For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[23]

Vanessa A. Countryman,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–100998; File No. SR–OCC–2024–009]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of Proposed Rule Change by The Options Clearing Corporation Concerning Its Backtesting Framework and To Establish a Resource Backtesting Margin Charge

September 11, 2024.

I. Introduction

On July 11, 2024, the Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change SR–OCC–2024–009 (''Proposed Rule Change'') pursuant to Section 19(b) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 19b–4 [2] thereunder. The Proposed Rule Change would amend the OCC rules to more comprehensively describe its approach to backtesting, including underlying assumptions; establish a new category of backtesting regarding the maintenance of sufficient margin resources; implement a new margin add-on charge based on breaches of the new category of resource backtesting; and clarify governance and escalation criteria related to the updated backtesting framework. The Proposed Rule Change was published for public comment in the **Federal Register** on July 30, 2024.[3] The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change.

II. Description of the Proposed Rule Change

OCC is a central counterparty (''CCP''), which means that as part of its function as a clearing agency it interposes itself as the buyer to every seller and the seller to every buyer for certain financial transactions. As the CCP for the listed options markets in the U.S.,[4] as well as for certain futures and stock loans, OCC is exposed to certain risks arising from providing settlement and clearing services to its Clearing Members.[5] Because OCC is obligated to perform on the contracts it clears even where one of its Clearing Members defaults, one such risk to which OCC is exposed is credit risk in the form of exposure to its members' trading activities. OCC manages such credit risk, in part, by collecting collateral from its members in the form of margin. OCC evaluates the margin requirements it imposes on members by periodically comparing such requirements to the potential risk of loss arising out of a member default (*i.e.,* backtesting).[6] While backtesting does not directly establish a member's margin requirements, OCC maintains authority under its rules to collect additional margin if OCC identifies—through backtesting results or otherwise—issues with its margin coverage.[7]

OCC's current backtesting framework measures its Clearing Members' losses in excess of calculated margin requirements to evaluate the adequacy of OCC's model performance, improve margin methodology and risk assessment processes, and identify trends in exceedances that may indicate broader behavioral changes by market participants. However, OCC's current backtesting framework does not provide detailed descriptions of the backtesting process, nor does it require OCC to measure whether it has collected sufficient margin resources in the event of a Clearing Member default (a process often referred to as ''resource sufficiency'' evaluation), or detail the underlying assumptions and governance process for the framework. To address these issues, the Proposed Rule Change would update OCC's current backtesting framework by:

- updating the current backtesting framework to more comprehensively describe material aspects of model backtesting;
- providing for a new category of backtesting—''Resource Backtesting''—that assesses the adequacy of OCC's margin resources to cover its credit exposure at the Clearing Member level; and
- detailing the underlying assumptions and reporting structure for the entire backtesting framework to provide for clearer governance procedures, including escalation criteria.

Additionally, OCC lacks a mechanism with which to collect additional margin resources in instances where backtesting suggests that OCC may otherwise not have sufficient resources to cover its credit exposure during a Clearing Member's default. To that end, OCC proposes to implement a new add-on charge called the ''Resource Backtesting Margin Charge.'' Although this add-on would not be part of the backtesting framework, OCC would use the proposed Resource Backtesting category of backtesting to determine if additional margin in the form of the Resource Backtesting Margin Charge is necessary and in what amount. Specifically, OCC would apply the Resource Backtesting Margin Charge to Clearing Members who experience Resource Backtesting deficiencies that bring their margin coverage rates below a 99% coverage target. OCC also proposes to include in the backtesting framework governance procedures related to the Resource Backtesting Margin Charge.[8]

A. OCC's Current Backtesting Framework

OCC conducts daily backtesting of collateral requirements generated by its margin methodology using standard predetermined parameters and assumptions. OCC uses such backtesting to update its credit risk management and margin methodology [9] or to adjust model parameters. OCC relies on backtesting to evaluate the accuracy of its margin models by comparing the calculated margin coverage for each margin account against the realized profit and loss on the margined

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[23] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 100584 (July 24, 2024), 89 FR 61211 (July 30, 2024) (File No. SR–OCC–2024–009) (''Notice of Filing'').

[4] OCC describes itself as ''the sole clearing agency for standardized equity options listed on a national securities exchange registered with the Commission ('listed options').'' *See* Securities Exchange Act Release No. 96533 (Dec. 19, 2022), 87 FR 79015 (Dec. 23, 2022) (File No. SR–OCC–2022–012).

