SR-OCC-2021-004: Why This Proposed Rule Change is Important and Possible Shell Games

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Possible DD

Intro

If you've followed my previous posts, my personal conclusion is that there are big forces holding the squeeze back primarily because the key players in this ecosystem in DTC and OCC are currently exposed to the default of its members. This is contrary to the more popular notion that DTC, OCC, NSCC are assembling tools to force the margin call of the shorts.

As I have said: shift your mindset from "*Citadel is shorting the market*" or "*It's a battle between Short HF and Long Whales!*" to "*DTC, OCC, SEC, **and** the shorts are preparing for the squeeze*"

First, let's take a look at who the members of DTC and OCC are:

- DTC: https://www.dtcc.com/-/media/Files/Downloads/client-center/DTC/alpha.pdf
- OCC: https://www.theocc.com/Company-Information/Member-Directory

Just a cross section:

Member	***DTC***	***OCC***
Apex Clearing	✓	✓
Barclays	✓	✓
Bank of America	✓	✓
Charles Schwab	✓	✓
Citadel Clearing	✓	✓
Citadel Securities	✓	✓
Credit Suisse Securities	✓	✓
Deutsche Bank	✓	✓
Goldman Sachs	✓	✓
Interactive Brokers	✓	✓
JP Morgan	✓	✓
Merrill Lynch	✓	✓

Member	*DTC*	*OCC*
Robinhood Securities	✓	✓
TD Ameritrade	✓	✓
UBS Securities	✓	✓
Vanguard	✓	✓

Note who's in both of these organizations:

- Our favorite chumps: Citadel and Robinhood
- The shark of sharks: Goldman Sachs
- Goldman's punching bag: Credit Suisse
- A big time GME long: Vanguard

Also make a mental note of *who's not in this list.*

While there has been intense focus from the community on **SR-NSCC-2021-801** which would potentially increase liquidity requirements and force a margin call on shorts, I think that this line of thinking is missing a critical aspect: margin calling the shorts right now would literally blow up the market.

A post by u/jamiegirl21 on an SEC filing detailing the merger of Northern Star and Apex reveals this on page 180 with regards to a legal action against Apex for the actions on 2021JAN28:

Legal Proceedings

Apex is a defendant in a series of putative class actions arising out of the same alleged conduct captioned as Cheng v. Ally Financial Inc., et al, Case No. 3:21-cv-00781 filed in the United States District Court for the Northern District of California; Clapp and Redfield v. Ally Financial Inc., et al, Case No. 3:21-cv-00896 filed in the United States District Court for the Northern District of California; Dechirico v. Ally Financial, et al, Case No. 1:21-cv-00677 filed in the U.S. District Court for the Eastern District of New York; Ross v Ally Financial Inc., et al, Civil Action No. 4:21-cv-00292 filed in the United States District Court for the Southern District of Texas; and Fox v. Ally Financial, et al, Case No. 0:21-cv-00689 filed in the United States District Court for the District of Minnesota in 2021 (collectively, the "Antitrust Matters"). Plaintiffs allege that Apex, along with over 30 other brokerages, trading firms and/or clearing firms, including Morgan Stanley, E*Trade, Interactive Brokers, Charles Schwab, Robinhood, Barclays, Citadel and DTCC engaged in a coordinated conspiracy in violation of anti-trust laws to prevent retail customers from operating and trading freely in a conspiracy to allow certain of the other defendants, primarily hedge funds, to stop losing money on short sale positions in GameStop, AMC and certain other securities. The matters were brought as class actions alleging violations of federal and state anti-trust laws, unfair competition and dissemination of untrue and misleading statements as well as negligence, breach of fiduciary duty, constructive fraud and breach of implied covenants of good faith and fair dealing. These cases are in the preliminary phases. Although there can be no assurance as to the ultimate disposition of the Antitrust Matters, Apex denies liability to the plaintiffs and the putative class members, believes that it has meritorious defenses against the plaintiffs' claims, and intends to vigorously defend itself.

