

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-90797; File No. SR-OCC-2020-014)

December 23, 2020

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Adopt the OCC Third-Party Risk Management Framework and Retire the OCC Counterparty Credit Risk Management Framework

I. INTRODUCTION

On November 4, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2020-014 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to adopt a proposed Third-Party Risk Management Framework (“TPRMF”) and retire OCC’s current Counterparty Credit Risk Management Policy (“CCRMP”).³ The Proposed Rule Change was published for public comment in the Federal Register on November 18, 2020.⁴ The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change.

II. BACKGROUND

In 2017, OCC adopted the CCRMP, which outlines the key components of OCC’s framework for identifying, measuring, monitoring, and managing OCC’s exposures to its

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing infra note 4, 85 Fed. Reg. at 73582.

⁴ Securities Exchange Act Release No. 90406 (Nov. 12, 2020), 85 Fed. Reg. 73582 (Nov. 18, 2020) (File No. SR-OCC-2020-014) (“Notice of Filing”).

counterparties.⁵ OCC requested confidential treatment of the CCRMP when it was proposed.⁶ OCC proposes to remove the confidential CCRMP from its rules and replace it with the proposed TPRMF, which OCC would make publically available. As described in more detail below, the proposed TPRMF includes some, but not all of the substance of the existing CCRMP. OCC represents that the details not carried forward into the proposed TPRMF reside in OCC's procedures, and that removing such procedural details from OCC's rules would eliminate redundancy that could lead to confusion.⁷ The proposed TPRMF includes information about the risk management lifecycle for Clearing Members, Financial Institutions,⁸ and Financial Market Utilities ("FMUs")⁹—all of which are currently addressed in the existing CCRMP—as well as information about the risk management lifecycle for Exchanges¹⁰ and vendors. OCC also

⁵ See Securities Exchange Act Release No. 82312 (Dec. 13, 2017), 82 Fed. Reg. 60242 (Dec. 19, 2017) (File No. SR-OCC-2017-009) ("CCRMP Approval Order").

⁶ See Securities Exchange Act Release No. 81949 (Oct. 26, 2017), 82 Fed. Reg. 50719 (Nov. 1, 2017) (File No. SR-OCC-2017-009).

⁷ See Notice of Filing, 85 Fed. Reg. at 73586. In proposing the replacement of the CCRMP with the TPRMF, OCC provided certain internal procedures related to third-party risk management, for which OCC requested confidential treatment. See *id.* at 73582.

⁸ In the context of the proposed TPRMF, "Financial Institutions" include clearing banks, custodians, liquidity providers, and investment counterparties. See Notice of Filing, 85 Fed. Reg. at 73582-83.

⁹ Under the proposed TPRMF, FMUs may include any person that manages or operates a multilateral system for the purpose of transferring, clearing, or settling payments, securities, or other financial transactions among Financial Institutions or between Financial Institutions and the person. See Notice of Filing, 85 Fed. Reg. at 73583, n. 12.

¹⁰ Under the proposed TPRMF, Exchange relationships may include options exchanges, futures markets, OTC Trade Sources or Loan Markets. See Notice of Filing, 85 Fed. Reg. at 73583, n. 13.

proposes to make conforming changes to its Risk Management Framework Policy, Liquidity Risk Management Framework, Margin Policy, and Collateral Risk Management Policy, all of which reference the CCRMP.

Removal of redundancies. As noted above, the proposed TPRMF does not include procedural details, found in the existing CCRMP, that are addressed elsewhere in OCC's rules, policies, and procedures. With regard to access and participation, for example, OCC's approach to risk management for Clearing Members, Financial Institutions and FMUs would not change under the proposed TPRMF, but the requirement that OCC monitor for a low probability of defaulting on obligations and assessing potential risks presented by indirect participants would reside in OCC's procedures, not the proposed TPRMF. Additionally, specific information related to the qualification and approval of Clearing Members and Financial Institutions is publicly available in the OCC By-Laws and Rulebook.¹¹ Similarly, with regard to counterparty credit risk, OCC's procedures require the measurement and reporting of credit risk as part of OCC's ongoing monitoring processes. In terms of managing counterparty credit risk, OCC proposes to describe the utilization of its Watch Level reporting in the proposed TPRMF, but to retain flexibility to respond to unforeseen circumstances by defining the details of its Watch Level tiers in procedure documents.

Overall third-party risk management. The proposed TPRMF defines the set of risks that OCC faces from third-party relationships, including financial, operational, information technology, security, legal, and regulatory risks. In the context of the proposed TPRMF,

¹¹ See e.g. OCC By-Laws, Art. V (Clearing Members), available at https://www.theocc.com/getmedia/3309eceb-56cf-48fc-b3b3-498669a24572/occ_bylaws.pdf (last visited November 25, 2020); OCC Rules, Ch. III (Financial Requirements), available at https://www.theocc.com/getmedia/9d3854cd-b782-450f-bcf7-33169b0576ce/occ_rules.pdf (last visited November 25, 2020).

financial risks would include the failure of Clearing Members to meet obligations to OCC as well as the failure of third-parties supporting daily settlement processes and OCC's access to collateral and liquidity. The proposed TPRMF describes OCC's processes for identifying, measuring, monitoring, and managing risks from third-parties at on-boarding, through ongoing monitoring, and finally, at off-boarding. The proposed TPRMF describes OCC's processes for managing risks presented by Clearing Members, Financial Institutions, and vendors as well as risks presented through OCC's links to FMUs and Exchanges.