[5] Capitalized terms have the same meaning as provided in OCC's By-Laws and Rules, which can be found on OCC's public website: *https://www.theocc.com/Company-Information/Documents-and-Archives/By-Laws-and-Rules.*

[6] Under the rules applicable to OCC, backtesting means an ex-post comparison of actual outcomes with expected outcomes derived from the use of margin models. 17 CFR 240.17ad–22(a) (''Backtesting'').

[7] *See* Notice of Filing, 89 FR at 61212.

[8] Under the Proposed Rule Change, OCC also would make conforming changes to its rules and internal policies and procedures to reflect these amendments and facilitate implementation, including consolidating internal procedures for all backtesting into a Backtesting Procedure and associated technical document, updating references and descriptions, and inserting headings. *See* Notice of Filing, 89 FR at 61219–20. OCC provided the new Backtesting Procedure as confidential Exhibit 3B, and the updated technical document as confidential Exhibit 3C to File No. SR–OCC–2024–009.

[9] OCC's margin methodology, adopted in 2006, is titled the System for Theoretical Analysis and Numerical Simulation (''STANS''). *See* Notice of Filing, 89 FR at 61212–13.

portfolios. However, OCC's policies and procedures do not currently identify the categories of relevant assumptions, provide for how they are established or modified, or explain how assumptions may differ across different types of backtesting depending on the purpose of those backtesting variants.

Currently, OCC conducts both backtesting of hypothetical portfolios (which OCC currently refers to as ''Model Backtesting'') and actual portfolios (which OCC currently refers to as ''Business Backtesting'').[10] OCC's internal backtesting procedures address data acquisition, application of statistical tests, analyses initiated to address root causes of exceedances, reporting of results, annual methodology reviews, and issue escalation.

OCC's backtesting framework includes its Margin Policy.[11] The Margin Policy requires that OCC's Financial Risk Management Department (''FRM'') continually evaluates the effectiveness of its margin models through daily backtesting of each margin account.[12] The Margin Policy requires further that OCC's Quantitative Risk Management business unit (''QRM'') design backtests to focus on satisfying OCC's regulatory obligations, identifying potential opportunities to improve the margin methodology, and identifying trends in exceedances that may be indicative of behavioral changes by market participants. Acknowledging that problems may arise from both technical[13] and model-related issues, the Margin Policy directs QRM to design backtests to find potential opportunities to improve OCC's risk-assessment processes. Under the current backtesting framework, FRM performs Business Backtesting to measure whether the losses observed for a constant set of positions over OCC's two-day margin period of risk were in excess of the total risk charges (*i.e.,* aggregate of expected shortfall, stress test charges and add-on charges) required for the account. FRM is then directed to classify any observation in which losses are in excess as an exceedance.

With regard to governance, the current Margin Policy directs QRM to report identified problems and overall performance to FRM and the Model Risk Working Group (''MRWG''), which then determines whether the results require escalation to OCC's Management Committee (''MC''). The Margin Policy further requires routine reporting from QRM to the MRWG that accumulate daily backtesting results and detailed descriptions of the accounts that have incurred exceedances, trends, and causes of the exceedances. As with the escalation of identified problems and overall performance, the Margin Policy directs QRM to provide notable results from these reviews to the Chief Financial Risk Officer, who is the head of FRM, and the MRWG; and that the MRWG similarly determines whether escalation is warranted to the MC, which may decide what remedial actions may be taken. Under the current Margin Policy, QRM must also perform a monthly review of parameters and assumptions for Business Backtesting, and report such review to the MRWG to discuss and escalate issues as necessary.

B. Proposed Updates to the Backtesting Framework

OCC's current backtesting framework does not specify certain materials aspects of OCC's backtesting processes, namely, a comprehensive description of the different types of backtesting OCC performs and their respective purposes, and how OCC establishes and modifies its assumptions for backtesting. Importantly, the current framework does not require OCC to conduct backtesting to measure margin resource sufficiency, but rather, is designed to identify technical and model-based issues as described above. OCC's current backtesting framework also lacks detailed guidance around governance, specifically the reporting process and escalation criteria and thresholds, which could lead to inconsistencies in the escalation of similar backtesting exceedances or deficiencies, and reviews of backtesting assumptions.

