



## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-82221; File No. SR-OCC-2017-805]

### **Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing Concerning The Use of the Society of Worldwide Interbank Financial Telecommunication (“SWIFT”) Messaging Network in OCC’s Cash Settlement Process**

**December 5, 2017.**

The Options Clearing Corporation (“OCC”) filed on October 10, 2017 with the Securities and Exchange Commission (“Commission”) advance notice SR-OCC-2017-805 (“Advance Notice”) pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 (“Payment, Clearing and Settlement Supervision Act”)<sup>1</sup> and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934<sup>2</sup> (“Exchange Act”) to propose changes to the current process OCC uses to conduct cash settlement with Clearing Members<sup>3</sup> by requiring Clearing Banks to integrate the use of the Society of Worldwide Interbank Financial Telecommunication (“SWIFT”) messaging network. The proposed changes are intended to enhance the resiliency, efficiency, and consistency of the cash settlement process and thereby mitigate risks that are

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<sup>1</sup> 12 U.S.C. 5465(e)(1). The Financial Stability Oversight Council designated OCC a systemically important financial market utility (“SIFMU”) 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.

<sup>2</sup> 17 CFR 240.19b-4(n)(1)(i).

<sup>3</sup> Unless specified otherwise, capitalized terms shall have the meaning OCC ascribes in its By-Laws and Rules.

associated with the existing cash settlement process. The Advance Notice was published for comment in the Federal Register on November 17, 2017.<sup>4</sup> The Commission has not received any comments on the Advance Notice to date. This publication serves as notice of no objection to the Advance Notice.

## **I. BACKGROUND**

In connection with OCC's performance of clearance and settlement services, OCC and its Clearing Members are obligated to perform cash settlement functions pursuant to OCC's By-Laws and Rules. For example, a Clearing Member may be obligated to pay OCC the premium for a cleared contract, or OCC may be obligated to pay a Clearing Member the settlement value of a cleared contract.<sup>5</sup> The cash settlement process for these and other clearance and settlement services is facilitated by Clearing Banks, which are banks or trust companies that have entered agreements with OCC to settle on behalf of Clearing Members and at which OCC and Clearing

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<sup>4</sup> Notice of Filing of Advance Notice Concerning the use of the Society of Worldwide Interbank Financial Telecommunication Messaging Network in OCC's Cash Settlement Process, Exchange Act Release No. 82055 (Nov. 13, 2017), 82 FR 54448 (Nov. 17, 2017) ("Notice of Filing of Advance Notice").

<sup>5</sup> See Article VI, Section 4 of OCC's By-Laws (Obligations of Purchasing Clearing Members); see also Chapter V of OCC's Rules (Daily Cash Settlement); Article VI, Section 6.01 of OCC's By-Laws (requiring, among other things, that OCC be substituted through novation as the buyer of every seller and seller to every buyer with respect to obligations owing to persons having positions in cleared contract); Article I, Section 1.S.(16) of OCC's By-Laws (defining the term "settlement time").

Members each maintain accounts.<sup>6</sup> Currently, there are eight Clearing Banks with which OCC effects cash settlements through the ENCORE clearing system (“OCS”).<sup>7</sup>

OCC generates settlement instructions associated with Cleared Contracts and Stock Loans of Clearing Members by running specific predefined settlement profiles<sup>8</sup> throughout the day. These settlement instructions are categorized as either start-of-day instructions or intra-day instructions. The resulting settlement instructions are generally transmitted by OCC to Clearing Banks by way of OCS, at which point the Clearing Banks are able to view batches of settlement instructions within OCS.<sup>9</sup> Clearing Bank staff review the settlement instructions by logging into OCS and opening the settlement batch.<sup>10</sup>

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<sup>6</sup> See OCC Rule 101.C.(1) (defining the term “clearing bank” to mean “a bank or trust company which has entered into an agreement with [OCC] in respect of settlement of confirmed trades on behalf of Clearing Members.”).

<sup>7</sup> See generally OCC Completes Second Major Installation of Encore™ Clearing System (November 25, 2002) available at [https://www.theocc.com/about/newsroom/releases/2002/11\\_25.jsp](https://www.theocc.com/about/newsroom/releases/2002/11_25.jsp).

