OCC THE FOUNDATION FOR SECURE MARKETS

Options Clearing Corporation
125 S. Franklin Street, Suite 1200
Chicago, IL 60606
312 322 6200 | theocc.com

April 11, 2022

VIA ELECTRONIC MAIL

Ms. Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

RE: File No. S7-05-02, Shortening the Securities Transaction Settlement Cycle

Dear Ms. Countryman:

The Options Clearing Corporation ("OCC") appreciates the opportunity to submit these comments on the above-referenced proposal ("Proposal")[1] under the Securities Exchange Act of 1934, as amended ("Exchange Act"). The Proposal would shorten the standard settlement cycle for most broker-dealer securities transactions to one business day after the trade date ("T+1"), or next-day settlement. The Proposal also requests comments on considerations around further shortening the standard settlement cycle in the future to require same-day ("T+0") settlement.[2]

OCC fully supports the Securities and Exchange Commission's ("SEC" or "Commission") goal of reducing risk in the securities settlement cycle and improving processing efficiencies by shortening the settlement cycle for most broker-dealer securities transactions to T+1. The focus of our comments is to note areas where next-day settlement could impact clearing and settlement services that OCC provides to market participants and to discuss considerations regarding same-day settlement.

About OCC

OCC, founded in 1973, is the world's largest equity derivatives clearing organization. OCC operates under the jurisdiction of both the SEC and the Commodity Futures Trading Commission ("CFTC"). As a registered clearing agency under SEC jurisdiction, OCC clears transactions for exchange-listed options and has settled the resulting obligations on a T+1 basis since 1973. As a registered derivatives clearing organization ("DCO") under CFTC jurisdiction, OCC clears transactions in futures and options on futures. OCC also provides central counterparty ("CCP") clearing and settlement services for securities lending transactions. In addition, OCC has been designated by the Financial Stability Oversight Council as a Systemically Important Financial Market Utility ("SIFMU") under

[1] SEC Release No. 34- 94196; IA-5957; File No. S7-05-22 (Feb. 9, 2022), 87 FR 10436 (Feb. 24, 2022).
[2] OCC understands "same-day settlement" to mean T+0 settlement that is not "real-time gross settlement," which would present additional questions about netting efficiencies. We agree with the Commission that the benefits of multilateral netting preclude a cost-effective real time gross settlement solution. See discussion at Part IV.B.1. of the Proposal; see also discussion of multilateral netting below.

Title VIII of the Dodd- Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). As a SIFMU, OCC is also subject to oversight by the Board of Governors of the Federal Reserve System. OCC operates as a market utility, is owned by five exchanges, and is governed by a Board that includes clearing member, exchange and public directors.

T+1 Impacts and Readiness

Risk Impacts

OCC generally supports the Commission's proposal to reduce CCP exposures to credit, market and liquidity risks by shortening the standard settlement timeline for most broker-dealer securities transactions. We agree with the Commission's view that reducing a CCP's exposure to credit, market and liquidity risk arising from obligations to its clearing members promotes the stability of the CCP, which in turn reduces the potential for systemic risk to transmit through the financial system in the event of a default and enhances efficiency in the national clearance and settlement system. Nevertheless, changes to settlement processing and operations will be necessary to achieve the intended risk reduction benefits. OCC believes that potential impacts from implementing such changes are important to consider, particularly with respect to settlement links between clearing agencies.

OCC and the National Securities Clearing Corporation ("NSCC") maintain a link to facilitate the settlement of obligations that result from the exercise of physically settled securities options and the maturation of physically settled stock futures through NSCC's systems. OCC's Rules provide that delivery of, and payment for, such securities are effected through the facilities of a correspondent clearing corporation – namely NSCC – and are not settled through the facilities of OCC.[3] OCC's Rules and its agreement with NSCC specify the time at which responsibility for the settlement of such obligations passes from OCC to NSCC. Thereafter, settlement is governed by NSCC's – and not OCC's – rules and procedures. This link allows common clearing members of the two clearing agencies, and their customers, to realize financial and operational efficiencies through the combined settlement of obligations resulting from their OCC and NSCC cleared positions.[4]

In addition to mitigating OCC's settlement risk from physically settled securities options and matured stock futures that settle "regular way," the link operates to reduce numerous risks that the Proposal also seeks to mitigate. The link reduces credit and liquidity risk for market participants by ensuring that they are only required to post margin to one clearing agency or the other for a given portfolio. Combined settlement of their OCC and NSCC positions reduces operational complexity and risk for market participants, while also mitigating potential market and liquidity risks that could arise if the OCC and NSCC cleared positions were settled on a gross basis.

