SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-98101; File No. SR-OCC-2022-012)

August 10, 2023

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change Concerning Collateral Haircuts and Standards for Clearing Banks and Letters of Credit

I. INTRODUCTION

On December 19, 2022, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the Proposed Rule Change SR-OCC-2022-012 ("Proposed Rule Change") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")[1] and Rule 19b-4[2] thereunder to amend OCC's rules, policies, and procedures regarding (i) the valuation of Government securities and government-sponsored enterprise ("GSE") debt securities deposited as margin or Clearing Fund collateral; (ii) minimum standards for OCC's Clearing Bank relationships; and (iii) letters of credit as margin collateral.[3] The Proposed Rule Change was published for public comment in the *Federal Register* on December 23, 2022.[4] The Commission received comments regarding the Proposed Rule Change.[5] The Commission designated a longer period within which to take action on the Proposed Rule Change on February 3, 2023, extending the period to March 23, 2023.[6] The Commission instituted proceedings

---

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

2 17 CFR 240.19b-4.

3 *See* Notice of Filing *infra* note 4, 87 FR at 79015.

4 Securities Exchange Act Release No. 96533 (Dec. 19, 2022), 87 FR 79015 (Dec. 23, 2022) (File No. SR-OCC-2022-012) ("Notice of Filing").

5 Comments on the proposed rule change are available at *https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012.htm*.

6 Securities Exchange Act Release No. 96797 (Feb. 3, 2023), 88 FR 8505 (Feb. 9, 2023) (File No. SR-OCC-2022-012) ("Extension").

to determine whether to approve or disapprove the Proposed Rule Change on March 21, 2023.[7] The Commission designated a longer period for Commission action on the proceedings to determine whether to approve or disapprove the Proposed Rule Change on June 20, 2023.[8] For the reasons discussed below, the Commission is approving the Proposed Rule Change.

II. BACKGROUND[9]

OCC is a central counterparty ("CCP"), which means it interposes itself as the buyer to every seller and seller to every buyer for financial transactions. As the CCP for the listed options markets in the U.S.,[10] as well as for certain futures, OCC is exposed to certain risks arising from its relationships with its members as well as the banks that support OCC's clearance and settlement services. Such risks include credit risk because OCC is obligated to perform on the contracts it clears even where one of its members defaults. OCC manages credit risk by collecting collateral from members (i.e., margin and Clearing Fund resources) sufficient to cover OCC's credit exposure to Clearing Members under a wide range of stress scenarios. In doing so, OCC requires its Clearing Members to deposit collateral as margin to support obligations on short options, futures contracts, and other obligations arising within the members' accounts at OCC. OCC also requires its members to deposit collateral serving as Clearing Fund assets to protect OCC,

---

7 Securities Exchange Act Release No. 97178 (Mar. 21, 2023), 88 FR 18205 (Mar. 27, 2023) (File No. SR-OCC-2022-012).

8 Securities Exchange Act Release No. 97765 (June 20, 2023), 88 FR 41441 (June 26, 2023) (File No. SR-OCC-2022-012).

9 Capitalized terms used but not defined herein have the meanings specified in OCC's Rules and By-Laws, available at *https://www.theocc.com/about/publications/bylaws.jsp*.

10 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* Notice of Filing *supra* note 4, 87 FR at 79015.

should the margin of a defaulting member be insufficient to address the potential losses from the defaulting member's positions. OCC imposes a haircut to collateral to address the risk that such collateral may be worth less in the future than at the time it was pledged to OCC. With regard to risks posed by the banks that support OCC's clearance and settlement services, OCC maintains standards for third-party relationships, such as those with banks through which OCC conducts settlement ("Clearing Banks"), and banks that issue letters of credit that Clearing Members may deposit as margin collateral.

As described in more detail below, OCC proposed to revise its rules, including certain policies,[11] to make the following three changes related to the management of collateral haircuts and banking relationships:

(1) Replace the current processes for applying haircuts to Government and GSE debt securities provided as collateral[12] with a new process for applying fixed collateral haircuts that it would set and adjust from time to time, based on a process defined in OCC's CRM Policy;

(2) Codify internal standards for Clearing Banks and letter-of-credit issuers in OCC's Rules to provide transparency on minimum standards for banking relationships that are critical to OCC's clearance and settlement services; and

(3) Authorize OCC to set more restrictive concentration limits for letters of credit than those limits currently codified in its Rules.

---

[11] These policies include the Collateral Risk Management Policy ("CRM Policy"), Margin Policy, and System for Theoretical Analysis and Numerical Simulation ("STANS") Methodology Description. *Id.*

[12] Generally, OCC defines, by rule, specific haircuts for Government and GSE debt securities. For margin collateral specifically, OCC currently also has authority to value such securities using Monte Carlo simulations as part of its STANS margin methodology (known as "Collateral in Margin" or "CiM").

Based on its impact analysis, OCC does not expect changes in collateral haircut valuation processes to have a significant impact on Clearing Members.[13] OCC stated that the fixed haircut schedule under the proposed procedures-based approach initially would be the same as currently codified in the Rules.[14] Regarding the additional minimum standards for Clearing Banks and letter-of-credit issuers, OCC indicated that the institutions currently approved as such already meet these proposed standards.[15]

A. Collateral Haircuts for Government Securities and GSE Debt Securities

OCC proposed to eliminate the CiM treatment of Government securities and GSE debt securities, as well as to remove the fixed collateral haircuts schedule from its rules in favor of adopting rules that describe OCC's process for setting and adjusting fixed haircuts from time to time. OCC asserted that such a "procedure-based approach" would allow for more frequent valuation, thus reflecting current market conditions, including periods of stress.[16] Under the current structure, OCC accepts Government securities from Clearing Members as contributions to the Clearing Fund.[17] Additionally, OCC accepts both Government securities and GSE debt securities as margin collateral.[18] Rule 604(b)

---

13 *See* Notice of Filing *supra* note 4, 87 FR at 79015. OCC provided its analysis in a confidential Exhibit 3 to File No. SR-OCC-2022-012.

14 *See* Notice of Filing *supra* note 4, 87 FR at 79015.

15 *Id.*

16 *See* Notice of Filing *supra* note 4, 87 FR at 79016-18.

17 *See* OCC Rule 1002(a).

18 *See* OCC Rule 604(b)(1), (2).

specifies haircuts for Government securities[19] and GSE debt securities[20] that are contributed as margin collateral, while Rule 1002(a)(ii)[21] specifies haircuts for Government securities that are contributed to the Clearing Fund.

(i) Removal of CiM Treatment

OCC proposed to remove its authority to value Government securities and GSE debt securities using the STANS margin methodology, which currently is used to calculate haircuts applicable to margin collateral.[22] As currently written, Interpretation and Policy ("I&P") .06 to Rule 601 and Rule 604(f) grant OCC the authority to determine the collateral value of any Government securities or GSE debt securities pledged by Clearing Members as margin collateral either by: (1) the CiM method of including them in Monte Carlo simulations as part of OCC's STANS margin methodology; or (2) applying the fixed haircuts that are specified in OCC Rule 604(b). OCC stated, however, that regulatory examination findings and OCC's model validation analyses have identified certain weaknesses, including that OCC may not adequately consider relevant stressed market conditions for Government securities and GSE debt securities deposited

---

19 "Government securities shall be valued for margin purposes at 99.5% of the current market value for maturities of up to one year; 98% of the current market value for maturities in excess of one year through five years; 96.5% of the current market value for maturities in excess of five years through ten years; and 95% of the current market value for maturities in excess of ten years." *See* OCC Rule 604(b)(1).

20 "GSE debt securities shall be valued for margin purposes at (1) 99% of the current market value for maturities of up to one year; (2) 97% of the current market value for maturities in excess of one year through five years; (3) 95% of the current market value for maturities in excess of five years through ten years; and (4) 93% of the current market value for maturities in excess of ten years." *See* OCC Rule 604(b)(2).

