waterfall should be reorganized so that Clearing fund deposits of non-defaulting firms are allocated losses before OCC's own pre-funded financial resources and the EDCP Unvested Balance (i.e., swap "3. OCC's own pre-funded financial resources" and "4. Clearing fund deposits of non-defaulting firms" in the OCC's Loss Allocation waterfall).

Changing the order of loss allocation would encourage Clearing Members to police themselves, since each Clearing Member would have a financial stake (i.e., their Clearing Fund deposits would be at-risk once the deposits of a suspended firm are exhausted) in advocating that their fellow Clearing Members take appropriate risk management measures. This change would also increase protections for the OCC, a SIFMU, by allocating losses to the clearing corporation after Clearing Member deposits are exhausted.

By extension, the public would benefit from a reduced risk in needing to bail-out a systemically important clearing agency.

Thank you for the opportunity to comment on this proposal, as all investors benefit from a fair, transparent, and resilient market.

[1] https://www.federalregister.gov/d/2024-01386/p-11

[2] https://www.federalregister.gov/d/2024-01386/p-8

[3] https://www.federalregister.gov/d/2024-01386/p-7

[4] https://www.federalregister.gov/d/2024-01386/p-50

[5] https://www.federalregister.gov/d/2024-01386/p-51

[6] https://en.wikipedia.org/wiki/Long_tail

[7] https://www.federalregister.gov/d/2024-01386/p-45

[8] https://www.federalregister.gov/d/2024-01386/p-79

[9] https://www.theocc.com/getmedia/e8792e3c-8802-4f5d-bef2-ada408ed1d96/default-rules-and-procedures.pdf, which is publicly available and linked to from the OCC's web page on Default Rules & Procedures at https://www.theocc.com/risk-management/default-rules-and-procedures

[10] https://www.federalregister.gov/documents/2021/04/12/2021-07454/self-regulatory-organizations-the-options-clearing-corporation-notice-of-no-objection-to-advance

[11] https://www.federalregister.gov/d/2024-01386/p-16

[12] https://www.bis.org/fsi/fsipapers11.pdf

Sincerely,

A Concerned Retail Investor