To help mitigate these issues, OCC proposes to:

- more comprehensively describe material aspects of its model backtesting framework, including the purpose and scope of the backtesting OCC performs;
- introduce a new category of backtesting, Resource Backtesting, to measure whether OCC's margin resources adequately cover its credit exposure at the Clearing Member level;
- list the assumptions underlying OCC's backtesting and the process for reviewing and modifying those assumptions; and
- outline in more detail the backtesting reporting process, including which decision-makers are involved and escalation criteria for exceedances or deficiencies and reviews.

1. Model Backtesting

Under the Proposed Rule Change, OCC would consolidate discussion of its two current ''Model'' and ''Business'' backtesting programs under the heading of Model Backtesting, without changing its current process for conducting daily backtesting of hypothetical and actual portfolios to evaluate the performance of its margin methodology. OCC proposes to add descriptions in the Margin Policy to explain that FRM conducts Model Backtesting of hypothetical portfolios to target specific aspects of the models that may be masked by the backtesting of actual portfolios, because margin accounts may have thousands of positions in many diverse products. Under the Proposed Rule Change, the Margin Policy would include additional details consistent with OCC's current backtesting practices. Such details would include that OCC would conduct Model Backtesting (i) over a set liquidation horizon; (ii) at the marginable account level;[14] and (iii) at a 99 percent confidence level. The Margin Policy would add a definition of ''exceedance'' to mean a daily outcome in which the loss in portfolio value over the applicable time horizon is larger in magnitude than what the daily STANS model predicted at the start of that time horizon.

OCC would continue to limit the purpose of Model Backtesting to assessing the performance of OCC's margin models in calculating margin requirements, as opposed to assessing the performance of other aspects of OCC's credit risk management. Consistent with this intent, the Margin Policy would state that OCC would continue to exclude collateral from Model Backtesting that is not modeled by STANS, such as collateral that is valued using the more traditional method of fixed collateral haircuts outside of the STANS margin methodology, or collateral that does not capture changes in market risk factors, such as add-ons that are unrelated to

[10] *See generally* Securities Exchange Act Release Nos. 73749 (Dec. 5, 2014), 79 FR 73673 (Dec. 11, 2014) and 75290 (June 24, 2015), 80 FR 37323 (June 30, 2015) (File No. SR–OCC–2014–810).

[11] OCC provided the Margin Policy as confidential Exhibit 5B to File No. SR–OCC–2024–009. OCC stated that, generally, ''the Margin Policy establishes a process for ongoing monitoring, review, testing and verification of OCC's risk-based margin system, including by requiring OCC to conduct daily backtesting, conduct analysis of exceedances, and report results at least monthly through OCC's governance process. . .'' *See* Notice of Filing, 89 FR at 61212.

[12] *See* Notice of Filing, 89 FR at 61213.

[13] OCC indicated that such technical issues may arise from corporate actions and special dividends. *Id.*

[14] *See* Notice of Filing, 89 FR at 61214 (''OCC conducts Model Backtesting at this level because Model Backtesting exceedances potentially indicate issues that could be actively impacting OCC's margin requirements for the margin accounts. In addition, backtesting at this level is consistent with OCC's obligations in its capacity as a derivatives clearing organization ('DCO') registered with the Commodity Futures Trading Commission.'')

changes in market risk factors (*e.g.,* when a Clearing Member's operational or financial condition presents elevated risks). The collateral that is not modelled by STANS instead would be accounted for under the new backtesting category of Resource Backtesting, as described in Section II.B.2. below.[15]

2. Resource Backtesting

In addition to formalizing the process of performing daily Model Backtesting in the Margin Policy, OCC would add a new category of backtesting, called Resource Backtesting, to evaluate whether OCC's financial resources are sufficient to cover its credit exposures during a Clearing Member default. Pursuant to the proposed Margin Policy, FRM would be required to conduct Resource Backtesting using actual portfolios at the Clearing Member level to evaluate whether OCC maintains sufficient financial resources to cover its credit exposure to the liquidation portfolio of each Clearing Member from the last deposit of margin assets until the end of the liquidation horizon following the Clearing Member's default. Since Resource Backtesting would be designed to determine whether the liquidating value of a Clearing Member's portfolios would be positive or negative at the end of OCC's liquidation horizon, it would take into account observed intraday position changes from the time of the last good margin collection until the assumed point of default.

The proposed Margin Policy would set the coverage target for Resource Backtesting at 99 percent, meaning that any Resource Backtesting deficiencies should be no more than one percent in the rolling 12-month lookback period for each Clearing Member. The proposed changes to the Margin Policy would define a ''deficiency'' as a daily result where the prefunded financial resources collected from the Clearing Member would have been insufficient to cover the potential loss in case of its default (*i.e.,* a negative liquidating value of the Clearing Member's portfolios).