The proposed TPRMF also describes OCC's processes regarding the escalation of identified risks through working groups that have defined decision-making authorities, functions, and responsibilities. Specifically, the proposed TPRMF describes the roles of the Credit and Liquidity Risk Working Group ("CLRWG"), the Exchange Working Group ("EWG"), and the Vendor Risk Working Group ("VRWG") in managing risks presented by third-parties. Under the proposed TPRMF, each working group would be responsible for escalating matters to OCC's Management Committee ("MC"), which, in specific circumstances, would be responsible for escalating matters to the Risk Committee of OCC's Board of Directors ("RC").

Further, the proposed TPRMF defines certain authorities relating to the management of Clearing Member, Financial Institution, and vendor relationships. For example, the proposed TPRMF states that OCC's Chief Executive Officer and Chief Operating Officer each has authority to approve the onboarding of Financial Institutions and FMUs. Similarly, the proposed TPRMF states that vendor agreements are executed by OCC officers (i.e., a Vice President or above).

Risks posed by Clearing Members, Financial Institutions, and vendors. The proposed TPRMF describes OCC's framework for managing risk throughout the relationship lifecycle

(i.e., at on-boarding, monitoring, and off-boarding) for Clearing Members, Financial Institutions, and vendors. The proposed TPRMF defines the teams responsible for managing the risks posed by Clearing Members, Financial Institutions, and vendors at the various lifecycle stages. For example, OCC's Financial Risk Management team would be responsible for monitoring and reporting financial and operational risks posed by Clearing Members.

The proposed TPRMF also describes the basis for OCC's evaluation of Clearing Members, Financial Institutions, and vendors with which it has relationships. For example, the proposed TPRMF states that OCC's evaluation of Clearing Member relationships is based on financial resources, operational capacity, personnel, and facilities pursuant to OCC's membership standards. Similarly, the proposed TPRMF states that OCC's evaluation of Financial Institution relationships is based on financial resources and operational capacity, such as whether a relationship is structured to allow prompt access to assets and whether a custodian is a supervised and regulated institution that adheres to generally accepted accounting practices, maintains safekeeping procedures, and has controls that fully protect these assets. Further, the proposed TPRMF states that OCC's evaluation of vendor relationships is based on a vendor's financial health and operational capacity, and that the level of due diligence and monitoring of a specific vendor is based on the inherent risk posed by OCC's relationship with the vendor.

Link-specific risk management. Similar to the management of risks posed by Clearing Members, Financial Institutions, and vendors, the proposed TPRMF describes OCC's framework for managing risk for FMUs and Exchanges throughout the relationship lifecycle. The proposed TPRMF defines the teams responsible for managing the risks posed by FMUs and Exchanges at the various lifecycle stages. For example, OCC's Business Operations, Financial Risk Management, Legal, and Third-party Risk Management teams are responsible for evaluating

FMU relationships at on-boarding while OCC's Product and Business Development team is responsible for evaluating Exchange relationships at on-boarding.

The proposed TPRMF also describes the basis for OCC's evaluation of FMUs and Exchanges with which it has relationships. For example, the proposed TPRMF states that OCC's evaluation of FMU relationships is based on financial condition, operational capabilities, and any legal or regulatory risks associated with the relationship. The proposed TPRMF states that OCC's review of Exchange relationships on an ongoing basis includes the assessment of an Exchange's operational performance, overall financial condition, and ability to meet contractual obligations.

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.¹² 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 Act¹³ as well as Rules 17Ad-22(e)(3)(i) and (20)¹⁴ thereunder, as described in detail below.

¹² 15 U.S.C. 78s(b)(2)(C).

¹³ 15 U.S.C. 78q-1(b)(3)(F).

¹⁴ 17 CFR 240.17Ad-22(e)(3)(i) and (20).

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 the rules of a clearing agency be 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, and to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements.¹⁵ Based on its review of the record, and for the reasons described below, the Commission believes that replacing the existing CCRMP with the proposed TPRMF as described above is consistent with assuring the safeguarding of securities and funds as well as promoting prompt and accurate clearance and settlement.