In connection with Apex's pause of allowing customers to establish new positions of AMC, GME and KOSS stock from approximately 10:30 a.m. Central time until approximately 1:55 p.m. Central time on January 28, 2021, the Office of the Attorney General of the States of Texas and New Jersey have requested information and issued civil investigative demands to Apex. Apex is cooperating in these matters.

> "Apex, along with over 30 other brokerages...including...Citadel and DTCC engaged in a coordinated conspiracy..."

Enter SR-DTC-2021-004 (Effective) and SR-OCC-2021-003 (Pending)

I'm rehashing my earlier post, but it is important to frame why these two proposed amendments to **existing rules** are important to understanding how the key players are positioning at the moment and why it's no longer about the margin call.

From page 14 of SR-DTC-2021-004:

Within Table 5-B, Corporate Contribution is the first entry under the column labeled "Tool." Currently, the narrative for this entry includes a description of Corporate Contribution and delineates that in the event of a cease to act, before applying the Participants Fund deposits of all other Participants to cover any resulting loss, DTC will apply the Corporate Contribution.[21] The proposed rule change would revise the current text of the definition of Corporate Contribution in order to more closely align with how this term is defined under Rule 4.[22] Specifically, pursuant to the proposed rule change, the definition of Corporate Contribution would be revised to state, "The Corporate Contribution is an amount that is equal to 50% of the amount calculated by DTC in respect of its General Business Risk Capital Requirement, for losses that occur over any rolling 12 month period." Similarly, the sentence directly above the definition of Corporate Contribution would be revised to remove the words "applying the Participants Fund deposits of all other Participants," and replace them with "charging Participants on a pro rata basis (other than the Defaulting Participant)."

SR-DTC-2021-004 proposed rule change which is already in effect

And page 11:

Currently, Section 5.1 (Introduction) identifies the financial resources available to DTC, pursuant to the Rules, to address losses arising out of the default of a DTC Participant. One paragraph contains a statement that such losses would be satisfied first by applying a Corporate Contribution and then, if necessary, by allocating remaining losses to non-defaulting Participants, in accordance with Rule 4.[17] The proposed rule change would add a sentence to the end of this paragraph that would provide that, in addition to the tools described in Rule 4 (which are to be applied when, and in the order, specified in that Rule), DTC may, in extreme circumstances, borrow net credits from Participants secured by collateral of the defaulting Participant.[18] DTC believes this additional language is necessary to more clearly set forth the full range of actions and tools DTC may employ in response to such conditions.

SR-DTC-2021-004 focuses heavily on how to manage defaulting participants and possible failure of DTC itself (page 19 section "Business-as-Usual Actions")

From page 10 of SR-OCC-2021-003:

(2) *Revising OCC's Default Waterfall*

OCC would also amend OCC Rule 1006 to insert the Minimum Corporate Contribution in OCC's default waterfall after contributing a defaulting Clearing Member's margin and Clearing Fund deposit, and before contributing OCC's LNAFBE greater than 110% of OCC's Target Capital Requirement, both of which OCC would exhaust before charging a loss to the Clearing Fund and the EDCP Unvested Balance, pari passu with the Clearing Fund deposits of non-defaulting Clearing Members. So

SR-OCC-2021-003 proposed rule change which was extended to MAY31 based on a filing by SIG

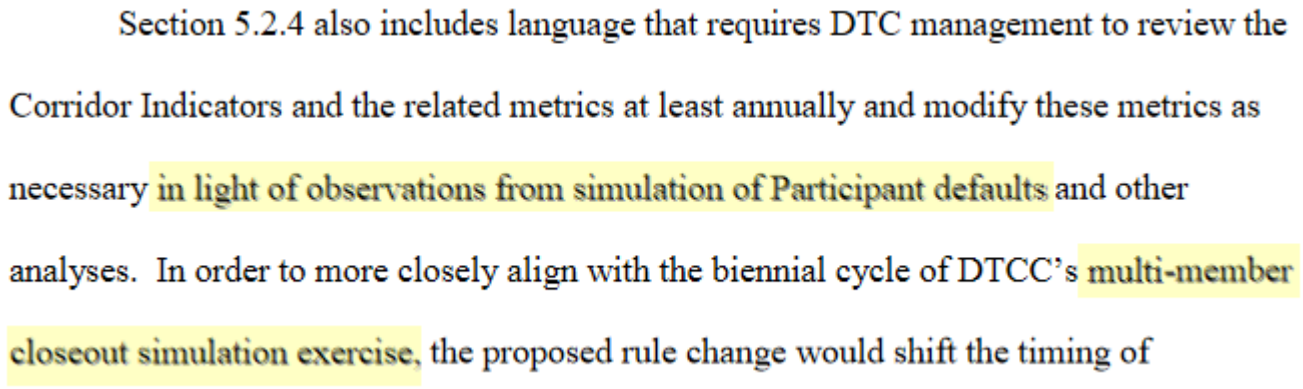
What you should take away easily from reading both of these is that there is a **common theme**: DTC and OCC members are shifting how they pay out from their common member funds in the event of a member default.