While OCC conducts Model Backtesting at the account level, OCC would consider resources and exposures across a given member's account for Resource Backtesting. Because OCC's By-Laws and Rules provide for different types of liens over different types of accounts, OCC would consider the liens on a particular account when netting deficits and surpluses across account types to ensure that surpluses in an account over which OCC maintains a restricted lien do not offset losses in another account for purposes of Resource Backtesting.

In contrast with Model Backtesting, OCC would include collateral that is not modelled by STANS in Resource Backtesting. The margin resources that would be considered by Resource Backtesting would be limited to a member's margin requirements; accordingly, any excess margin collateral would be excluded. OCC would continue to exclude Clearing Fund deposits from all margin backtesting.

3. Backtesting Assumptions and Reporting

The proposed Margin Policy would explicitly list certain assumptions that inform OCC's backtesting practices: the timing of default, liquidation horizon, available resources, confidence level, lookback period, and the backtesting portfolio.[16] The proposed changes to the Margin Policy would define OCC's process for evaluating and changing such assumptions. Specifically, changes to backtesting assumptions would require escalation by MRWG and the MC, with ultimate approval by the Risk Committee (''RC''). Under the proposed changes to the Margin Policy, changes to backtesting assumptions that would result in or arise from changes to OCC's margin methodology, in such a way as to require a rule change proposal to be filed with the Commission, would continue to require the approval of OCC's Board of Directors.

As proposed, the Margin Policy would provide that, at least monthly,[17] FRM will review the results of backtesting to identify any Model Backtesting exceedances or Resource Backtesting deficiencies and present a detailed analysis of such information, as well as a review of backtesting assumptions, to the MRWG to determine whether OCC's backtesting practices are appropriate for measuring the adequacy of margin requirements. The proposed changes to the Margin Policy state that escalation criteria for backtesting results would include (i) thresholds related to the size and number of exceedances for Model Backtesting of actual portfolios; (ii) thresholds related to statistical tests for Model Backtesting of hypothetical portfolios; and (iii) thresholds related to the size of an individual Clearing Member's Resource Backtesting deficiency and the coverage rate across all Clearing Members in the aggregate. Further, escalation criteria for backtesting assumptions would include (i) market conditions, (ii) changes to OCC's risk methodologies, and (iii) unusual exceedances.[18] Under the proposed Margin Policy, FRM would prepare and present to MRWG a review of the backtesting assumptions more frequently than monthly in the event of triggers related to high market volatility, low market liquidity, and significant increases or decreases in position size or concentration risk.

The amended Margin Policy would provide that, annually, QRM will present to MRWG a backtesting framework evaluation, including QRM's recommendations regarding whether OCC should change any of its assumptions or exceedance escalation criteria. The Margin Policy would require that changes to the escalation criteria must be approved by the governing body to which the escalation must be made. That is, the MRWG would be authorized to approve changes to the criteria for escalation to the MRWG, and the MC would be authorized to approve changes to the escalation criteria to the MC. The MRWG also would be responsible for determining whether to escalate any changes to backtesting assumptions or the escalation criteria to the MC or RC for consideration. On an annual basis, the MC would report to the RC the results of the annual Backtesting Framework evaluation, including any changes it believes should be made to OCC's backtesting assumptions or the escalation criteria to the RC. The RC would be authorized to approve such assumption changes and escalation criteria to the RC for implementation, as proposed in the Margin Policy.

C. Establishing the Resource Backtesting Margin Charge

In addition to the Model Backtesting and Resource Backtesting amendments described above, OCC proposes to implement a margin add-on charge to help ensure it has sufficient financial resources as a method of managing its credit risk exposure. OCC determined that the proposed Resource Backtesting would identify deficiencies showing whether its Clearing Members fall below

[15] Notwithstanding the inclusion of such collateral in Resource Backtesting rather than in Model Backtesting, OCC also would have the authority under the proposed Margin Policy to maintain variations of Model Backtesting for diagnostic or informational purposes that include such add-ons. *See* Notice of Filing, 89 FR at 61214.

[16] Although the type of assumptions would be listed in the Margin Policy, OCC would maintain the specific assumptions in its underlying documentation.

[17] The monthly reviews are part of the current backtesting framework, as described in Section II.A. above. The Proposed Rule Change does not seek to change this monthly cadence.

