



8011-01
SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-79096; File No. SR-OCC-2016-802)

October 13, 2016

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing Concerning The Options Clearing Corporation's Escrow Deposit Program

The Options Clearing Corporation ("OCC") filed on August 15, 2016 with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2016-802 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")¹ and Rule 19b-4(n)(1)(i)² under the Securities Exchange Act of 1934 ("Exchange Act") to implement changes to its escrow deposit program. The Advance Notice was published for comment in the Federal Register on September 20, 2016.³ The Commission did not receive any comments on the Advance Notice. This publication serves as notice of no objection to the Advance Notice.

¹ 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated OCC a systemically important financial market utility on July 18, 2012. See Financial Stability Oversight Council 2012 Annual Report, Appendix A, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>. Therefore, OCC is required to comply with the Payment, Clearing and Settlement Supervision Act and file advance notices with the Commission. See 12 U.S.C. 5465(e).
² 17 CFR 240.19b-4(n)(1)(i).

³ See Securities Exchange Act Release No. 78834 (September 14, 2016), 81 FR 64536 (September 20, 2016) (File No. SR-OCC-2016-802). OCC also filed a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder, seeking approval of changes to its Rules necessary to implement the Advance Notice. 15 U.S.C. 78s(b)(1) and 17 CFR 240.19b-4, respectively. This proposed rule change was published in the Federal Register on August 31, 2016. Securities Exchange Act Release No. 78675 (August 25, 2016), 81 FR 60108 (August 31, 2016) (SR-OCC-2016-009).

I. Description of the Advance Notice

OCC is the sole clearing agency for the U.S. listed options markets and a systemically important financial market utility. OCC seeks to manage risks that could cause a financial loss or settlement disruption and, therefore, threaten the stability of the U.S. financial system. One way OCC manages such risks is by collecting collateral to protect against potential losses stemming from the default of a clearing member or its customers. OCC obtains this collateral by collecting margin from its clearing members, or from deposits in lieu of margin of clearing members' customers through OCC's escrow deposit program. OCC states that the users of its escrow deposit program are customers of clearing members who, through the escrow deposit program, are permitted to collateralize eligible positions directly with OCC (instead of with the relevant clearing member who would, in turn, deposit margin at OCC). OCC states that when a customer of a clearing member makes a deposit in lieu of margin through OCC's escrow deposit program, the relevant positions are excluded from the clearing member's margin requirement at OCC. OCC believes that the escrow deposit program therefore provides users of OCC's services with a means to more efficiently use cash or securities they may have available.

As described by OCC in the Advance Notice, the purpose of the proposed change is to improve the resiliency of OCC's escrow deposit program ("EDP"). First, OCC states that the changes would increase OCC's visibility into and control over collateral deposits made under the escrow deposit program. As described in the Advance Notice, currently, securities deposits in the EDP ("specific deposits") are held at either the Depository Trust Company ("DTC") or custodian banks, and cash deposits in the EDP ("escrow deposits") are held at custodian banks. While OCC currently can verify the value of the securities deposited at DTC through DTC's systems, it lacks similar visibility into cash and securities held in custodian bank accounts, relying instead

on the custodian banks to verify the value of such collateral. The proposed changes would require securities in the EDP to be held at DTC, providing OCC with increased visibility into the collateral, as OCC will be able to view, validate, and value the collateral in real time and perform the controls currently performed by custodian banks. As stated in the Advance Notice, a bank participating in the escrow deposit program (“Tri-Party Custodian Bank”) would also provide OCC with online view access to each customer’s cash account designated for the escrow deposit program, allowing visibility into transactional activity and account balances without having to rely upon a third party to value or warrant the existence of the collateral.