21 "For purposes of valuing Government securities for calculating contributions to the Clearing Fund, Government securities shall be valued at (1) 99.5% of the current market value for maturities less than one year; (2) 98% of the current market value for maturities between one and five years; (3) 96.5% of the current market value for maturities between five and ten years; and (4) 95% of the current market value for maturities in excess of ten years." *See* OCC Rule 1002(a)(ii).

22 *See* Notice of Filing *supra* note 4, 87 FR at 79016.

as margin and Clearing Fund collateral.[23] OCC proposed to resolve such shortcomings by deleting I&P .06 to Rule 601 and Rule 604(f), and instead subjecting all Government securities and GSE debt securities pledged as margin collateral to a fixed haircut schedule set in accordance with a revised CRM Policy, discussed in more detail below.

OCC asserted that the resulting approach would be less procyclical.[24] Under the proposed change, OCC would value all such deposits using a fixed haircut schedule.[25] OCC stated that this change would prevent spikes in margin requirements during periods of heightened volatility that can occur under the current CiM approach.[26] As stated in the Notice of Filing, while the proposed fixed haircut approach may be more conservative in periods of low market volatility, it would prevent spikes in margin requirements during periods of heightened volatility that may take place under the existing CiM approach.[27] The proposed changes would result in an average impact of less than one percent of the value of Government securities and GSE debt securities.[28] OCC stated that it intends to

---

23 *Id.*

24 *Id.* The Commission has stated that procyclicality typically refers to changes in risk-management practices that are positively correlated with market, business, or credit cycle fluctuations that may cause or exacerbate financial stability. Standards for Covered Clearing Agencies, Securities Exchange Act Release No. 78961 (Sept. 28, 2016), 81 FR 70786, 70816 n.318 (Oct. 13, 2016). The Commission stated further that, while changes in collateral values tend to be procyclical, collateral arrangements can increase procyclicality if haircut levels fall during periods of low market stress and increase during periods of high market stress. *Id.*

25 Additionally, OCC would shift its categorization of Government security and GSE debt security deposits currently valued using STANS from margin balances to collateral balances to align its reporting with the proposed haircut methodology. Specifically, the value of CiM-eligible Government securities and GSE debt securities would no longer be included in margin calculations, and thus would no longer be included on OCC's margin reports. Following implementation of the proposed changes, the value of the previously CiM-eligible Government securities and GSE debt securities would be found in OCC's collateral reports. *See* Notice of Filing *supra* note 4, 87 FR at 79016 n.10.

26 *See* Notice of Filing *supra* note 4, 87 FR at 79016.

27 *Id.*

28 *Id.* As noted below, OCC is proposing to replace the fixed haircut schedule in its rules that applies to Government securities deposited in the Clearing Fund. The change would result in a negligible

provide parallel reporting to its Clearing Members for a period of at least four consecutive weeks prior to implementing the change.[29]

(ii) Removal of the Fixed Haircut Schedule from OCC's Rules

OCC proposed to eliminate the fixed haircut schedules in its rules for Government securities and GSE debt securities used as margin collateral and Government securities deposited in the Clearing Fund, and instead to adopt new subsections that would grant OCC the authority to specify a schedule of haircuts from time to time based on changing market conditions. Specifically, OCC's proposal would delete the fixed collateral haircut schedule stated in Rule 604(b)(1)-(2) for Government securities and GSE debt securities used as margin collateral, and in Rule 1002(a)(ii) for Government securities deposited in the Clearing Fund.[30] OCC proposed to adopt a new section (e) under Rule 604 and amend language in Rule 1002(a)(ii), to authorize OCC to determine the current value of these types of securities, and generally apply a schedule of haircuts that is specified from time to time upon prior notice to Clearing Members. OCC proposed to describe the new process for valuing such securities in its CRM Policy, as described in greater detail in Section II.A.iii. below. Additionally, the proposed changes to the CRM Policy would require OCC to communicate changes in haircut rates to Clearing Members at least one full day in advance, and to maintain the haircut schedule on OCC's public website.

---

impact to Clearing Fund collateral haircuts. *Id.* OCC provided supporting data as a confidential Exhibit 3 to File No. SR-OCC-2022-012.

29 *See* Notice of Filing *supra* note 4, 87 FR at 79016. *See* note 25 *supra* regarding reporting changes that would be implemented in connection with the proposed change. Further, OCC's rules require it to provide reporting related to margin and Clearing Fund collateral each day. *See* OCC Rule 605 and OCC Rule 1007.

30 OCC does not accept GSE debt securities as Clearing Fund collateral.

As noted above, OCC would publish a haircut schedule from time to time on its website, and such schedule would be determined based on the proposed methodology in the CRM Policy. The proposed changes to Rule 604 would also authorize OCC to apply haircuts to Government securities and GSE debt securities that are more conservative than those defined in such haircut schedule, or, in unusual or unforeseen circumstances, to assign partial or no value to such securities. The proposed change would authorize OCC to take such action for its protection or the protection of Clearing Members or the general public with prior notice to Clearing Members.

OCC also proposed changes to the CRM Policy that would provide additional detail regarding the authority to apply more conservative haircuts or reduce the value attributed to Government securities and GSE debt securities.[31] Consistent with the proposed addition to Rule 604, the CRM Policy would require OCC to communicate such actions to Clearing Members prior to implementation. Additionally, OCC proposed to add language to the CRM Policy to enumerate the factors that OCC would consider when determining if such action would be appropriate for its protection or the protection of Clearing Members or the general public, including (i) volatility and liquidity, (ii) elevated sovereign credit risk,[32] and (iii) any other factors OCC determines are relevant.[33]

---

31 The CRM Policy currently authorizes OCC to take additional mitigating actions in the form of reducing the value of such securities and review and approval of such actions by OCC's Management Committee and/or its delegates.

32 OCC explained that while it already has authority under I&P .15 to Rule 604 to make disapprovals of collateral based on similar factors, the proposal is intended to enumerate sovereign credit risk as a factor in the CRM Policy for haircuts on Government securities. *See* Notice of Filing *supra* note 4, 87 FR at 79017, n.16.

33 OCC also proposed to include "any other factors the Corporation determines are relevant" for consistency with I&P .15 to OCC Rule 604 and because such a catch-all is designed to capture unforeseen circumstances that might not previously have been considered possible. *Id.*

(iii) A Procedures-Based Approach to Setting Collateral Haircuts

As described above, OCC proposed to establish a new process for applying fixed collateral haircuts for Government securities and GSE debt securities that OCC would set and adjust from time to time. OCC proposed to define its new process, which it refers to as a "procedures-based approach," in the CRM Policy. The proposed procedures-based approach would replace the processes that OCC proposed removing from its rules (i.e., dynamic haircuts calculated by OCC's margin methodology and fixed haircuts defined by rule).

The proposed procedures-based approach would rely on a financial model to set and assess the adequacy of collateral haircuts. In particular, the proposed amendments to the CRM Policy would provide that OCC's Pricing and Margins team within its Financial Risk Management ("FRM") department would monitor the adequacy of the haircuts using a Historical Value-at-Risk approach ("H-VaR") with multiple look-back periods (e.g., 2-year, 5-year, and 10-year), updated at least monthly.[34] Each look-back period would comprise a synthetic time series of the greatest daily negative return observed for each combination of security type and maturity bucket (e.g., Government securities maturing in more than 10 years). The longest look-back period under the proposed H-VaR approach would include defined periods of market stress.[35] The CRM Policy would further require OCC to maintain haircuts at a level at least equal to a 99 percent confidence interval of the look-back period that provides for the most conservative

---

34 Upon implementation of the proposed changes, OCC anticipates that the collateral haircuts initially would be identical to those outlined in Rules 604(b) and 1002(a). *See* Notice of Filing *supra* note 4, 87 FR at 79017.