[18] OCC's internal procedures would include further detail regarding escalation criteria for backtesting results and assumptions.

the 99 percent coverage threshold described above.[19] To address such deficiencies, OCC proposes to adopt a new margin charge to increase the likelihood that OCC's margin resources would be sufficient to cover fully its potential future exposure to each participant.[20]

To implement the Resource Backtesting Margin Charge, OCC proposes to add subsection (h) to its Rule 601 and amend its Margin Policy.[21] Under the Proposed Rule Change, Rule 601(h)(1) would provide that OCC may require a Clearing Member to deposit additional margin assets to mitigate OCC's exposures that may not otherwise be covered by calculated margin requirements in accordance with Rule 601 and OCC's policies and procedures. Additionally, Rule 601(h)(1) would state that OCC may assess this charge as part of a Clearing Member's daily margin requirement, as needed, to enable OCC to achieve its Resource Backtesting coverage rate. As proposed, Rule 601(h)(1) would state that this add-on may apply to Clearing Members that have a 12-month trailing Resource Backtesting coverage rate below OCC's 99 percent backtesting coverage target.

Rule 601(h)(2) would provide that, generally, the Resource Backtesting Margin Charge will be equal to the third-largest Resource Backtesting deficiency during the previous 12 months, rounded up to the nearest $1,000. Rule 601(h)(2) also would grant OCC the discretion to adjust the Resource Backtesting Margin Charge if it determines that circumstances particular to a Clearing Member's clearance and settlement activity and/or market volatility warrant a different approach to determining or applying such charge in a manner consistent with achieving OCC's Resource Backtesting coverage target.

Under proposed Rule 601(h)(3), in calculating a Clearing Member's Resource Backtesting coverage for purposes of the Resource Backtesting Margin Charge and in calculating the third-largest Resource Backtesting deficiency, OCC will not include amounts already collected as a Resource Backtesting Margin Charge from that Clearing Member.

Lastly, under the proposal, Rule 601(h)(4) would provide that for the purposes of this rule, "Resource Backtesting" means backtesting pursuant to OCC's policies and procedures that is designed to evaluate, with a high degree of confidence, whether OCC maintains sufficient financial resources to cover its credit exposure to the liquidation portfolio of each Clearing Member from the last margin collection until the end of the liquidation horizon following the Clearing Member's default.

In addition to new Rule 601(h), OCC proposes amendments to its Margin Policy governing how the Resource Backtesting Margin Charge would be applied, calculated and, in certain circumstances, adjusted. OCC states that the Resource Backtesting Margin Charge would apply to any Clearing Member whose 12-month trailing Resource Backtesting falls below the 99 percent coverage target, using three or more confirmed Resource Backtesting deficiencies over the previous 12 months.[22] At least once per month, and more often in circumstances described below, OCC would review and determine which Clearing Member may be subject to the Resource Backtesting Margin Charge, or which Clearing Member's existing Resource Backtesting Margin Charge is subject to change, based on the trailing 12-month Resource Backtesting coverage rate. The Resource Backtesting Margin Charge would be applied daily to the accounts of Clearing Members that contributed to the deficiencies. If in the subsequent month an affected Clearing Member's trailing 12-month coverage rises above 99 percent, the Resource Backtesting Margin Charge would be removed.

The Resource Backtesting Margin Charge would be calculated as the equivalent of a member's third largest Resource Backtesting deficiency in the rolling 12-month lookback period rounded up to the nearest $1,000, subject to adjustment described below. The Resource Backtesting Margin Charge generally would be allocated proportionally to the Clearing Member's accounts contributing to the third-largest Resource Backtesting deficiency, with the goal of restoring the Clearing Member's margin coverage to the 99 percent target. If applying and allocating the Margin Resource Backtesting Margin Charge would not bring the Clearing Member above this coverage target based on the third largest deficiency,[23] the proposed rules would allow OCC to increase the add-on for a particular account in an amount necessary to meet the coverage target. For purposes of application, calculation, or adjustment, OCC would not take into account any Resource Backtesting Margin Charge(s) already in effect, but would take into account the number and size of deficiencies subsequent to the Resource Backtesting Margin Charge(s) already applied.[24]