Second, OCC states that the proposed changes provide more specificity concerning the manner in which OCC would take possession of collateral in OCC’s escrow deposit program in the event of a clearing member or custodian bank default. As described in the Advance Notice, proposed Rules 610A(b), 610B(f), 610C(q), and 610C(r) would provide that in the event of a clearing member or custodian bank default, OCC would have the right to direct DTC to deliver the securities included in a member specific deposit, third-party specific deposit or escrow deposit to OCC’s DTC participant account for the purpose of satisfying the obligations of the clearing member or reimbursing itself for losses incurred as a result of the failure. Similarly, pursuant to proposed Rules 610C(q) and 610C(r), OCC would have the right in the event of a Tri-Party Custodian Bank default to take possession of cash included within an escrow deposit for the same purposes. Further, Rule 1106(b)(2) would be amended to provide that OCC may close out a short position of a suspended clearing member covered by a member specific, third-party specific or escrow deposit, subject to the ability of the suspended clearing member or its representative to transfer the short position to another clearing member under certain circumstances.

Third, OCC states the proposed changes would clarify clearing members' rights to collateral in the EDP in the event of a customer default to the clearing member. According to the Advance Notice, Proposed Rules 610B(c) and 610C(f) would provide for the grant of a security interest by the customer to the clearing member with respect to any given third-party specific deposit and escrow deposit, as applicable, with the clearing member's right subordinate to OCC's interest. Proposed Rules 610C(d), 610C(o), 610C(p) and 610C(s), relating to escrow deposits, and proposed Rules 610B(d) and 610B(e), relating to third-party specific deposits, would provide that, in the event of a customer default to a clearing member, the clearing member would have the right to request a "hold" on a deposit, which would prevent the withdrawal of deposited securities or cash by a custodian bank or the release of a deposit that would otherwise occur in the ordinary course. OCC states that placing the "hold" instruction gives a clearing member the right to request that OCC direct delivery of the deposit to the clearing member through DTC's systems, in the case of securities, or an instruction to the Tri-Party Custodian Bank in the case of cash. OCC believes that providing clearing members with transparent instructions regarding how to place a hold instruction on and direct delivery of a deposit in the escrow deposit program would be a significant enhancement to the current escrow deposit program.

Fourth, OCC states the changes would improve the readability of the rules governing OCC's escrow deposit program by consolidating all such rules into a single location in OCC's Rulebook. Upon implementation of the proposed change, all securities collateral in OCC's escrow deposit program would be held at DTC, and custodian banks would only be allowed to hold cash collateral.

Rule Consolidation and Terminology Changes

OCC's current rules concerning its escrow deposit program are located in OCC Rules 503, 610, 613 and 1801. Additionally, OCC and custodian banks participating in OCC's escrow deposit program enter into an Escrow Deposit Agreement ("EDA"), which also contains substantive provisions governing the program. OCC proposes to consolidate all of the rules concerning the escrow deposit program, including the provisions of the EDA relevant to the revised escrow deposit program, into proposed Rules 610, 610A, 610B and 610C. OCC states that consolidating the many rules governing the escrow deposit program into a single location would significantly enhance the understandability and transparency of the rules concerning the escrow deposit program for current users of the program as well as any persons that may be interested in using the program in the future.

OCC proposes to rename the types of escrow deposits available within the escrow deposit program, as well as rename the term "approved depository" to "approved custodian." Specific deposits, which are equity securities deposited by clearing members at DTC at the direction of their customers, would now be called "member specific deposits"; third-party escrow deposits, which are equity securities deposited by custodian banks at DTC at the direction of their customers, would now be called "third-party specific deposits"; and escrow program deposits, which are either cash deposits held at a custodian bank for the benefit of OCC, or Government securities deposited at DTC by custodian banks at the direction of their customers, would now be called "escrow deposits". The term "approved depository" would also be changed to "approved custodian" to eliminate any potential confusion with the term "Depository," which is defined in the Rules to mean DTC.

New Rule Organization

With respect to the rules governing the escrow deposit program, OCC states that proposed Rule 610 would set forth general terms and conditions common to all types of deposits permitted under the escrow deposit program. Specifically, proposed Rule 610: (1) sets forth the different types of eligible positions for which a deposit in lieu of margin may be used, (2) sets forth operational aspects of the escrow deposit program such as the days and the times during which a deposit in lieu of margin may be made and where the different types of deposits in lieu of margin must be maintained (either DTC or a custodian bank), (3) provides the conditions under which OCC may take possession of a deposit in lieu of margin (from DTC or a custodian bank), and (4) describes OCC's security interest in deposits in lieu of margin.⁴ Proposed Rule 610 is supplemented by: (1) proposed Rule 610A for member specific deposits, (2) proposed Rule 610B for third-party specific deposits, and (3) proposed Rule 610C for escrow deposits.