In other words, DTC and OCC members would previously have paid out of the common member funds to "cushion" a defaulting member and ensure continuity. But DTC-004 and OCC-003 change the language to make sure that the defaulting member's *own contributions* (in the case of OCC-004, it even adds a new Minimum Corporate Contribution) are drawn first and then assets are used as collateral ("*charging participants on a pro rata basis*") for access to member funds. DTC-004 even says "*DTC may, in extreme circumstances, borrow net credits from Participants secured by collateral of the defaulting Participant*" or "we use the defaulting participants assets as collateral for liquidity before we pay".

So let's circle back to late 2020 and JAN28: DTC and OCC notice these anomalies in the market. They step in to allow RH and Citadel to bend the rules to stave off pretty much certain doom. The "BUY" button literally disappears from Robinhood for crying out loud! SEC doesn't object because the whole system was about to crash down. So the objective is first and foremost to do what is necessary to stop imminent collapse. Then they start quickly drawing up the necessary changes to their own charters to protect themselves from the the tsunami of shorts uncovered through these events.

This doesn't mean that the shorts have covered; it means that they are not allowing the shorts to fail just yet because the system itself is not yet ready for this shock.

To that end, I believe they have used existing models to simulate the squeeze and the outcome:



Section 5.2.4 also includes language that requires DTC management to review the Corridor Indicators and the related metrics at least annually and modify these metrics as necessary in light of observations from simulation of Participant defaults and other analyses. In order to more closely align with the biennial cycle of DTCC's multi-member closeout simulation exercise, the proposed rule change would shift the timing of

SR-DTC-2021-004 page 12: "in light of observations from simulation of Participant defaults" and "multi-member closeout simulation exercise"

They are adjusting their Corridor Indicators "*in light of observations from simulation of Participant defaults*" which includes a "*multi-member closeout simulation exercise"* and have decided that these changes are necessary to protect the system. What are these indicators?

19 The majority of the Corridor Indicators, as identified in the Recovery Plan, relate directly to conditions that may require DTC to adjust its strategy for hedging and liquidating collateral securities, and any such changes would include an assessment of the status of the Corridor Indicators. Corridor Indicators include, for example, the effectiveness and speed of DTC's efforts to liquidate Collateral securities, and an impediment to the availability of DTC's resources to repay any borrowings due to any Participant Default. For each Corridor Indicator, the Recovery Plan identifies (1) measures of the indicator, (2) evaluations of the status of the indicator, (3) metrics for determining the status of the deterioration or improvement of the indicator, and (4) "Corridor Actions," which are steps that may be taken to improve the status of the indicator, as well as management escalations required to authorize those steps.

"Corridor Indicators include, for example, the effectiveness and speed of DTC's efforts to liquidate Collateral securities...due to any Participant Default"

Enter SR-OCC-2021-004 (Pending)

This one is the real kicker. After I read this the first time, it got me thinking about why we're trading sideways and inspired that post.