<sup>8</sup> Predefined settlement profiles are programmed to track various types of obligations to pay or collect cash in connection with Cleared Contracts and Stock Loans that are in turn used to generate settlement instructions.

<sup>9</sup> A settlement batch is a set of individual debit or credit settlement instructions that may either instruct a Clearing Bank to move funds to or from an OCC settlement account or to or from a Clearing Member’s account at the same Clearing Bank.

<sup>10</sup> One of the Clearing Banks, however, currently does not utilize OCS as its primary means of effecting cash settlement. Instead, the Clearing Bank primarily receives settlement instructions from OCC via facsimile, reviews the settlement instructions, approves or rejects them, and then returns a facsimile confirmation to OCC. After receipt of the confirmation, OCC staff manually enters the approvals or rejections into OCS. This Clearing Bank will transfer to the SWIFT messaging network after implementation of the proposals described herein.

Each Clearing Bank has entered into a Cash Settlement Procedures Agreement (“CSPA”) with OCC that details the substantive rights and responsibilities of the parties and specifies operational procedures for which they are responsible regarding start-of-day and intra-day settlement instructions. This process includes prescribed communication methods and settlement procedures, including a requirement that the Clearing Bank act upon the settlement instructions before a defined settlement time. If a Clearing Bank does not expressly accept or reject a settlement instruction by the specified settlement time, the Clearing Bank is deemed to have accepted the instruction.

The processes agreed to in the CSPAs currently are conducted via OCS because the SWIFT messaging network is available for cash settlement processes in narrow circumstances only. For example, OCC states that SWIFT is available to Clearing Members to deposit letters of credit for margining purposes provided: (i) they are denominated in U.S. dollars, (ii) they are issued by banks or trust companies, (iii) they are approved by OCC as margin assets, and (iv) the issuer of any such letter of credit submits amendments to OCC using the SWIFT network. OCC states that it manages this process through a SWIFT system that interfaces with OCC’s OCS so that OCC is able to track and process the amendment messages.<sup>11</sup>

The proposals set forth in OCC’s Advance Notice would change its current cash settlement process with Clearing Members by: (i) requiring Clearing Banks to expand the use of the SWIFT messaging network, and (ii) creating a new standardized CSPA template.

Collectively, OCC believes these changes would improve OCC’s resiliency, efficiency, and

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<sup>11</sup> See Notice of Filing of Advance Notice.

consistency, thereby mitigating risks.<sup>12</sup> The specifics of the proposals are described in detail below.

## **II. DESCRIPTION OF THE ADVANCE NOTICE**

### **A. Proposed Change to Increase SWIFT Utilization**

OCC's Advance Notice states that the changes to its cash settlement process are intended to improve OCC's current cash settlement process by implementing the SWIFT messaging network as the primary means of transmitting daily cash settlement between OCC and the Clearing Banks. Currently, OCS requires Clearing Banks to process aspects of the cash settlement process manually, including logging into OCS to reject settlement instructions or to accept in instances where Clearing Banks opt to actively accept settlement instructions prior to the specified settlement time. These requirements result in inconsistent operational practices across Clearing Banks since OCS is a proprietary online cash settlement system and not all Clearing Banks use OCS consistently.<sup>13</sup> Furthermore, the manual processing steps introduce risks for error and can result in elongated times for processing, response, and approval. Requiring all of the Clearing Banks to integrate the use of SWIFT into their operations facilitating OCC's cash settlement with Clearing Members would eliminate the facsimile, telephone, and e-mail communications as primary communication methods for settlement processing while harmonizing the cash settlement process across all Clearing Banks.

Due to the automated nature of the SWIFT messaging network, OCC believes that implementing SWIFT would reduce manual processing and approval steps. For instance,

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<sup>12</sup> See Notice of Filing of Advance Notice for a more detailed description of the specific rule changes OCC is proposing.

<sup>13</sup> See supra note 10.

settlement instructions would be automatically transmitted to Clearing Banks over the SWIFT network so that Clearing Bank staff would not need to log into OCS to accept or reject them. Similarly, OCC automatically would receive any acceptances provided.<sup>14</sup> In addition, OCC could monitor all cash-settlement related SWIFT messages it sends or receives.