35 The delineation of look-back periods, periods of stressed market volatility included in the longest-term look-back period, and the type and maturity buckets would be defined in procedures maintained by OCC's Pricing and Margins business unit.

haircuts. Changes to the haircut rate would be communicated to Clearing Members at least one full day in advance and the schedule would be maintained on OCC's public website.

(iv) Increased Frequency of Valuations

OCC's proposed addition of Rule 604(e) and amendments to Rule 1002(a)(ii) would resolve an inconsistency between its Rules, which require monthly reviews of collateral haircuts in relation to the Clearing Fund, and its CRM Policy, which requires daily review of all collateral haircuts, including both margin and Clearing Fund collateral. Specifically, under the proposal, OCC would determine the current market value for Government securities and GSE debt securities at such intervals as it may from time to time prescribe, at least daily, based on the quoted bid price supplied by a price source designated by OCC.[36] The proposed change also would explicitly remove from the Rules the Risk Committee's authority for prescribing the interval at which haircuts are set. Rather, the Pricing and Margins business unit would continue to hold this authority, consistent with the current CRM Policy.

Under the current CRM Policy, the Pricing and Margins business unit monitors haircuts daily for "breaches" (i.e., an erosion in value exceeding the relevant haircut) and adequacy, with any issues being promptly reported to appropriate decision-makers at OCC.[37] Changes to OCC's Rules and the CRM Policy, including the minimum valuation

---

[36] Additionally, both the current and proposed language in the CRM Policy provide leeway for more frequent valuation, when warranted, and help to ensure that the designation of minimum valuation intervals would not be a limiting factor. *See* Notice of Filing *supra* note 4, 87 FR at 79017.

[37] OCC believed that Pricing and Margins, as the business unit responsible for such monitoring, is well positioned to make the determination about more frequent valuation intervals consistent with the directive of the CRM Policy approved by the Risk Committee. *See* Notice of Filing *supra* note 4, 87 FR at 79018.

interval, would remain subject to Risk Committee approval and the Risk Committee would retain oversight over OCC's risk management determinations.

(v) Conforming Changes to OCC's Policies

Based on the proposed changes to its Rules and policies, OCC also proposed conforming changes to its CRM Policy, Margin Policy, and STANS Methodology Description by:

- Establishing the CRM Policy as the relevant OCC policy governing OCC's process for valuing Government securities and GSE debt securities;
- Deleting descriptions that indicate that Government securities and GSE debt securities pledged as margin collateral may be valued using Monte Carlo simulations as part of OCC's STANS margin methodology;[38]
- Conforming capitalization of terms in the CRM Policy with OCC's By-Laws;
- Deleting certain portions of the STANS Methodology Description that exist to support the valuation of Government securities and GSE debt securities using Monte Carlo simulations;
- Removing Treasuries (i.e., Government securities) from OCC's model for generating yield curve distributions to form theoretical price distributions for U.S. Government securities and for modeling Treasury rates within STANS joint distribution of risk factors;[39]
- Revising the STANS Methodology Description to reflect the fact that the Liquidation Cost Add-on charge would no longer be assessed to Government security collateral deposits,[40] while incorporating stressed

---

38 The Margin Policy currently states that Government securities may be valued using the CiM approach. OCC did not propose to change the description of CiM generally, but rather would maintain it other than the removal of references suggesting that it applies to Government securities and GSE debt securities pledged as margin. *See* Notice of Filing *supra* note 4, 87 FR at 79018.

39 As described above, OCC would value such securities as described in the CRM Policy rather than pursuant to STANS.

40 The Liquidation Cost charge is a margin add-on charge that is designed to estimate the cost to liquidate a portfolio based on the mid-points of the bid-ask spreads for the financial instruments within the portfolio, and would scale up such liquidation costs for large or concentrated positions that would likely be more expensive to close out. See Securities Exchange Act Release No. 86119 (June 17, 2019), 84 FR 29267, 29268 (June 21, 2019) (File No. SR-OCC-2019-004). The

market periods in the H-VaR approach for setting and adjusting the haircuts for collateral in the form of Government securities and GSE debt securities used in margin accounts and Government securities in the Clearing Fund, which is comparable to the approach for incorporating stressed markets into the Liquidation Cost Add-on.

B. Minimum Standards for Clearing Banks and Letter-of-Credit Issuers

OCC's proposal would update and codify existing internal minimum standards that OCC uses to establish relationships with Clearing Banks and letter-of-credit issuers. The core of these proposed minimum standards would be the same for both Clearing Banks and letter-of-credit issuers, including requirements for, at a minimum, $500 million in Tier 1 Capital;[41] maintaining certain Tier 1 Capital Ratios; and providing that non-U.S. entities must be domiciled in a country that has a sovereign rating considered to be "low credit risk." OCC would reserve the right to set other such standards from time to time. OCC stated that these proposed changes would provide transparency on minimum standards for banking relationships that are critical to its clearance and settlement services. Details of proposed amendments to Rule 203 for Clearing Banks and the Interpretations and Policies for Rule 604 relating to letter-of-credit issuers are described below.

Liquidation Cost charge considers the cost of liquidating an underlying security, such as a Government security, during a period of market stress. *Id.* As described above, OCC now proposes to include defined periods of market stress in its collateral haircuts methodology under the CRM Policy. OCC indicated that the Liquidation Cost charge for such collateral is currently, and is expected to remain, immaterial, based on its analysis of the average daily Liquidation Cost charge across all accounts. *See* Notice of Filing *supra* note 4, 87 FR at 79018.

41 Tier 1 Capital is the required regulatory capital that is permanently held by banks to absorb unexpected losses. *See generally*, Bank for International Settlements, Financial Stability Institute, "Definition of capital in Basel III – Executive Summary" (June 27, 2019), *available at https://www.bis.org/fsi/fsisummaries/defcap_b3.htm#:~:text=Regulatory%20capital%20under%20Basel%20III,the%20components%20of%20regulatory%20capital*; and The Federal Deposit Insurance Corporation (FDIC), "Risk Management Manual of Examination Policies," Section 2.1 (Capital), *available at https://www.fdic.gov/regulations/safety/manual/section2-1.pdf*. Tier 1 Capital includes common equity Tier 1 Capital, such as certain bank-issued common stock instruments, and additional Tier 1 Capital. *See* 12 CFR 217.20.

(i) Clearing Banks

OCC indicated that Clearing Banks play a critical role in its clearance and settlement of options.[42] As currently written, Rule 203 requires that every Clearing Member establish and maintain a bank account at a Clearing Bank for each account maintained by it with OCC. However, the sole eligibility requirement for a Clearing Bank expressly delineated in current Rules is that the Clearing Bank be a bank or trust company that has entered into an agreement with OCC in respect of settlement of confirmed trades on behalf of Clearing Members.[43] OCC's By-Laws and Rules are silent on the internal governance process for approving Clearing Bank relationships. Rather, the details as to the financial and operational capability requirements and the governance process for approving Clearing Banks are housed in OCC's internal procedures, which are not publicly available.[44] OCC proposed to amend Rules 101 and 203 to clarify the term "Clearing Bank" and codify minimum capital and operational requirements and the governance process for approving its Clearing Banks.[45] OCC believed that expressly listing these requirements in its By-Laws and Rules will provide Clearing Members and other market participants greater clarity and transparency concerning OCC's Clearing Bank relationships.[46] Specifically, Rule 101 would amend the definition of "Clearing Bank" to reflect that such Clearing Bank relationships are approved by the Risk

---

42 *See* Notice of Filing *supra* note 4, 87 FR at 79018.

43 *See* OCC Rule 101.C(1).