Primarily, OCC-004 amends existing agreements between OCC members with regards to member suspension and handling of the suspended members' assets:

Background

Rule 1102 enumerates the grounds upon which OCC may suspend one of its Clearing Members.[4] Following the suspension of any Clearing Member, OCC would take a number of steps designed to reasonably ensure that the Clearing Member's suspension is managed in an orderly fashion. Among the steps that OCC may take to manage a Clearing Member's suspension is liquidating the remaining collateral, open positions and/or exercised/matured contracts (i.e., the remaining portfolio) of the

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[4] The grounds for suspension, as summarized, include a Clearing Member (i) having been expelled or suspended from any self-regulatory organization; (ii) failing to make any delivery of cash, securities or other property to OCC in a timely manner as required by OCC's By-Laws or Rules; (iii) failing to make any delivery of funds or securities to another Clearing Member required pursuant to OCC's By-Laws or Rules; (iv) failing to make any delivery of funds or securities to the correspondent clearing corporation in a timely manner; (v) being in such financial or operating difficulty that OCC's Board of Directors or a Designated Officer determines that suspension is necessary for the protection of OCC, other Clearing Members, or the general public; or (vi) in the case of a non-U.S. Clearing Member, having been expelled or suspended by its non-U.S. regulator or any securities exchange or clearing organization of which it is a member.

SR-OCC-2021-004 background on the underlying member agreement being updated

Once again, we see the same theme in the wording: "*necessary for the protection of OCC, other Clearing Members, or the general public*" and defines the conditions for which a member will be suspended.

There are a few interesting parts of this document, however. First, the primary proposed change is to "*facilitate the process of on-boarding Clearing Members and non-Clearing Members as potential bidders*".

Page 4:

OCC is proposing to change I&P .02(c) in order to clarify and further facilitate the process of on-boarding Clearing Members and non-Clearing Members as potential bidders in future auctions of a suspended Clearing Member's remaining portfolio. To achieve a successful auction pursuant to Rule 1104 and enable OCC to take timely action to contain any losses and liquidity pressures that may be caused by a Clearing Member's default, it is important for OCC to encourage participation in such auctions. OCC believes that participation by more bidders generally facilitates more competitive bids on a suspended Clearing Member's portfolio. Competitive bids are necessary for OCC to sell the portfolio at a market price that minimizes the loss to OCC and its Clearing Members, and enable OCC to successfully complete an auction in a timely manner and thereby manage a Clearing Member default in a timely manner. Therefore, OCC

There are two changes related to this broadening of bidders in an auction.

Change 1 on page 4:

First, OCC proposes to revise I&P .02(c) to reflect that Clearing Members would not need to be invited by OCC to become pre-qualified auction bidders; instead, the revised language in I&P .02(c) would make clear that all Clearing Members are invited to participate in auctions of a suspended Clearing Member's remaining portfolio. OCC would retain, but slightly rephrase, the existing requirement that any Clearing Member seeking to be included in the pool of pre-qualified auction bidders must complete required auction documentation in advance; OCC's proposed changes would explain that in order for a Clearing Member to be pre-qualified as an auction bidder, the Clearing Member would need to complete any required auction documentation in advance.

Previously, even Clearing Members needed to qualify separately, but now all members qualify by applying.

Change 2 on page 5:

Second, OCC proposes to revise I&P .02(c) to reflect that non-Clearing Members would no longer need to be invited to become pre-qualified auction bidders by OCC posting notices to its website from time-to-time. Further, the revisions to I&P .02(c) would remove the existing requirements that a non-Clearing Member must actively trade in the asset class in which it proposes to submit bids and must actively trade in markets cleared by OCC. Instead, the revisions to I&P .02(c) would make clear that non-Clearing Members could become pre-qualified auction bidders by (i) having a Clearing Member sponsor to submit bids on behalf of the non-Clearing Member, (ii) having a Clearing Member agree to guarantee and settle any accepted bid made by the non-Clearing Member, and (iii) completing any required auction documentation in advance.

Now Non-Clearing Members have a streamlined process to join the bidding process.