OCC proposes to amend the Margin Policy further to outline the governance around the calculation of and adjustment to the Resource Backtesting Margin Charge, as defined in proposed Rule 601(h)(2). As proposed, the Margin Policy would require FRM to review the Resource Backtesting results at least monthly[25] to determine whether a Clearing Member should be assessed a Resource Backtesting Margin Charge and, if so, the amount of the add-on. Imposing a Resource Backtesting Margin Charge on a Clearing Member would require an FRM Officer's approval, which the FRM Officer would grant unless an adjustment to the charge is necessary. Any adjustment to increase the charge would require approval by an FRM Officer, while any adjustment to reduce the charge would require escalation to and approval by the MRWG.[26] Under the Proposed Rule Change, the MRWG may authorize such adjustment under certain circumstances, including, but not limited to, differences in magnitude of the deficiencies observed over the last 12-month period, variability in the Clearing Member's

[19] *See* Notice of Filing, 89 FR at 61217. ("[. . .B]ased on 2023 historical data, approximately 25% of Clearing Members would have fallen below the Resource Backtesting coverage target.)

[20] OCC represented that the Resource Backtesting Margin Charge is modeled on the implementation of similar add-ons by other clearing agencies to collect additional financial resources when a Clearing Member's margin coverage falls below the agency's coverage target. *See* Notice of Filing, 89 FR at 61217, citing Securities Exchange Act Release No. 79167 (Oct. 26, 2016), 81 FR 75883, 75884 (Nov. 1, 2016) (SR–FICC–2016–006; SR–NSCC–2016–004).

[21] Implementation of the proposed charge would also require revisions to OCC's internal documentation, including the Backtesting Procedure and associated technical document, which OCC provided as confidential Exhibits 3B and 3C, respectively, to File No. SR–OCC–2024–009.

[22] *See* Notice of Filing, 89 FR at 61217–18.

[23] This may occur when the account driving the third largest deficiency, such as a customer account, is experiencing losses that cannot be offset by funds is a different type of account, such as a firm account. *See* Notice of Filing, 89 FR at 61218, n. 55 and accompanying text.

[24] *See* Notice of Filing, 89 FR at 61217. Additionally, OCC would test the sufficiency of the Resource Backtesting Margin Charge against a Resource Backtesting variant that includes that charge as a financial resource for purposes of: (i) confirming that the charge, as allocated proportionally to the accounts contributing to the third-largest Resource Backtesting deficiency, would be sufficient to achieve the 99 percent coverage target, and (ii) increasing the Resource Backtesting Margin Charge for a particular account that may be contributing a proportionally greater amount to other Resource Backtesting deficiencies if the coverage target is not met. *Id.,* at 61218–19.

[25] This review and determination would be conducted at least monthly but could be done on an intramonth basis based on the daily backtesting results reviewed by FRM.

[26] Such adjustments are distinct from the routine process of setting the charge on a monthly basis.

activity since the observed deficiencies, cyclicality of observed deficiencies, and/or market volatility. Under the Proposed Rule Change, if OCC implements changes to its margin methodology that affect Clearing Members' margin requirements, FRM would reevaluate Resource Backtesting coverage within the 12-month lookback period based on the margin resources OCC would have collected under the revised methodology to determine whether a Resource Backtesting Margin Charge for a particular Clearing Member is required and, if so, in what amount.[27]

III. Discussion and Commission Findings

Section 19(b)(2)(C) of the Exchange Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.[28] Under the Commission's Rules of Practice, the ''burden to demonstrate that a proposed rule change is consistent with the Exchange Act and the rules and regulations issued thereunder . . . is on the self-regulatory organization ['SRO'] that proposed the rule change.'' [29]

The description of a proposed rule change, its purpose and operation, its effect, and a legal analysis of its consistency with applicable requirements must all be sufficiently detailed and specific to support an affirmative Commission finding,[30] and any failure of an SRO to provide this information may result in the Commission not having a sufficient basis to make an affirmative finding that a proposed rule change is consistent with the Exchange Act and the applicable rules and regulations.[31] Moreover, ''unquestioning reliance'' on an SRO's representations in a proposed rule change is not sufficient to justify Commission approval of a proposed rule change.[32]

After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act,[33] and Rules 17Ad–22(e)(6),[34] 17Ad–22(e)(4),[35] and 17Ad–22(e)(2) [36] thereunder, as described below.

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

Section 17A(b)(3)(F) of the Exchange Act requires, among other things, that a clearing agency's rules are designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.[37] Based on its review of the record, and for the reasons described below, the changes described above are consistent with assuring the safeguarding of securities and funds which are in OCC's custody or control or for which it is responsible.