44 These internal procedures include, for example, a Tier 1 Capital requirement of $100 million for U.S. banks and $200 million for non-U.S. banks, and in effect align with standards for Clearing Banks codified in I&P .01 to OCC Rule 604 with respect to banks or trust companies that OCC may approve to issue letters of credit as margin collateral.

45 *See* Notice of Filing *supra* note 4, 87 FR at 79018.

46 *Id.*

Committee, while leaving the rest of the definition intact. The proposed changes to Rule 203 would codify the following practices for Clearing Banks:

- Provide in Rule 203(b) that the Risk Committee may approve a bank or trust company as a Clearing Bank if it meets the minimum requirements;

- Require under Rule 203(b)(1) that any Clearing Bank, whether domiciled in the U.S. or outside the U.S., maintain at least $500 million (U.S.) in Tier 1 Capital, rather than the existing $100 million Tier 1 Capital requirement for letter-of-credit issuers currently required under I&P .01 to OCC Rule 604;

- Require under Rules 203(b)(2) and (4) that Clearing Banks maintain (i) common equity Tier 1 Capital (CET1)[47] of 4.5%, (ii) minimum Tier 1 Capital of 6%, (iii) total risk-based capital of 8%, and (iv) a Liquidity Coverage Ratio of at least 100%, unless the Clearing Bank is not required to compute the Liquidity Coverage Ratio;

- Provide under Rule 203(b)(3) that non-U.S. Clearing Banks must be domiciled in a country that has a sovereign rating considered to be "low credit risk" (i.e., A- by Standard & Poor's, A3 by Moody's, A- by Fitch, or equivalent);

- Require under Rule 203(b)(5) that a Clearing Bank must execute an agreement with OCC, including that the Clearing Bank: (A) maintain the ability to utilize the Society for Worldwide Interbank Financial Telecommunication ("SWIFT"), (B) maintain access to the Federal Reserve Bank's Fedwire Funds Service, and (C) provide its quarterly and annual financial statements to OCC and promptly notify OCC of material changes to its operations, financial condition, and ownership;

- Allow under Rule 203(b)(5)(A) the use of such other messaging protocol, apart from SWIFT, as approved by the Risk Committee;[48] and

- Add catchall language in Rule 203(b)(6) to provide that an institution must meet such other standards as OCC may determine from time to time.

---

47 *See* Rule 203(c). "For purposes of this Rule, 'Tier 1 Capital,' 'Common Equity Tier 1 Capital (CET1),' 'total risk-based capital,' and 'Liquidity Coverage Ratio' will mean those amounts or ratios reported by a bank or trust company to its regulatory authority."

48 OCC stated that the Risk Committee may elect to temporarily accommodate a Clearing Bank that does not meet these requirements if it is actively implementing such capabilities. *See* Notice of Filing *supra* note 4, 87 FR at 79019.

Language that forms the basis of Rule 203(b)(1)-(3) was taken, in part, from the previously codified standards for letter-of-credit issuers found in I&P .01 to Rule 604. OCC proposed to delete this rule text relating to letter-of-credit issuers and move the essential concepts to Rule 203(b)(1)-(3) concerning Clearing Banks. In doing so, OCC also proposed to adjust certain thresholds related to Tier 1 Capital requirements and sovereign credit ratings. Most notably, the proposed change would increase the Tier 1 Capital minimum requirement from $100 million for U.S. institutions and $200 million for non-U.S. institutions to $500 million for all institutions serving as Clearing Banks or letter-of-credit issuers. Additionally, the proposed change would lower the sovereign credit risk threshold for institutions domiciled outside of the U.S. from countries rated as AAA to countries that have a rating considered to be low credit risk (A- by Standard & Poor's, A3 by Moody's, A- by Fitch, or equivalent). OCC then proposed to incorporate by reference minimum requirements for Clearing Banks in I&P .01 to Rule 604, which applies to letter-of-credit issuers, thus aligning standards for Clearing Banks and letter-of-credit issuers and erasing some distinctions between U.S. and non-U.S. institutions.

OCC explained that the proposed changes in Rule 203(b) are meant to serve as the articulation of minimum standards for establishing relationships with Clearing Banks, and that OCC is not obligated to enter into any Clearing Bank relationship merely because a bank or trust company meets these enumerated standards.[49] In proposing these changes, OCC believed that the Risk Committee is the appropriate governing body to approve such relationships because of the nature of the risks presented by OCC's Clearing Bank relationships, including the risk that OCC would need to borrow from or

[49] *See* Notice of Filing *supra* note 4, 87 FR at 79019.

satisfy a loss using Clearing Fund assets in order to meet its liquidity needs as a result of the failure of a Clearing Bank to achieve daily settlement.[50] Further, in reviewing its existing Clearing Banks, OCC found that a $500 million (U.S.) Tier 1 Capital standard was more representative of these institutions.[51] In expanding the definition of "low credit risk" under the proposed Rule 203(b)(3), OCC stated that these ratings better reflect current understanding of countries considered to be "low credit risk," and that, for example, it would permit OCC to establish relationships with institutions from France with which OCC previously had relationships before France's sovereign credit rating fell below AAA.[52]

(ii) Letter-of-Credit Issuers

OCC proposed to revise Rule 604 regarding the acceptability of letters of credit as margin collateral. Under the proposal, OCC would align the minimum requirements for letter-of-credit issuers with some of those for OCC's other banking relationships, including the above-proposed standards for Clearing Banks.[53] I&P .01 to OCC Rule 604 currently sets forth minimum standards for the types of U.S. and non-U.S. institutions that OCC may approve as an issuer of letters of credit, including minimum Tier 1 Capital requirements, and, for non-U.S. institutions, the ultimate sovereign credit rating for the country where the principal executive office is located, credit ratings for the institution's commercial paper or other short-term obligations, and standards that apply if there is no

50 *See* Notice of Filing *supra* note 4, 87 FR at 79018.

51 *Id.*

52 *See* Notice of Filing *supra* note 4, 87 FR at 79018-9.

53 *See* Notice of Filing *supra* note 4, 87 FR at 79015.

credit rating on the institution's commercial paper or other short-term obligations. OCC proposed to amend I&P .01 to Rule 604 in the following ways:

- Combine and restate, without substantive change, the description of which institutions OCC may approve as letter-of-credit issuers;
- Replace specific capital and sovereign credit rating requirements with reference to proposed Rule 203(b)(1)-(3) prescribing minimum standards for Clearing Banks;[54]
- Remove external credit rating standards for a non-U.S. institution's commercial paper, other short-term obligations or long-term obligations;[55] and
- Add catchall language to provide that an institution must meet such other standards as OCC may determine from time to time.

Additionally, OCC proposed conforming changes to better align I&P .03 and .09 to Rule 604, requiring that all letters of credit must be payable at an issuer's domestic branch.[56] Currently, I&P .03 requires any letter of credit issued by a non-U.S. institution be payable at a Federal or State branch or agency thereof, while I&P .09 provides that a letter of credit may be issued by a Non-U.S. branch of a U.S. institution, as long as it otherwise conforms with Rule 604 and the Interpretations and Policies thereunder and is payable at a U.S. office of such institution. OCC's proposal would eliminate the text of

---

54 OCC stated that in eliminating I&P .01(b)(3) concerning credit ratings, OCC would remove the subjective process for determining a "AAA" equivalent country based on consultation with entities experienced in international banking and finance matters satisfactory to the Risk Committee, in favor of the more objective standards. *See* Notice of Filing *supra* note 4, 87 FR at 79019.

55 OCC stated that it has had to terminate several letter-of-credit issuer relationships pursuant to these external credit rating standards even though the institutions otherwise met OCC's requirements and were not reporting elevated internal credit risk metrics. By deleting I&P .01(b)(4), OCC would make its Rules consistent with industry best practice, and instead would rely on its Watch Level and Internal Credit Rating surveillance processes under its Third-Party Risk Management Framework to determine creditworthiness of institutions. *Id.* Proposed I&P .01(c) to OCC's Rule 604 would provide OCC authority sufficient to determine additional standards for issuers of letters of credit.