Before we continue, look at that table above and you'll see some notable GME long entities who are ***not*** DTC or OCC members: **BlackRock** and **Fidelity** among others.
So if we connect these with DTC-004 and OCC-003, it all dovetails with the same theme of how to wind down the current market tension with minimal impact to DTC, OCC, and the general well-being of the markets.
After I read this, I was convinced that the reason we're not going anywhere is because no one wants the system to fall apart until these "firewalls" are in place to protect the non-defaulting DTC and OCC members and the market itself. But furthermore, it's about wealthy entities lining up to feast on the discounted assets liquidated from the defaulting OCC members via the auction process. OCC-004 eases the on-boarding of non-Clearing Members (BlackRock? Fidelity?) to the bidding process.
If you are Goldman Sachs, perhaps this is a reason to acquire some liquidity and cripple a competitor that decides to do something...interesting on APR06.
Therefore I believe that OCC-004 is a critical piece of the member agreement changes that is required before we are "allowed" to squeeze. Any other change that introduces a tool to margin call the shorts is a secondary tool.

What's This About a Shell Game?

OCC-004 goes further and this is where on second reading, it gets **REALLY INTERESTING** (YEAH, I REALLY WANT TO EMPHASIZE THIS) on page 5:

OCC is also proposing to delete from I&P .02(c) two sentences that discuss OCC's administration of the pool of pre-qualified auction bidders. Currently, I&P .02(c) explains that OCC maintains a pool of pre-qualified auction bidders, periodically reviews the pool of such bidders and their qualifications, and notifies any pre-qualified auction bidder that is removed from the pool. OCC is concerned that the trading activity review process contemplated by I&P .02(c) could inappropriately limit the number of pre-qualified bidders by excluding, *inter alia*, prospective bidders who did not have sufficient trading activity that was visible to OCC at the time of pre-qualification or review but were suitable bidders at the time of a particular auction. Accordingly, OCC proposes to eliminate the pre-qualification requirements related to a non-Clearing Member's trading experience.

"OCC proposes to eliminate the pre-qualification requirements related to non-Clearing Member's trading experience"

So in other words, prior to OCC-004, non-Clearing Members had to "*actively trade in the asset class in which it proposes to submit the bids and must actively trade in markets cleared by OCC*" to participate in the auction bidding process.
After OCC-004? "*OCC proposes to eliminate the pre-qualification requirements related to non-Clearing Member's trading experience*". Anyone can join the auction bidding process by application.
Don your tin-foil hat with me for a moment. If you are one of the DTC and/or OCC entities that's about to get wiped out by this and all of your assets are about to go to auction, how can you still "win" this game? Why would you go along with this? What if you use this window to shift some capital and assets to a new shell company that has no "trading experience" and you simply bid and buy back your assets at a discount through that shell company? What if you're a rich billionaire and you know that one of your competitors is about to be wiped out? Hmmmm....could it be Glacier?

Conclusion?

If you've been following my posts and you've been following my train of thought, then my take is that at some point late 2020 through late January 2021, there was a sense that they wanted to margin call these shorts and get it over with ("Let me just pop this zit"). When DTC, OCC, and SEC realized how bad the situation was ("That's not a zit, it's melanoma"), they changed course to try to hold everything steady while they readied the "*medicine*".

Therefore, we've been trading sideways since MAR16 (with a few shenanigans here and there) simply because any volatility could blow this all up before the firewalls are in place.
Before the defaults are allowed to happen (via SR-NSCC-2021-801 or otherwise), these three key pieces need to be in place for an orderly wind down:

Proposed Change	***Filing Date***	***Review Window***	***Extension Window***	**Effective?**
SR-DTC-2021-004	2021MAR29	Immediate		✓
SR-OCC-2021-003	2021FEB24	45 days	90 days	✕
SR-OCC-2021-004	2021MAR31	45 days	90 days	✕

OCC-003 was recently extended to 2021MAY31 based on a comment from SIG so we are looking at a possible timeline that extends right out to just before the GME shareholder meeting.
Keep your eye on these two pages for updates:

1. Daily SEC update
2. Archive of SEC updates

I also think that some of the recent DFV tweets have a message focused on patience that is highly relevant. In particular, this tweet (turn on the sound). Listen to the dialogue very carefully. "Why is this happening to me?" "It's OK bud, it's just from the medicine, OK" "Is this going to be forever?" "No, it won't be forever"