Accordingly, OCC believes that the proposed changes would increase the efficiency, accuracy, and resiliency of OCC's cash settlement process while eliminating certain risks inherent in both having Clearing Banks using different systems that employ manual processes. In addition, OCC states that the changes would adopt communication procedures and standards that are internationally accepted and therefore are consistent with the requirements in Rule 17Ad-22(e)(22) under the Exchange Act.<sup>15</sup>

B. Proposed Changes to CSPA

The CSPA is the principal form of agreement that: (i) governs the rights and responsibilities of OCC and each Clearing Bank, (ii) details operational procedures (including backup procedures) and security protocols, and (iii) identifies individuals at OCC and at the Clearing Bank who are authorized to act on behalf of each party with respect to cash settlement instructions. According to OCC, the CSPAs currently in effect between OCC and its Clearing Banks were implemented over many years as OCC's operations expanded and it became appropriate to maintain service agreements with a range of Clearing Banks. In addition, many of OCC's CSPAs have not been renegotiated in a long time. Accordingly, OCC states that there are

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<sup>14</sup> If a Clearing Bank fails to accept the settlement instructions, OCC would follow up with the Clearing Bank to determine the reason no acceptance was provided and to coordinate with the Clearing Bank that appropriate action is taken with respect to the instructions.

<sup>15</sup> 17 CFR 240.17Ad-22(e)(22).

substantial deviations among some of the terms and conditions of the respective CSPAs and the corresponding Clearing Bank practices.

As a part of the transition to SWIFT, Clearing Banks would enter into new CSPAs with OCC. Each CSPA would be based on a standardized template developed by OCC in collaboration with its Clearing Banks. Each CSPA would establish various deadlines for OCC and the Clearing Bank as well as backup procedures.<sup>16</sup> OCC believes that the renegotiation of the CSPAs with the Clearing Banks to accommodate the adoption of the SWIFT messaging network as the primary process to support daily cash settlement also would allow the agreements to be updated to ensure their uniform compliance with the requirements in Rule 17Ad-22(e)(22).<sup>17</sup>

### **III. DISCUSSION AND COMMISSION FINDINGS**

Although the Payment, Clearing and Settlement Supervision Act of 2010 (“Act”) does not specify a standard of review for an advance notice, the stated purpose of the Act is instructive.<sup>18</sup> The stated purpose of the Act is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs and strengthening the liquidity of SIFMUs.<sup>19</sup>

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<sup>16</sup> A key change is that Clearing Banks would not be deemed to have accepted settlement instructions in the absence of a communication.

<sup>17</sup> 17 CFR 240.17Ad-22(e)(22).

<sup>18</sup> See 12 U.S.C. 5461(b).

<sup>19</sup> Id.

Section 805(a)(2) of the Act<sup>20</sup> authorizes the Commission to prescribe regulations containing risk-management standards for the payment, clearing, and settlement activities of designated clearing entities engaged in designated activities for which the Commission is the supervisory agency. Section 805(b) of the Act<sup>21</sup> provides the following objectives and principles for the Commission’s risk-management standards prescribed under Section 805(a):

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

Section 805(c) provides, in addition, that the Commission’s risk-management standards may address such areas as risk-management and default policies and procedures, among others areas.<sup>22</sup>

The Commission has adopted risk-management standards under Section 805(a)(2) of the Act and the Exchange Act (the “Clearing Agency Rules”).<sup>23</sup> The Clearing Agency Rules require

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<sup>20</sup> 12 U.S.C. 5464(a)(2).

<sup>21</sup> 12 U.S.C. 5464(b).

<sup>22</sup> 12 U.S.C. 5464(c).