56 *See* Notice of Filing *supra* note 4, 87 FR at 79020.

I&P .09 in its entirety, and instead amend the text of I&P .03 to require letters of credit used as margin collateral to be payable at an issuer's "domestic branch,"[57] or at the issuer's Federal or State branch or agency.[58] The amended I&P .03 would apply to U.S. and Non-U.S. institutions alike.

C. Letter-of-Credit Concentration Limits

Lastly, the proposal would allow OCC to set more restrictive concentration limits for accepting letters of credit, while retaining the currently codified concentration limits as thresholds.[59] As currently written, I&P .02 to Rule 604 provides that "[n]o more than 50% of a Clearing Member's margin on deposit at any given time may include letters of credit in the aggregate, and no more than 20% may include letters of credit issued by any one institution." In addition, I&P .04 to Rule 604 limits the total amount of letters of credit issued for the account of any one Clearing Member by a U.S. or non-U.S. institution to a maximum of 15% of such institution's Tier 1 Capital. OCC proposed to retain these provisions, while simultaneously deleting the current text of I&P .09 to Rule 604, as described above, and replacing it with language that grants OCC the authority to specify, from time to time, more restrictive limits for the amount of letters of credit a Clearing Member may deposit in the aggregate or from any one institution.[60] Such determinations would be made based on market conditions, the financial condition of approved issuers, and any other factors OCC determines are relevant. Any such restrictive limit would apply to all Clearing Members.

---

57 As that term is defined in the Federal Deposit Insurance Act. *See* 12 U.S.C. 1813(o).

58 As those terms are defined in I&P .01 by reference to the International Banking Act of 1978.

59 *See* Notice of Filing *supra* note 4, 87 FR at 79015.

60 *Id.* at 79020.

Under the proposal, the CRM Policy would explicitly state that the responsibility of setting and adjusting more conservative concentration limits for letters of credit would lie with the Credit and Liquidity Risk Working Group ("CLRWG"), which is a cross-functional group that comprises representatives from relevant OCC business units including Pricing and Margins, Collateral Services, and Credit Risk Management. Similar to determinations surrounding collateral haircuts, the CRM Policy would provide that OCC will maintain the concentration limits on its website and will provide prior notice of any changes to the limits. OCC would retain the current requirements under the CRM Policy and the Model Risk Management Policy regarding the CLRWG's, at a minimum, annual review of the CRM Policy, including concentration limits, and the requirement that any changes to the CRM Policy resulting from the review be presented the Management Committee and, if approved, then the Risk Committee.

OCC stated that the anticipated impact of more restrictive concentration limits is low, considering that the use of letters of credit as margin collateral is currently low.[61] OCC explained that while utilization of letters of credit is low, it plans to continue to support letters of credit based on their acceptability as collateral under Commodity Futures Trading Commission regulations.[62]

The final proposed change would amend I&P .08 to Rule 604, which currently provides that OCC will not accept a letter of credit issued pursuant to Rule 604(c) for the account of a Clearing Member in which the issuing institution, a parent, or an affiliate has an equity interest in the amount of 20 percent or more of such Clearing Member's total

---

61 *Id.*

62 *Id.*

capital. The Proposed Rule Change would eliminate the reference to 20 percent, thus resulting in a total prohibition on accepting letters of credit for the account of a Clearing Member in which the issuing institution, a parent, or an affiliate has any equity interest in such Clearing Member's total capital.

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.[63] After carefully considering the Proposed Rule Change and the comment letters received, 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) and (I) of the Exchange Act,[64] and Rule 17Ad-22(e)(5),[65] Rule 17Ad-22(e)(9),[66] Rule 17Ad-22(e)(22),[67] and Rule 17Ad-22(e)(23)[68] thereunder, as described in detail below.

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

Section 17A(b)(3)(F)[69] of the Exchange Act requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and

---

63 15 U.S.C. 78s(b)(2)(C).

64 15 U.S.C. 78q-1(b)(3)(F) and 15 U.S.C. 78q-1(b)(3)(I).

65 17 CFR 240.17Ad-22(e)(5).

66 17 CFR 240.17Ad-22(e)(9).

67 17 CFR 240.17Ad-22(e)(22).

68 17 CFR 240.17Ad-22(e)(23).

69 15 U.S.C. 78q-1(b)(3)(F).

settlement of securities transactions and derivative agreements, contracts, and transactions; and 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.

Based on its review of the record, and for the reasons described below, the Commission believes that the proposed changes to OCC's rules and procedures regarding collateral haircuts and concentration limits for letters of credit are consistent with promoting the prompt and accurate clearance and settlement of securities and derivatives transactions. As stated above, OCC is exposed to credit risk stemming from its relationships with Clearing Members during the course of fulfilling its core clearing services. One of the ways OCC manages this credit risk is by collecting high-quality collateral for margin accounts and the Clearing Fund, while recognizing that this collateral may decrease in value at a future date. The Commission continues to believe that a clearing agency generally should reduce the need for procyclical adjustments by establishing stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practicable and prudent.[70] Procyclical adjustments (i.e., lower haircuts during periods of low stress followed by increased haircuts during times of high market stress) could exacerbate market stress and contribute to driving down asset prices further, resulting in additional collateral requirements.[71] The imposition of more conservative haircuts during normal market conditions, therefore, would reduce the amount by which haircuts must be adjusted during times of market stress. Based on the data provided by OCC, the proposed replacement of OCC's current

---

70 *See* Standards for Covered Clearing Agencies *supra* note 24, 81 FR at 70816-17.

71 *See* Committee on Payment and Settlement Systems, *Principles for Financial Market Infrastructures*, section 3.5.6 (Apr. 2012); *available at https://www.bis.org/publ/cpss101a.pdf*.

process for setting collateral haircuts with the proposed H-VaR approach would yield more conservative haircuts during times of low market stress, which, in turn, would help reduce spikes in collateral haircuts during heightened market volatility. As noted above, reducing such spikes would reduce the potential for driving down asset prices that could result in the imposition of additional collateral requirements on market participants already faced with increased market stress.

The proposed approach also would attempt to address the weaknesses identified in the CiM model in response to regulatory and internal examinations by, for example, incorporating periods of market stress into the look-back period for the model under the proposed H-VaR approach. Further, the proposed changes would add flexibility for OCC to more frequently value collateral haircuts during time of deteriorating market or other conditions while preserving notice requirements to ensure that Clearing Members are aware of risk management changes. Similarly, the proposed changes related to letters of credit (e.g., limits not linked to a specific domicile in order to impose the same requirements on both U.S. and non-U.S. issuers, concentration limits, and a prohibition on affiliated issuers) would support OCC's ability to manage risks posed by the collateral it accepts from participants.