The CCRMP outlines OCC's framework for: (1) the identification of credit risk, (2) counterparty access and participation standards, (3) the measurement of counterparty exposures, (4) the monitoring and managing of counterparty exposures, and (5) voluntary termination of counterparty relationships.¹⁶ The Commission continues to believe that the formalization of the components captured in the existing CCRMP is consistent with the requirement that OCC's rules be designed to assure the safeguarding of securities and funds which are in OCC's custody or control or for which it is responsible.¹⁷ As described above, the proposed TPRMF carries forward the substance of the existing CCRMP with the exception of certain procedural details already addressed elsewhere in OCC's rules, policies, and procedures. The proposed TPRMF also includes components that are not part of the existing CCRMP, such as the management of operational risk posed by relationships with Financial Institutions—namely, whether a

¹⁵ 15 U.S.C. 78q-1(b)(3)(F).

¹⁶ See CCRMP Approval Order, 82 Fed. Reg. at 60245.

¹⁷ See id.

relationship is structured to allow prompt access to assets and whether a custodian is a supervised and regulated institution that adheres to generally accepted accounting practices, maintains safekeeping procedures, and has controls that fully protect these assets. The Commission believes that the addition of such components to OCC's rules is consistent with the assurance of safeguarding of securities and funds in OCC's custody or control or for which it is responsible.

While the existing CCRMP provides a framework for addressing credit risk specifically,¹⁸ the proposed TPRMF addresses financial risk more broadly, which includes risks related to daily settlement. Further, the proposed TPRMF specifically addresses risk posed by OCC's relationships with entities more directly involved in the clearance and settlement of securities transactions. For example, the proposed TPRMF addresses risks posed by OCC's relationship with other FMUs. One such relationship is OCC's reliance on the National Securities Clearing Corporation to effect delivery of, and payment for, securities underlying certain physically settled stock options and single stock futures cleared by OCC.¹⁹ The Commission believes that replacement of the narrowly focused CCRMP with the broader proposed TPRMF that includes specific rules addressing risks related to OCC's relationship with other FMUs is consistent with the promotion of prompt and accurate clearance and settlement.

Based on the foregoing, the Commission believes that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.²⁰

¹⁸ See id.

¹⁹ See Securities Exchange Act Release No. 81266 (Jul. 31, 2017), 82 Fed. Reg. 36484 (Aug. 4, 2017) (File No. SR-OCC-2017-013).

²⁰ 15 U.S.C. 78q-1(b)(3)(F).

B. Consistency with Rule 17Ad-22(e)(3)(i) under the Exchange Act

Rule 17Ad-22(e)(3)(i) requires each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to maintain a sound risk management framework for comprehensively managing legal, credit risk, liquidity, operational, general business, investment, custody, and other risks that arise or are borne by the covered clearing agency, which includes risk management policies, procedures, and systems designed to identify, monitor, and manage the range of risks that arise in or are borne by the covered clearing agency, that are subject to review on a specified periodic basis and approved by the board of directors annually.²¹

As noted above, the existing CCRMP provides a framework for addressing credit risk specifically,²² but the proposed TPRMF addresses a broader range of risks. Specifically, the proposed TPRMF outlines OCC's approach to identifying, measuring, monitoring, and managing financial, operational, information technology, security, legal, and regulatory risks posed by Clearing Members, Financial Institutions, FMUs, Exchanges, and vendors. The proposed TPRMF describes, among other things, OCC's processes regarding the escalation of identified risks through working groups all the way up to the RC as appropriate. Further, the proposed TPRMF defines which teams within OCC are responsible for managing risks posed by specific types of third parties as well as the basis for evaluating relationships with such third parties. The Commission believes, therefore, that the replacement of the existing CCRMP with the proposed TPRMF is consistent with the requirements of Rule 17Ad-22(e)(3)(i) under the Exchange Act.²³

²¹ 17 CFR 240.17Ad-22(e)(3)(i).

²² See CCRMP Approval Order, 82 Fed. Reg. at 60245.

²³ 17 CFR 240.17Ad-22(e)(3)(i).

C. Consistency with Rule 17Ad-22(e)(20) under the Exchange Act

Rule 17Ad-22(e)(20) requires each covered clearing agency to establish, implement, maintain and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies, financial market utilities (“FMUs”), or trading markets.²⁴ As described above, the proposed TPRMF outlines OCC’s approach to identify, measure, monitor, and manage risks arising from relationships with FMUs and Exchanges. Just as with the management of risks from third parties more broadly, the proposed TPRMF defines which teams within OCC are responsible for managing risks posed by FMUs and Exchanges. Further, the proposed TPRMF describes the basis for OCC’s evaluation of FMUs and Exchanges with which it has relationships. The proposed TPRMF also states that OCC’s Chief Executive Officer and Chief Operating Officer each has authority to approve the onboarding of FMUs. The Commission believes, therefore, that the proposed adoption of the proposed TPRMF is consistent with the requirements of Rule 17Ad-22(e)(20) under the Exchange Act.²⁵

²⁴ 17 CFR 240.17Ad-22(e)(20).

²⁵ Id.

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 Act²⁶ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,²⁷ that the Proposed Rule Change (SR-OCC-2020-014) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁸

Eduardo A. Aleman,
Deputy Secretary.

²⁶ 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).

²⁷ 15 U.S.C. 78s(b)(2).

²⁸ 17 CFR 200.30-3(a)(12).