Realization of these reduced risks and efficiencies depends on coordinated operations,

---

[3] See OCC Rule 901(d).

[4] All OCC Clearing Members that effect transactions in physically settled stock option and stock futures contracts are required to be members of NSCC or to have appointed or nominated an NSCC member to act on its behalf. See OCC Rulebook Chapter IX.

technology and information sharing between OCC and NSCC. The timelines for interactions between the clearing agencies for transactions that settle “regular way” have been configured to reflect the existing T+2 settlement requirement. Reducing the standard settlement timeframe to T+1 would reduce the timeframes available to OCC and NSCC to transmit information and perform the operational and risk management steps associated with their link arrangement. OCC believes the Proposal supports many of the same risk management goals as the link arrangement does, and we would continue working with NSCC to accommodate T+1 settlement and identify related operational risks and technology constraints; however, developing solutions would require coordination with NSCC plus sufficient time for implementation and regulatory consideration.[5]

If adopted as proposed, compliance with the T+1 standard settlement cycle would be required by March 31, 2024. OCC encourages the Commission to consider an implementation timeline that enables market participants, including clearing agencies, to identify and fully address all potential risk management and operational impacts from a T+1 settlement timeframe. Additionally, as the Commission is aware, OCC is currently engaged in a multiyear technology modernization effort to update its clearance and settlement infrastructure.[6] Moving to T+1 settlement with legacy infrastructure would impose technology and resource requirements that OCC and its Clearing Members would need to address concurrently with their ongoing development work related to OCC’s new architecture. We respectfully encourage the Commission to be mindful of large technology projects that may be pending at SIFMUs and other market participants, and those projects’ potential to impact T+1 readiness.

Policies and Procedures

We suggest that any rule changes under the Proposal that would require a registrant to maintain policies and procedures should include the standard qualifier that such policies and procedures be “reasonably designed to achieve compliance” with the relevant rule. This approach is consistent with the framework the SEC has used for other rules initiatives and allows market participants to develop compliance programs tailored to their business operations. The “reasonably designed” standard fosters innovation and encourages competition by enabling each registrant to adopt compliance methodologies aligned to its role and capabilities.

Pathways and Challenges to T+0 Settlement

The Proposal also solicits comments on potential pathways to and challenges associated with a T+0 settlement cycle.

Multilateral Netting

As a preliminary matter, OCC views multilateral netting at CCPs as essential to creating

---

[5] As indicated in the subsequent section, OCC’s view is that T+0 settlement would create further operational, technological and risk management challenges and considerations regarding the link.

[6] See https://www.theocc.com/Company-Information/Transformation for further details.

capital efficiencies financial liquidity benefits for market participants while reducing credit, market and liquidity risk in the national clearance and settlement system. CCP intermediation eliminates bilateral credit risk between the original counterparties on each transaction and enables multilateral netting of transactions and positions, both of which enhance capital efficiencies for market participants. Multilateral netting further reduces risk in the settlement process by reducing the overall number of obligations that must be settled. Multilateral netting also centralizes each participant's financial liquidity obligation for a given portfolio and standardizes the time at which those obligations settle, which in turn reduces liquidity risk for market participants.

OCC agrees with the Commission's preliminary belief that the capital efficiencies and risk reduction benefits that result from multilateral netting preclude a cost-effective real time gross settlement solution.[7] OCC further believes that real time gross settlement without multilateral netting would adversely impact capital efficiency. Centralized multilateral netting at NSCC purports to achieve 98% reduction in the value of payments that need to be exchanged each day.[8] While OCC has not quantified the capital efficiencies that accrue to its market participants from multilateral netting, the benefits are expected to be comparable to those achieved by NSCC and other clearing agencies.

In addition to the capital efficiency and liquidity benefits created through multilateral netting at CCPs, it is important to note that CCPs performed exceptionally well during the 2008 global financial crisis and again through the market turmoil that coincided with the COVID-19 pandemic. No CCPs defaulted on a payment obligation during either crisis, while OCC successfully managed its liquidation of Lehman Brothers' portfolio without recourse to the mutualized resources of non-defaulting Clearing Members. CCPs have become increasingly critical components in the financial system. The functioning of CCPs as independent risk managers for financial markets has proven to be an effective means of supporting the stability and resiliency of global financial markets while creating capital and financial liquidity efficiencies for market participants. OCC believes that the benefits of central clearing and multilateral net settlement among trusted counterparties will remain critical to the proper functioning of the securities markets and their clearance and settlement systems, notwithstanding operational and technological developments that could eventually enable same-day settlement of securities transactions on a decentralized or a real-time gross basis.