Based on its review of the record, and for the reasons described below, the Commission believes that OCC's proposed changes to rules and procedures regarding minimum standards for Clearing Banks and letter-of-credit issuers are consistent with assuring the safeguarding of securities and funds which are in its custody or control or for which it is responsible. The quality of acceptable custodians is crucial to safeguarding these types of securities and funds, and one of the key ways to measure this quality is by

establishing minimum qualifying standards. OCC's proposed Rule amendments would set more stringent Tier 1 Capital requirements for both Clearing Banks and letter-of-credit issuers, while amending the sovereign credit ratings to reflect current understanding, and requiring Clearing Banks to maintain the ability to use SWIFT, a generally accepted and secure communication method, as a primary messaging protocol. Although the proposal would remove from OCC's Rules the external credit rating standards for a non-U.S. institution's commercial paper and related obligations, the ability of these institutions to meet their financial and other obligations to OCC would still be considered under the Third-Party-Risk Management Framework ("TPRMF"), along with other risk factors.[72] Additionally, the proposed changes to the minimum standards for Clearing Banks and letter-of-credit issuers, when viewed as a whole, serve to strengthen OCC's process for accepting letters of credit, which comprise a fraction of margin,[73] come with many related restrictions, and pose minimal risk to OCC. Moreover, the proposal would provide clarity by aligning minimum standards for Clearing Banks and letter-of-credit issuers, and would make clear that these rule changes

---

72 The TPRMF is an OCC rule that requires OCC to evaluate financial institutions such as Clearing Banks and other liquidity providers when they on-board or off-board with OCC, and to continuously monitor such institutions for so long as they maintain a relationship with OCC. It requires OCC to evaluate such financial institutions across a variety of factors, several of which assess the ability of the institution to meet its financial and other obligations to OCC, such as the financial, operational, legal, and regulatory risks faced by the institution. *See* Securities Exchange Act Release No. 90797 (Dec. 23, 2020), 85 FR 86592 (Dec. 30, 2020) (File No. SR-OCC-2020-014) (approving adoption of OCC's TPRMF). The TPRMF also provides for Watch List processes and internal escalation procedures in instances of an institution's deteriorating financial or operational ability to timely meet its future obligations to OCC, including assessing the institution's operational difficulties, late financial reports, and risk management issues. OCC, "Third-Party Risk Management Framework" (Dec. 22, 2022), *available at https://www.theocc.com/getmedia/68a1ea2d-ddae-4a93-a309-100bf70a0f28/Third-Party-Risk-Management-Framework.pdf*.

73 As of Dec. 31, 2022, OCC reported that bank letters of credit accounted for only $130 million out of $152.7 billion of margin at OCC. *See* OCC 2022 Financials, at 10, *available at https://www.theocc.com/company-information/documents-and-archives/annual-reports*.

are meant to serve as the articulation of minimum standards for establishing relationships, and OCC would not be obligated to enter into any such relationship merely because an institution meets these enumerated standards. The Commission believes that aligning and codifying such standards in OCC's rules facilitate OCC's maintenance of banking and letter-of-credit issuer relationships that support its ability to safeguard securities and funds for which it is responsible or that are in its custody or control.

The Commission received comments stating that the proposal to calculate collateral haircuts using the H-VaR model, rather than the current CiM methodology, would ignore long-tail risks[74] and historical periods of significant market stress.[75] Commenters also stated that fixed collateral haircuts do not accurately reflect the

---

74 The commenters did not elaborate on what was meant by "long tail risk." *See, e.g.*, Letter from Jean Garcia-Gomez (Feb. 12, 2023), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012-325181.htm*. Given the related comments and context, the Commission believes this to refer to the risk of loss due to an event that has an extremely low probability of occurring (i.e., an event that is far out in the tail of a distribution of possible events).

75 *See, e.g.*, *id.* Commenters raised additional concerns regarding sovereign credit ratings, and OCC's redaction of certain exhibits to the filing. *See, e.g.*, *id.* Regarding OCC's redaction of certain exhibits, the Commission notes that OCC asserted that Exhibits 3A-3C and 5B-5D to the filing, which contain internal policies and procedures, internal statistical calculations and descriptions, and confidential regulatory findings, were entitled to confidential treatment because they contained commercial and financial information that is not customarily released to the public and is treated as the private information of OCC. Under Section 23(a)(3) of the Exchange Act, the Commission is not required to make public statements filed with the Commission in connection with a proposed rule change of a self-regulatory organization if the Commission could withhold the statements from the public in accordance with the Freedom of Information Act ("FOIA"), 5 U.S.C. 552. 15 U.S.C. 78w(a)(3). The Commission has reviewed the documents for which OCC requests confidential treatment and concludes that they could be withheld from the public under the FOIA. FOIA Exemption 4 protects confidential commercial or financial information. 5 U.S.C. 552(b)(4). Under Exemption 4, information is confidential if it "is both customarily and actually treated as private by its owner and provided to government under an assurance of privacy." *Food Marketing Institute v. Argus Leader Media*, 139 S. Ct. 2356, 2366 (2019). In its requests for confidential treatment, OCC stated that it has not disclosed the confidential exhibits to the public, and the information is the type that would not customarily be disclosed to the public. In addition, by requesting confidential treatment, OCC had an assurance of privacy because the Commission generally protects information that can be withheld under Exemption 4. Thus, the Commission has determined to accord confidential treatment to the confidential exhibits.

potential fluctuations in asset values, including during times of market stress.[76] The Commission has reviewed the proposed H-VaR methodology, including confidential policies, procedures, and related materials.[77] The H-VaR model would reflect asset value fluctuations during times of market stress because it specifically includes such periods in the defined lookback periods. With regard to long-tail risk, the proposed rules would require OCC to maintain haircuts at a level at least equal to a 99 percent confidence interval of the look-back period that provides for most conservative haircuts.[78] Further, the Commission notes that regulatory and internal examinations showed that the CiM method has previously resulted in inaccuracies in sizing haircuts, and concludes that the use of the H-VaR model in place of the CiM method would improve accuracy of collateral haircuts. Additionally, fixed collateral haircuts are not a fundamentally new approach for OCC. For example, OCC's Rule 1002 currently applies fixed haircuts to Government securities in the Clearing Fund, and such haircuts are currently subject to review and recalculation based, in part, on market fluctuations.[79] Based on its review of the record and having considered the comments described above, the Commission believes that the proposed H-VaR methodology and the continued use of fixed collateral haircuts is consistent with the Exchange Act and the relevant rules thereunder.[80]

---

76 Comments on the Proposed Rule Change are available at *https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012.htm*. *See, e.g.*, Letter from Jean Garcia-Gomez (Feb. 12, 2023), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012-325181.htm*.

77 *See* Notice of Filing *supra* note 4, 87 FR at 79016-79018. OCC provided its policies, procedures, and related documents in confidential Exhibits 3A-3C, and 5B-5D to File No. SR-OCC-2022-012. Such documents included changes to both high-level policies and detailed technical documentation, as well as an analysis of the impact that changes in the haircut methodology would have on the value of collateral posted by members.

78 *See* Notice of Filing *supra* note 4, 87 FR at 79017.

79 *Id.*

80 Commenters also raised a concern that the proposed rule change would "cut margin requirements." *See, e.g.*, letter from Daniel Lambden (Feb. 25, 2023), *available at*

The Commission also received comments stating that lowering or eliminating sovereign credit rating requirements for non-U.S. Clearing Banks and letter-of-credit issuers increases the risk taken on by OCC.[81] The Commission has considered the materials submitted by OCC with regard to the Proposed Rule Change.[82] OCC's rules do not currently prescribe acceptable sovereign credit rating for the domicile of any non-U.S. Clearing Bank. OCC is not proposing to weaken minimum standards, but rather to codify the current requirement to allow only those Clearing Banks domiciled in the U.S. or in locations with sovereign rating considered to be low credit risk. The Commission believes the proposed standards (i.e., A- by Standard & Poor's, A3 by Moody's, A- by Fitch, or equivalent, which would include institutions domiciled in countries such as France) represents a reasonable choice by OCC to identify sovereigns with low credit risk.[83] The Commission recognizes that the proposal would change the acceptable ratings for letter-of-credit issuers; however, the proposed standard would still require that such banks be domiciled in the United States or in locations with sovereign ratings considered to be low credit risk, as noted above. Moreover, the removal of external credit rating standards for a non-U.S. institution's commercial paper and related obligations from OCC's Rules does not mean that creditworthiness will not be considered

---

https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012-326082.htm. Such comments are not relevant to the filing because OCC did not propose changes to how it calculates margin requirements.

81 *See* note 75, *supra*.