As discussed above, OCC's backtesting framework is used, in part, to monitor whether STANS-calculated margin requirements are adequate, as well as to evaluate the adequacy of credit risk assessment procedures. As described above, OCC proposes to improve its current backtesting by, among other things, clearly defining terms and parameters. However, the current backtesting focuses on the identification of technical or model-related issues, rather than on the sufficiency of OCC's resources to cover its credit exposure during a Clearing Member's default.

To address the gap in its current backtesting, OCC proposes to implement a new category of backtesting, Resource Backtesting, that would measure whether OCC maintains sufficient financial resources to cover its credit exposure to the liquidation portfolio of each Clearing Member from the last deposit of margin assets until the end of the liquidation horizon following the Clearing Member's default. Based on the information OCC provided to the Commission,[38] the proposed Resource Backtesting would reveal that OCC does not always meet its coverage target at the member level.

To address the gap in coverage, which suggests OCC may not be holding sufficient margin collateral, OCC also proposes to implement a new margin add-on, the Resource Backtesting Margin Charge, that is designed to increase the likelihood that OCC collects margin sufficient to cover its potential future exposure to each participant in the interval between the last margin collection and the close-out of positions following a participant default. Working in tandem, the proposed backtesting category and add-on would support OCC's efforts to collect sufficient margin resources to maintain a 99 percent coverage.

Improving OCC's current backtesting processes as well as adoption of the proposed Resource Backtesting and Resource Backtesting Margin Charge add-on would increase the likelihood that OCC collects sufficient margin collateral to mitigate OCC's credit exposure to a Clearing Member default. Increasing the likelihood that OCC collects sufficient margin collateral to address a member default would, in turn, assure the safeguarding of non-defaulting Clearing Members' collateral by reducing the likelihood that OCC would be forced to charge losses to the Clearing Fund.

Accordingly, the changes proposed to the backtesting framework are consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.[39]

B. Consistency With Rule 17Ad–22(e)(6)(vi)(A) Under the Exchange Act

Rule 17Ad–22(e)(6)(vi)(A) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to cover, if the covered clearing agency provides central counterparty services, its credit exposures to its participants by establishing a risk-based margin system that, at a minimum is monitored by management on an ongoing basis and regularly reviewed, tested, and verified by conducting backtests of its margin model at least once each day using standard predetermined parameters and assumptions.[40] In adopting Rule 17Ad–22(e)(6), the Commission provided guidance that a covered clearing agency generally should consider in establishing and maintaining policies and procedures for margin, including whether the covered clearing agency analyzes and monitors its model performance and overall margin coverage by conducting rigorous daily backtesting and at least monthly, and more frequent when appropriate, sensitivity analysis; as well as whether, in conducting sensitivity analysis of the model's coverage, the covered clearing agency has taken into account a wide

[27] OCC stated that such a reevaluation is designed to avoid double-margining Clearing Members if and/or when OCC would begin to collect additional margin resources after a margin methodology change. *See* Notice of Filing, 89 FR at 61219.

[28] 15 U.S.C. 78s(b)(2)(C).

[29] Rule 700(b)(3), Commission Rules of Practice, 17 CFR 201.700(b)(3).

[30] *Id.*

[31] *Id.*

[32] *Susquehanna Int'l Group, LLP* v. *Securities and Exchange Commission,* 866 F.3d 442, 447 (D.C. Cir. 2017) (''Susquehanna'').

[33] 15 U.S.C. 78q–1(b)(3)(F).

[34] 17 CFR 240.17Ad–22(e)(6).

[35] 17 CFR 240.17Ad–22(e)(4).

[36] 17 CFR 240.17Ad–22(e)(2).

[37] 15 U.S.C. 78q–1(b)(3)(F).

[38] OCC provided impact data as confidential Exhibit 3A to File No. SR–OCC–2024–009.

[39] *Id.*

[40] 17 CFR 240.17Ad–22(e)(6)(vi)(A).

range of parameters and assumptions that reflect possible market conditions.[41]

As described above, OCC's Proposed Rule Change is designed to improve the level of detail about the material aspects of OCC's backtesting framework included in the overall framework, including how OCC establishes and modifies its assumptions for backtesting. OCC's proposal also is designed to establish a process for assessing the adequacy of OCC's margin resources to cover its credit exposure at the Clearing Member level, and would detail the assumptions underlying OCC's margin backtesting framework and the process for reviewing and modifying those assumptions.