<sup>23</sup> 17 CFR 240.17Ad-22. See Securities Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11). See also Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786 (October 13, 2016) (S7-03-14) (“Covered Clearing Agency Standards”). The Commission established an effective date of December 12, 2016, and a compliance date of April 11, 2017, for the Covered Clearing Agency Standards. On March 4, 2017, the Commission granted covered clearing agencies a temporary exemption from compliance with Rule 17Ad-22(e)(3)(ii) and certain requirements in Rules 17Ad-22(e)(15)(i) and (ii) until December 31, 2017, subject to certain conditions. OCC is a “covered clearing agency” as defined in Rule

each covered clearing agency, among other things, to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for operations and risk-management practices on an ongoing basis. As such, it is appropriate for the Commission to review advance notices for consistency with the objectives and principles for risk-management standards described in Section 805(b) of the Act and the Clearing Agency Rules.

*A. Consistency with Section 805(b) of the Payment, Clearing and Settlement Supervision Act*

The Commission believes each proposal in OCC's Advance Notice is consistent with promoting robust risk management, promoting safety and soundness, reducing systemic risks, and supporting the stability of the broader financial system, the stated objectives and principles of Section 805(b) of the Act.<sup>24</sup>

First, the Commission believes that OCC's proposal to implement the SWIFT messaging network as the primary means of transmitting cash settlement instructions between OCC and each Clearing Bank is consistent with promoting safety and soundness. The Commission agrees with OCC's analysis that usage of the SWIFT messaging network would mitigate risks that arise in the existing cash settlement process due to manual processing steps and inconsistent practices across OCC's Clearing Banks. By having an automated and standardized process that sends automatic messages without requiring Clearing Bank staff members to log into OCS to manually accept or reject settlement instructions, the Commission further believes the proposal would enhance the resiliency, efficiency, and consistency of OCC's cash settlement process. The

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17Ad-22(a)(5).

<sup>24</sup> 12 U.S.C. 5464(b).

Commission therefore believes this specific proposal is consistent with promoting safety and soundness.

Second, the Commission believes that OCC's proposal to update, enhance and standardize a uniform set of CSPAs between OCC and each Clearing Bank would promote robust risk management. Specifically, the Commission believes that this proposal will reduce the risk of settlement delay or error that may arise due to each Clearing Bank operating according to disparate CSPA terms and requirements. The Commission therefore believes this specific proposal is consistent with promoting robust risk management.

Consistent with the conclusions discussed above, the Commission also believes that OCC's proposal is consistent with supporting the broader stability of the financial system. Specifically, the Commission believes that promoting the prompt and accurate messaging between OCC and the Clearing Banks would promote safety and soundness of both OCC and Clearing Banks. The reduction in errors and delays arising from the proposed implementation of SWIFT and more harmonized CSPAs would also enhance the reliability and resilience of OCC's cash settlement process for Clearing Members, thereby decreasing systemic risks. Accordingly, the proposed changes would support the stability of the broader financial system. Thus, the Commission believes that the proposals contained in the Advance Notice are consistent with the stated objectives and principles of Section 805(b) of the Act.

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

The Commission further believes that OCC's proposals in the Advance Notice are consistent with the Covered Clearing Agency Standards, specifically Rule 17Ad-22(e)(22) under

the Exchange Act.<sup>25</sup> Rule 17Ad-22(e)(22) 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.”<sup>26</sup> In adopting this requirement, the Commission stated that, “[r]elevant internationally accepted communication procedures and standards could include messaging standards such as SWIFT, FIX and FpML.”<sup>27</sup> Accordingly, the Commission believes that the proposals to expand the usage of the SWIFT messaging network and standardize the CSPAs with each Clearing Bank pursuant to the SWIFT messaging network implementation are consistent with Rule 17Ad-22(e)(22) under the Exchange Act.

#### **IV. CONCLUSION**

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(G) of the Payment, Clearing and Settlement Supervision Act,<sup>28</sup> that the Commission DOES NOT OBJECT to Advance Notice (SR-OCC-2017-805) and that OCC is AUTHORIZED to implement the proposed change.

By the Commission.

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<sup>25</sup> 17 CFR 240.17Ad-22(e)(22).

<sup>26</sup> Id.

<sup>27</sup> Securities Exchange Act Release No. 78961 (September 28, 2016), 81 FR 70786, 70842 at n. 510 (October 13, 2016).

<sup>28</sup> 12 U.S.C. 5465(e)(1)(G).

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