Agreements Concerning the Escrow Deposit Program

In addition to the above-described Rule changes, many provisions of the EDA would be moved in to the Rules. OCC proposes to eliminate the EDA and replace it with a streamlined agreement entitled the "Participating Escrow Bank Agreement." OCC states that the Participating Escrow Bank Agreement would provide that custodian banks are subject to all terms of the Rules governing the revised escrow deposit program, as they may be amended from

⁴ OCC would continue to maintain a perfected security interest in deposits in the escrow deposit program under the proposed Rules notwithstanding changes to the location of the rules that perfect such security interest. OCC's security interest in securities deposits in the escrow deposit program, which are held at DTC, is perfected by operation of DTC's rules. OCC's security interest in cash deposits in the escrow deposit program is perfected under proposed Rules 610C(i), 610C(j) and 610C(k), which replace Sections 3.3, 3.4, 4.3, 4.4, 5.3, 5.4 and 21 of the EDA. Proposed Rule 610(g) also concerns OCC's security interest in deposits in escrow deposit program.

time to time.⁵ OCC states that the Participating Escrow Bank Agreement would contain eligibility requirements for custodian banks, including representations regarding the custodian bank's Tier 1 Capital, and provide OCC with express representations concerning the bank's authority to enter into the Participating Escrow Bank Agreement.

OCC is also proposing, under Proposed Rule 610C(b), to require customers wishing to deposit cash collateral and custodian banks holding escrow deposits comprised of cash to enter into a tri-party agreement involving OCC, the customer and the applicable custodian bank. While cash collateral pledged in the escrow deposit program will continue to be facilitated through existing interfaces, OCC states that pledges would be required to be made in the customer's account at the Tri-Party Custodian Bank. OCC states that the Tri-Party Agreement would govern the customer's use of cash in the program, confirm the grant of a security interest in the customer's account to OCC and the relevant clearing member (as set forth in proposed Rule 610C(f)), and cause customers of clearing members to be subject to all terms of the Rules governing the revised escrow deposit program. Each custodian bank entering into the Tri-Party Agreement would also agree to follow the directions of OCC with respect to cash escrow deposits without further consent by the customer.

II. Discussion and Commission Findings

Although the Payment, Clearing and Settlement Supervision Act does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of the

⁵ Under the Participating Escrow Bank Agreement, however, OCC will agree to provide custodian banks with advance notice of material amendments to the Rules relating to deposits in lieu of margin and custodian banks will have the opportunity to withdraw from the escrow deposit program if they object to the amendments. As a general matter, the Participating Escrow Bank Agreement will not be negotiable, although OCC may determine to vary certain non-material terms in limited circumstances.

Payment, Clearing and Settlement Supervision Act is instructive.⁶ The stated purpose of the Payment, Clearing and Settlement Supervision Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically important financial market utilities and strengthening the liquidity of systemically important financial market utilities.⁷

Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act⁸ authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Payment, Clearing and Settlement Supervision Act⁹ states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Payment, Clearing and Settlement Supervision Act (“Clearing Agency Standards”) and the

⁶ See 12 U.S.C. 5461(b).

⁷ Id.

⁸ 12 U.S.C. 5464(a)(2).

⁹ 12 U.S.C. 5464(b).

Exchange Act.¹⁰ The Clearing Agency Standards became effective on January 2, 2013, and require registered clearing agencies to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis. As such, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards, and the objectives and principles of these risk management standards as described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act.¹¹

The Commission believes the proposed change is consistent with the objectives and principles described in Section 805(b) of the Payment, Clearing and Settlement Supervision Act,¹² and the Clearing Agency Standards, in particular, Rule 17Ad-22(d)(1),¹³ Rule 17Ad-22(d)(3),¹⁴ and Rule 17Ad-22(d)(11)¹⁵ under the Exchange Act, as described in detail below.