As described above, OCC proposes to codify in the framework its current backtesting procedures, including incorporating definitions, detailing coverage level measurements of actual and hypothetical portfolios, and establishing which types of collateral would be reviewed. Further, OCC's proposal would consolidate its current backtests under one heading (Model Backtesting) that would be governed by a single set of rules and internal procedures. The proposed revisions would improve clarity and consistency across OCC's current backtesting framework. Likewise, OCC proposes adding to the framework a new category of backtesting, Resource Backtesting, as well as related definitions and descriptions of material aspects of how this new resource sufficiency measurement would apply at a Clearing Member level. The proposed rules would also address how OCC would consider different types of accounts and liens when netting, and would provide OCC with more accurate insights into the collected margin levels of its Clearing Members, that could, in turn, affect OCC's credit exposures. OCC's proposal to specifically list the assumptions on which Model Backtesting and Resource Backtesting would rest, and how these assumptions would be reviewed and, if necessary, escalated according to set criteria, would standardize these assumptions and parameters, incorporates the Commission's guidance provided in the adopting release,[42] and provide OCC's management with clear guidelines to continue its monitoring on an ongoing basis.

Accordingly, the proposed changes to OCC's backtesting framework are consistent with the requirements of Rule 17Ad–22(e)(6)(vi)(A) under the Exchange Act.[43]

C. Consistency With Rule 17Ad–22(e)(4)(i) Under the Exchange Act

Rule 17Ad–22(e)(4)(i) under the Exchange Act 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, including by maintaining sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.[44] In adopting Rule 17Ad–22(e)(4), the Commission provided guidance that a covered clearing agency generally should consider in establishing and maintaining policies and procedures that address credit risk, including whether, if providing central counterparty services, the covered clearing agency has covered its current and potential future exposures to each participant fully with a high degree of confidence using margin and other prefunded financial resources.[45]

As described above, OCC proposes to adopt the Resource Backtesting Margin Charge to address coverage gaps identified by the proposed Resource Backtesting. The proposed Resource Backtesting Margin Charge would be applied daily based on an at-least monthly assessment of a Clearing Member's 12-month trailing deficiencies to the extent they fall below OCC's 99 percent coverage rate. Collecting additional margin based on such deficiencies would reduce the likelihood of future margin deficiencies for each member. This, in turn, would increase the likelihood that OCC would maintain sufficient financial resources to cover its credit exposure to each participant fully with a high degree of confidence.

Accordingly, the proposed adoption of the Resource Backtesting Margin Charge is consistent with the requirements of Rule 17Ad–22(e)(4)(i) under the Exchange Act.[46]

D. Consistency With Rule 17Ad–22(e)(2)(v) Under the Exchange Act

Rule 17Ad–22(e)(2)(v) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to provide for governance arrangements that specify clear and direct lines of responsibility.[47]

OCC's backtesting framework documentation lacks explicit guidance around the reporting process as well as escalation criteria and thresholds, which could lead to inconsistencies in the escalation of similar backtesting exceedances or deficiencies, and inconsistencies in reviews of backtesting assumptions. The Proposed Rule Change would list the escalation criteria considered during reviews of backtesting results and assumptions and would clearly specify which business units, working groups, and committees would be involved in such reviews, as well as each group's respective authorities and obligations. The Proposed Rule Change also would describe OCC's reporting process and timelines for review of backtesting results, assumptions, and parameters. Adding such detail to OCC's rules would more clearly specify the lines of responsibly governing OCC's backtesting framework.

Accordingly, the proposed changes to further detail OCC's processes for governing its backtesting framework are consistent with the requirements of Rule 17Ad–22(e)(2)(v) under the Exchange Act.[48]

IV. Conclusion

On the basis of the foregoing, the Commission finds that the Proposed Rule Change is consistent with the requirements of the Exchange Act, and in particular, the requirements of Section 17A of the Exchange Act[49] and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Exchange Act,[50] that the proposed rule change (SR–OCC–2024–009), hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[51]

Vanessa A. Countryman,

Secretary.

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[41] Securities Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786, 70819 (Oct. 13, 2016) (File No. S7–03–14) ("Standards for Covered Clearing Agencies").

[42] *Id.*

[43] 17 CFR 240.17Ad–22(e)(6)(vi)(A).

[44] 17 CFR 240.17Ad–22(e)(4)(i).

[45] *See* Standards for Covered Clearing Agencies, 81 FR at 70814–15.

[46] *Id.*

[47] 17 CFR 240.17Ad–22(e)(2)(v).

[48] *Id.*

[49] In approving this Proposed Rule Change, the Commission has considered the proposed rules' impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[50] 15 U.S.C. 78s(b)(2).

[51] 17 CFR 200.30–3(a)(12).