82 *See* Notice of Filing *supra* note 4, 87 FR at 79018-79020. OCC provided its policies, procedures, and related documents in confidential Exhibits 3A-3C, and 5B-5D to File No. SR-OCC-2022-012. Such documents include changes to policy governing OCC's management of risk presented by letters of credit.

83 OCC acknowledged that the sovereign credit rating requirement historically applied to letter-of-credit issuers is different than what is currently applied to its Clearing Banks, and that OCC would change the sovereign credit rating requirement for letter-of-credit issuers to conform to that for the Clearing Banks. *See* Notice of Filing *supra* note 4, 87 FR at 79018-79019.

at all. Rather, the proposal calls for an evaluation of credit risk as part of a broader review of factors, such as financial, operational, legal, and regulatory risks, with regard to Clearing Banks and liquidity providers, such as letters of credit issuers under the TPRMF.[84] The sovereign credit rating requirements are part of a broader set of minimum standards for Clearing Banks and letter-of-credit issuers, including the Tier 1 Capital that OCC proposes to increase, thus providing further safeguards that mitigate or eliminate the additional risk to OCC. Based on its review of the record and having considered the comments described above, the Commission believes that the proposed sovereign credit rating requirements are consistent with the Exchange Act and the relevant rules thereunder.

The Commission received further comments stating that the proposed changes would reduce or remove external audit, supervision, and credit ratings, contrary to recommendations made in a 2015 paper from the Bank of International Settlements ("BIS").[85] These comments are not relevant to the proposal being considered here. The Proposed Rule Change is unrelated to and does not address external audit or supervision and, contrary to commenters' assertions, it would not remove the consideration of credit ratings. Where the proposal addresses credit ratings, it does so in the limited context of sovereign credit ratings considered to be of low credit risk, transferring the rules regarding consideration of creditworthiness of Clearing Banks and liquidity providers from the OCC rulebook to the TPRMF, and as part of a broader set of minimum

---

84 *See* note 72, *supra*.

85 Isabella Arndorfer, Bank of International Settlements, and Andrea Minto, Utrecht University, Occasional Paper No. 11, "The 'four lines of defence model' for financial institutions," Financial Stability Institute ((Dec. 23, 2015), *available at https://www.bis.org/fsi/fsipapers11.pdf*. ("BIS paper").

requirements for Clearing Banks and letter-of-credit issuers. The BIS paper discusses, among other things, how interactions among internal lines of defense and external controls can enhance governance at financial institutions.[86] These issues are not relevant to the Proposed Rule Change. Further, unlike the commenters suggest, the BIS paper does not discuss credit ratings at all. Additionally, even though the proposal would adjust the required sovereign credit rating, and transfer the rules regarding consideration of creditworthiness of Clearing Banks and liquidity providers from the OCC rulebook to the TPRMF, it would still only allow for countries with low credit risk and institutions that are able to meet obligations to OCC, and these requirement are part of a larger set of minimum standards, such as more stringent Tier 1 Capital requirements and the requirement for Clearing Banks to maintain the ability to use SWIFT, that serve to enhance OCC's banking and letter-of-credit relationships. As such, after having considered the comments relating to the BIS paper, the Commission continues to believe that the proposal is consistent with the Exchange Act and the relevant rules thereunder.

Therefore, the Commission finds that, taken together, the proposed changes described above are consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.[87]

B. Consistency with Section 17A(b)(3)(I) of the Exchange Act

Section 17A(b)(3)(I) of the Exchange Act requires that the rules of a clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.[88]

---

86 *Id.*

87 15 U.S.C. 78q-1(b)(3)(F).

88 15 U.S.C. 78q-1(b)(3)(I).

In response to the Notice of Filing,[89] the Commission received a comment[90] opposing the proposal stating that the "increase to the current Tier 1 Capital requirement will have a negative effect by eliminating [Lakeside Bank] as a member Clearing Bank" and that such elimination "will reduce competition."[91] The commenter, Lakeside, states further that large Clearing Banks "tend to not provide service for small and mid-sized Clearing Brokers," which appears to suggest that the proposed change could reduce direct access to clearing for OCC's current membership.[92] Finally, the commenter states that the "proposed Tier 1 Capital rule change to $500 million is arbitrary and capricious and not explained other than the OCC's belief the new requirement reduces the risk of a Clearing Banks failure to achieve their daily settlement obligations."[93]

In a subsequent comment letter, OCC responded to the concerns raised by Lakeside.[94] OCC stated that its proposal would not impose a burden on competition[95] because Clearing Members of various sizes "currently have established relationships with

---

89 *See* Notice of Filing *supra* note 4, 87 FR at 79015.

90 Letter from Lakeside Bank dated January 26, 2023 ("Lakeside Ltr"), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012.htm*. *See also* Letter from Lakeside Bank dated March 15, 2023 ("Lakeside Ltr 2"), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012-328270.htm*. Lakeside Ltr 2 did not present novel comments.

91 Lakeside Ltr at 1.

92 *Id.* The Commission also received a comment stating that the proposed increase to capital requirements would impact smaller members. Letter from Kevin Lau (Feb. 14, 2023), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012-325669.htm*.

93 Lakeside Ltr at 2.

94 Letter from Megan Cohen, Managing Director, OCC, to Vanessa Countryman, Secretary, Commission, dated February 2, 2023 ("OCC Ltr"), *available at https://www.sec.gov/comments/sr-occ-2022-012/srocc2022012.htm*.

95 The Exchange Act requires that the rules of the clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. *See* 15 U.S.C. 78q-1(b)(3)(I).

OCC-approved Clearing Banks that meet the proposed standards."[96] Further, OCC stated that "Lakeside Bank does not currently provide settlement banking services as a Clearing Bank for any OCC Clearing Member."[97] Moreover, OCC stated that its "current rules do not obligate OCC to enter into a Clearing Bank relationship with a bank simply because the bank meets its present standards."[98] OCC stated that obligating it to enter into Clearing Bank relationships simply because an institution meets the minimum standards and without further due diligence "would not be consistent with sound third-party risk management practices."[99] On the contrary, "OCC believes that strengthening OCC standards for entering into Clearing Bank arrangements is necessary and appropriate to ensure the overall safety and soundness of the markets OCC serves."[100] OCC stated further that it "determined the proposed Tier 1 Capital requirement to align with the Tier 1 Capital held by the Clearing Banks that have demonstrated records of performance, including the resources to devote to and meet OCC's operational expectations for providing such critical services."[101]

Based on the information provided, the Commission believes that the proposal would not impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act. All of OCC's current members

---

96 OCC Ltr at 3.

97 *Id.* at 1.

98 *Id.* at 2.

99 *Id.* at 2.

100 *Id.* at 3. As OCC additionally explained, "If a Clearing Bank is unable to timely make incoming payments on behalf of one or more Clearing Members, OCC may face liquidity challenges requiring it to draw on resources that could impose unexpected costs or other adverse consequences for its Clearing Members and, ultimately, market participants." *Id.*

101 *Id.*

maintain relationships with Clearing Banks that meet the proposed standards. The Commission did not receive comments raising concerns from current or prospective OCC participants. With regard to monitoring, managing, and limiting the credit and liquidity risk arising from commercial settlement banks, the Commission has provided guidance that a clearing agency generally should consider establishing and monitoring adherence to strict criteria for its settlement banks that take account of, among other things, their capitalization.[102] The Commission believes, therefore, that strengthening capital requirements for settlement banks, such as OCC's Clearing Banks, can serve an important risk management purpose. The Commission acknowledges the concerns raised by Lakeside with regard to competition among settlement banks and access to central clearing at OCC.[103] As noted above, the proposal does not limit access to current OCC members, and, even if the proposed changes were not approved, OCC's current rules would not necessarily obligate OCC to maintain a Clearing Bank relationship with Lakeside or a similar institution.