A. Consistency with Section 805(b)(1) of the Act

The objectives and principles of Section 805(b) of the Payment, Clearing and Settlement Supervision Act are to promote robust risk management, promote safety and soundness, reduce systemic risks, and support the stability of the broader financial system.¹⁶ The proposed change is consistent with the objectives and principles described in Section 805(b)(1) of the Act,

¹⁰ 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

¹¹ 12 U.S.C. 5464(b).

¹² Id.

¹³ 17 CFR 240.17Ad-22(d)(1).

¹⁴ 17 CFR 240.17Ad-22(d)(3).

¹⁵ 17 CFR 240.17Ad-22(d)(11).

¹⁶ 12 U.S.C. 5464(b).

including consistency with promoting robust risk management.¹⁷ OCC collects margin and deposits in lieu of margin to protect OCC and market participants from risks resulting from the default of a clearing member. The proposed change will enhance OCC's ability to validate and value EDP deposits in real time and enhance its ability to expeditiously take possession of such deposits in the event of a default. These enhancements will enable OCC to better ensure that it monitors and maintains adequate financial resources in the event of a clearing member default and thereby promote robust risk management. As such, the Commission believes that the proposed change is consistent with the promotion of robust risk management.

B. Consistency with Exchange Act Rule 17Ad-22(d)

Rule 17Ad-22(d)(1) under the Exchange Act requires OCC to establish, implement, maintain and enforce written policies and procedures reasonably designed to provide a well-founded, transparent, and enforceable legal framework for each aspect of its activities in all relevant jurisdictions.¹⁸ Through the proposed change, OCC will provide clarity to clearing members, their customers, and potential users of OCC's escrow deposit program regarding the operations of the escrow deposit program and the manner in which OCC would risk manage a clearing member or customer default using the escrow deposit program. For example, the proposed change would better codify OCC's and clearing members' rights to EDP collateral in the event of a clearing member or customer default and provide greater transparency regarding the operational steps involved in taking possession of such collateral. Moreover, consolidating the rules governing the EDP and terms previously located in the EDA into a single location will

¹⁷ 12 U.S.C. 5464(b)(1).

¹⁸ 17 CFR 240.17Ad-22(d)(1).

enhance the transparency of the applicable EDP rules. As such, the Commission believes the proposed change is consistent with Exchange Act Rule 17Ad-22(d)(1).¹⁹

In addition, the Commission believes that the proposed change is consistent with Exchange Act Rule 17Ad-22(d)(3).²⁰ Rule 17Ad-22(d)(3) requires OCC to, among other things, establish, implement, maintain and enforce written policies and procedures reasonably designed to hold assets in a manner that minimizes risk of loss or delay or in its access to them.²¹ Under the proposed change, all non-cash collateral in the EDP would be held at DTC, which will allow OCC to validate and value collateral in real time and quickly obtain possession of deposited securities in an event of default without involving custodian banks by issuing a transfer instruction through DTC's systems. With respect to cash collateral, the proposed change would codify OCC's right to take possession of cash within an escrow account upon a clearing member or custodian bank default and provide OCC with online view access to each customer's cash account at the custodian bank. Together, these changes would allow OCC monitor the adequacy of collateral in the EDP and be able to more quickly take possession of collateral in the EDP in the event of a clearing member default, which would, thereby, reduce potential losses to OCC, other clearing members and market participants.

Finally, the Commission believes that the proposed change is consistent with Exchange Act Rule 17Ad-22(d)(11), which requires OCC to, among other things, establish, implement, maintain and enforce written policies and procedures reasonably designed to make key aspects of

¹⁹ Id.

²⁰ 17 CFR 240.17Ad-22(d)(3).

²¹ *Id.*

their default procedures publicly available.²² The Commission believes that the proposed change is consistent with Rule 17Ad-22(d)(11) because it would incorporate the substantive terms of the EDP, and specifically the rules concerning default management, into OCC's Rules, which are publicly available on OCC's website, rather than in private agreements.

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Payment, Clearing and Settlement Supervision Act,²³ that the Commission DOES NOT OBJECT to Advance Notice (SR-OCC-2016-802) and that OCC is AUTHORIZED to implement the proposed change.

By the Commission.

Robert W. Errett
Deputy Secretary

²² 17 CFR 240.17Ad-22(d)(11).

²³ 12 U.S.C. 5465(e)(1)(I).

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