Other T+0 Considerations

OCC agrees with the consensus view reflected in "Accelerating the U.S. Securities Settlement Cycle to T+1" ("T+1 Report")[9] that same-day settlement is not achievable in the short-term, and that moving towards shortening the settlement cycle to T+0 would require an overhaul of the U.S. clearing and settlement infrastructure.[10]

---

[7] See discussion at Part IV.B.1. of the Proposal.
[8] See DTCC, Advancing Together: Leading the Industry to Accelerated Settlement, at 4 (Feb. 2021) ("DTCC White Paper") at 3, *available at* https://www.dtcc.com/-/media/Files/PDFs/White%20Paper/DTCC-Accelerated-Settle-WP-2021.pdf.
[9] Deloitte, DTCC, ICI, & SIFMA, Accelerating the U.S. Securities Settlement Cycle to T+1 (Dec. 1, 2021), *available at* https://www.sifma.org/wp-content/uploads/2021/12/Accelerating-the-U.S.-Securities-Settlement-Cycle-to-T1-December-1-2021.pdf.
[10] See id. at 10. The T+1 Report also identifies significant impacts to other key areas of the securities markets,

Shortening the standard settlement cycle to T+1 would necessitate operational and technological changes by vendors and market participants, including but not limited to clearing agencies. As discussed in the previous section of this letter, compressing the timeline for operational activities and processes in order to achieve next-day settlement is not without challenges, though OCC generally believes such challenges to be resolvable with existing infrastructure and technology. A transition from T+1 to T+0 presents different and considerable challenges. While each day removed from the settlement cycle reduces settlement risk by approximately the same increment,[11] the move to same-day settlement would entail foundational changes to existing processes and technology that far exceed the challenges associated with the proposed T+1 transition. The impact of such changes is difficult to anticipate or quantify, but below we have identified some key challenges to achieving T+0 settlement in a centrally cleared environment.

Same-day settlement of securities would require significant changes to clearing agency risk management, operations and technology infrastructure. Risk management processes and money settlements would have to account for significantly shorter timeframes than are in effect today. The technology infrastructure and processes supporting these activities would have to be developed, tested and implemented over a long and resource-intensive timeframe. Even upon successful implementation, the reduced operational timelines would leave little time to resolve errors and outages, which could lead to increased risk of failed transactions and associated liquidity and market risks. Irrespective of the number of fails, same-day settlement would require market participants – and particularly asset managers, overseas participants and certain intermediaries – to have financial liquidity funding available much later in the business day and with less notice than in a T+1 settlement environment, which would increase liquidity risk. The likelihood that market participants would have to pre-fund their trading activity in order to meet same-day settlement obligations could also impact liquidity risk and funding processes, which in turn could have downstream impacts on market accessibility.[12] Depending on the state of technology and infrastructure at the time of any future transition to T+0 settlement, there is also a possibility that market hours would need to be curtailed to ensure that same-day money settlements are possible following completion of daily processing activities, which could have significant impacts on market risk. Other concerns with market participant funding and stock loan processing in a T+0 environment that would not be expected to impact OCC directly[13] could exacerbate stresses in the markets that OCC serves, which could have downstream risk impacts on OCC's cleared markets and their participants.

For these reasons, OCC believes that achieving T+0 settlement, especially where the pathway involves wide-scale implementation as previous reductions of the standard

---

including processing, funding requirements, prime brokerage and global settlement, primary offerings and derivatives markets. OCC agrees generally with the assessment of such impacts without offering specific comments.

[11] See Part V.C.1 of the Proposal ("holding transaction volumes constant, the market value of transactions awaiting settlement at any given point of time under a T+1 settlement cycle will be approximately one half lower than under the current T+2 settlement cycle").

[12] Participants without sufficient access to same-day liquidity could face restrictions on their market access as a result.

[13] See T+1 Report at 11 (discussing impacts to funding requirements, securities lending, prime brokerage and global settlement from T+0 settlement).

settlement cycle have, would be exceptionally challenging and, depending on the approach taken, could introduce new and unintended risks into the financial system.

Conclusion

We thank the Commission for the opportunity to provide comments on the Proposal. As described more fully above, OCC encourages the SEC to account for operational and related risks, and the time required for clearing agencies and their participants to identify and address such risks, in the implementation timeline for any rules adopted pursuant to the Proposal. We agree with the current industry consensus that implementing same-day settlement would require foundational changes to the clearance and settlement system. OCC further believes that such changes could entail significant unintended risks and should not be undertaken without first ensuring that they can be appropriately managed.

We would be pleased to further discuss our comments. If you have any questions, comments, or need any further information, please do not hesitate to contact me at [redacted]

Sincerely,

Joseph P. Kamnik
Chief Regulatory Counsel