Therefore, the Commission finds that the proposed changes described above are consistent with the requirements of Section 17A(b)(3)(I) of the Exchange Act.[104]

---

102 *See* Standards for Covered Clearing Agencies *supra* note 24, 81 FR at 70826.

103 Lakeside also raised concerns regarding potential future rule changes at the Chicago Mercantile Exchange ("CME") and the Depository Trust and Clearing Corporation ("DTCC"). *See* Lakeside Ltr at 2. Such concerns are not ripe for consideration here because (1) CME is not currently registered as a clearing agency with the Commission, and (2) there are no proposed changes related to this matter pending with the Commission from the Depository Trust Company, Fixed Income Clearing Corporation, or National Securities Clearing Corporation (i.e., the three registered clearing agencies whose parent is DTCC).

104 15 U.S.C. 78q-1(b)(3)(I).

C. Consistency with Rule 17Ad-22(e)(5) under the Exchange Act

Rule 17Ad-22(e)(5)[105] under the Exchange Act requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to set and enforce appropriately conservative haircuts and concentration limits if the covered clearing agency requires collateral to manage its or its participants' credit exposures; and require a review of the sufficiency of its collateral haircuts and concentration limits to be performed not less than annually. In adopting Rule 17Ad-22(e)(5), the Commission provided guidance that "to reduce the need for procyclical adjustments, a covered clearing agency generally should consider establishing stable and conservative haircuts that are calibrated to include periods of stressed market conditions, to the extent practical and prudent."[106]

Based on the information and data provided by OCC, the Commission believes that OCC's proposed H-VaR approach would help reduce spikes during heightened market volatility by yielding more conservative haircuts during normal market conditions. The proposed approach also would attempt to address the weaknesses identified in the CiM model in response to regulatory and internal examinations by, for example, incorporating periods of market stress into the look-back period for the model. Additionally, OCC's proposal to amend its internal CRM Policy to list specific factors, such as volatility and liquidity, and elevated sovereign credit risk when determining the value of GSE debt securities and Government securities used as margin or Clearing Fund collateral, would provide guideposts to set and enforce appropriately conservative

105 17 CFR 240.17Ad-22(e)(5).

106 *See* Standards for Covered Clearing Agencies *supra* note 24, 81 FR at 70816-17.

haircuts. OCC's proposed changes also would grant it new authority to set and adjust more restrictive concentration limits for accepting letters of credit, as well as expressly list the factors for making such determinations, and establish a prohibition on accepting letters of credit for the account of a Clearing Member where the issuing institution, a parent, or an affiliate has any equity interest in such Clearing Member's total capital. Thus, the Commission believes that OCC's proposed changes to letter-of-credit concentration limits, when reviewed in combination with the proposed minimum standards for Clearing Banks and letter-of-credit issuers, would be appropriately conservative and may help eliminate wrong-way risk found in some Clearing Members' relationships with such issuers.[107] Finally, the Commission believes that reviews at regular intervals of collateral haircuts and concentration limits proposed in the CRM Policy and Rules would be consistent with the requirement for, at a minimum, an annual review.

Accordingly, the Commission finds that the proposed changes are consistent with Rule 17Ad-22(e)(5)[108] under the Exchange Act.

---

107 Wrong-way risk can be either general or specific. General wrong-way risk arises at a central counterparty ("CCP") when the potential losses of either a participant's portfolio or a participant's collateral is correlated with the default probability of that participant. Specific wrong-way risk arises at a CCP when an exposure to a participant is highly likely to increase when the creditworthiness of that participant is deteriorating. *See* Standards for Covered Clearing Agencies *supra* note 24, 81 FR at 70816, n.317.

108 17 CFR 240.17Ad-22(e)(5).

D. Consistency with Rule 17Ad-22(e)(9) under the Exchange Act

Rule 17Ad-22(e)(9)[109] under the Exchange Act requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to, among other things, minimize and manage credit and liquidity risk arising from conducting its money settlements in commercial bank money if central bank money is not used by the covered clearing agency. The Commission believes that including OCC's minimum standards for Clearing Banks in its rules would support OCC's ability to monitor its relationships with Clearing Banks and manage the financial and operational risks inherent in such relationships. The Commission also believes that the requirements for Clearing Banks, taken as a whole, as well as the mandatory approval of any new Clearing Bank by the Risk Committee prior to onboarding, would help reduce credit and liquidity risk arising from conducting its money settlements in commercial bank money. Accordingly, the Commission finds that the proposed changes are consistent with Rule 17Ad-22(e)(9)[110] under the Exchange Act.

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

Rule 17Ad-22(e)(22)[111] under the Exchange Act requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to use, or at a minimum accommodate, relevant internationally accepted communication procedures and standards in order to facilitate efficient payment, clearing, and settlement. As described above, OCC proposed codifying its requirement that its Clearing Banks maintain the ability to utilize SWIFT, whenever

---

109 17 CFR 240.17Ad-22(e)(9).

110 *Id.*

111 17 CFR 240.17Ad-22(e)(22).

possible. The proposed change would codify the process that OCC proposed in 2017.[112] Previously, the Commission did not to object to the process, in part, based on the belief that the proposal to expand the usage of SWIFT as a standard for OCC's Clearing Banks is consistent with Rule 17Ad-22(e)(22).[113] The Commission believes that codifying the requirement would further support OCC's existing process and use of SWIFT to facilitate efficient payment, clearing, and settlement. Accordingly, the Commission finds that the proposed changes are consistent with Rule 17Ad-22(e)(22)[114] under the Exchange Act.

F. Consistency with Rule 17Ad-22(e)(23) under the Exchange Act

Rule 17Ad-22(e)(23)(i) and (ii)[115] under the Exchange Act requires each covered clearing agency to establish, implement, maintain, and enforce written policies and procedures reasonably designed to, among other things, publicly disclose all relevant rules and material procedures; and provide sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs they incur by participating in the covered clearing agency. Based on its review of the record, and for the reasons described below, the Commission finds that the proposed changes, taken together, are consistent with the requirements of Rule 17Ad-22(e)(23)(i) and (ii).[116]

By adopting rules that require OCC to provide prior notice through public disclosures on its website relating to information on collateral haircuts for Government

---

112 *See* Securities Exchange Act Release No. 82055 (Nov. 13, 2017), 82 FR 54448 (Nov. 17, 2017) (File No. SR-OCC-2017-805).

113 *See* Securities Exchange Act Release No. 82221 (Dec. 5, 2017), 82 FR 58230, 58232 (Dec. 11, 2017) (File No. SR-OCC-2017-805).

114 17 CFR 240.17Ad-22(e)(22).

115 17 CFR 240.17Ad-22(e)(23)(i) and (ii).

116 *Id.*

securities and GSE debt securities, and concentration limits for letters of credit, the Commission believes that OCC's rules would support the communication of information that Clearing Members may use to identify and evaluate the haircuts and concentration limits resulting from OCC's valuation processes. Additionally, the Commission believes that codifying minimum standards for Clearing Banks and letter-of-credit issuers in OCC's public rules would provide increased clarity and transparency to Clearing Members and market participants, while preserving OCC's flexibility and authority in disapproving specific relationships based on individual facts and circumstances. As such, the Commission believes that the proposed rule and policy revisions are consistent with publicly disclosing all relevant rules and material procedures; and providing sufficient information to enable participants to identify and evaluate the risks, fees, and other material costs incurred with participation in the covered clearing agency.

The Commission finds, therefore, that OCC's proposals, described above, are consistent with the requirements of Rule 17Ad-22(e)(23)(i) and (ii) under the Exchange Act.[117]

---

117 *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 Act[118] and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,[119] that the Proposed Rule Change (SR-OCC-2022-012), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[120]

Sherry R. Haywood,

Assistant Secretary.

---

118 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).

119 15 U.S.C. 78s(b)(2).

120 17 CFR 200.30-3(a)(12).