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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-90464; File No. SR-OCC-2020-011]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change to Adopt a New Second Amended and Restated Cross-Margining Agreement Between The Options Clearing Corporation and The Chicago Mercantile Exchange

November 19, 2020

I. INTRODUCTION

On September 22, 2020, the Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2020-011 (“Proposed Rule Change”) pursuant to Section 19(b) of the Securities Exchange Act of 1934 (“Exchange Act”)¹ and Rule 19b-4² thereunder to provide OCC with express authority to adopt a new Second Amended and Restated Cross-Margining Agreement (“Proposed X-M Agreement”) between OCC and the Chicago Mercantile Exchange (“CME”).³ The Proposed Rule Change was published for public comment in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Notice of Filing *infra* note 4, 85 FR at 63305.

the *Federal Register* on October 7, 2020.⁴ The Commission has received no comments regarding the Proposed Rule Change. This order approves the Proposed Rule Change.

II. BACKGROUND

OCC and CME are parties to an Amended and Restated Cross-Margining Agreement dated May 28, 2008, as further amended by Amendment No. 1 dated October 23, 2008⁵ and Amendment No. 2 dated May 20, 2009⁶ (the “Existing X-M Agreement”). OCC and CME first implemented their cross-margining program (the “X-M Program”) in 1989. The purpose of the X-M Program is to: (1) facilitate the cross-margining of positions in options cleared by OCC with positions in futures and commodity options cleared by CME and (2) address the fact that Clearing Members may have been required to meet higher margin requirements at each clearinghouse than were warranted by the risk of combined positions, because each portfolio was margined separately without regard to positions held in the other portfolio.⁷

According to OCC, the Proposed X-M Agreement is designed to improve the clarity and readability by consolidating certain redundant provisions and moving certain

⁴ Securities Exchange Act Release No. 90065 (Oct. 1, 2020), 85 FR 63305 (Oct. 7, 2020) (File No. SR-OCC-2020-011) (“Notice of Filing”).

⁵ Securities Exchange Act Release No. 58258 (Jul. 30, 2008), 73 FR 46133 (Aug. 7, 2008) (File No. SR-OCC-2008-12) (amending the agreement to, among other things, permit money market fund shares as margin).

⁶ Securities Exchange Act Release No. 60063 (Jun. 8, 2009), 74 FR 28738 (Jun. 17, 2009) (File No. SR-OCC-2009-10) (amending the agreement to redefine the term “Eligible Contracts” and deleting the list of such contracts attached as Schedule A).

⁷ Securities Exchange Act Release Nos. 26607 (Mar. 7, 1989), 48 FR 10608 (Mar. 14, 1989) (File No. SR-OCC-89-1); 27296 (Sep. 26, 1989) (File No. SR-OCC-89-11).

operational details from the Existing X-M Agreement to a standalone service level agreement (“SLA”).⁸ OCC has also characterized the proposed updates to the Existing X-M Agreement as bringing it into conformity with current operational procedures and eliminating provisions that are out of date.⁹ Finally, according to OCC, the Proposed Rule Change is designed to streamline and consolidate certain related Clearing Member Agreements.¹⁰

Creation of a Separate Service Level Agreement

OCC proposes moving certain operational details from the Existing X-M Agreement to the new SLA, including: (1) Section 6 of the Existing X-M Agreement, which covers acceptable forms of collateral; (2) Section 7 of the Existing X-M Agreement, which covers the timing, methods, and forms of daily settlement in the Cross-Margining accounts; and (3) Section 15 of Existing X-M Agreement, which covers OCC and CME’s information-sharing regarding Joint and Affiliated Clearing Members, banks, and their financial status.

The other changes to the Existing X-M Agreement that OCC proposes may be considered in two broad categories. The first category is modifications to conform the terms of the agreement to existing practices. The second category is modifications to the X-M Program (i.e., changes to both the Existing X-M Agreement and related processes) designed to improve existing practices.

Changes Conforming to Existing Practices

⁸ See Notice of Filing, 85 FR at 63306.

⁹ Id.

¹⁰ Id.

The first category, modifications to conform the terms of the agreement to existing practices, includes various new or updated definitions: (1) the newly-defined terms “FSOC,” “Dodd Frank Act,” “DCO,” “Exchange Act,” and “SEC” to reflect OCC and CME’s registration statuses and designations as systemically important by the Financial Stability Oversight Counsel;¹¹ (2) “Eligible Contracts,” to conform with the substance of the definition that was adopted in 2009 as part of Amendment No. 2 to the Existing X-M Agreement, by including any contracts that have been “jointly designated” by OCC and CME as eligible for inclusion in the list of eligible contracts jointly maintained by OCC and CME; (3) “Accepted Transaction,” to provide certainty and clarity regarding the specific transactions for which OCC and CME would be jointly responsible, and would include all positions that are Eligible Contracts and have been included on the “daily margin detail report” generated by OCC and transmitted to CME; (4) added and updated terms to describe the accounts related to the X-M Program and their purpose more accurately, including “Proprietary Joint Margin Cash Account” (in place of “Proprietary Joint Margin Account”), “Segregated Joint Margin Cash Account” (in place of “Segregated Joint Margin Account”), “Proprietary Joint Margin Custody Account” (in place of “Proprietary Joint Custody Account”), “Segregated Joint Margin Custody Account” (in place of “Segregated Joint Custody Account”), “Proprietary Bank Account,” “Segregated Funds Bank Account,” and “Liquidating Accounts;” (5) updated terminology to more accurately characterize the margin requirement set by OCC’s

¹¹ See Financial Stability Oversight Council (“FSOC”) 2012 Annual Report, Appendix A, available at <https://www.treasury.gov/initiatives/fsoc/Documents/2012%20Annual%20Report.pdf>.

System for Theoretical Analysis and Numerical Simulations (“STANS”), such as “Posted Collateral” (in place of “Margin” and “Initial Margin”) and the terms “Collateral Requirement,” “Collateral Deficit,” and “Collateral Excess” to replace references to margin requirements and deficits or surpluses in respect to such requirements; and (6) defined terms that are already used and defined elsewhere in the Existing X-M Agreement but that are not currently listed in Section 1, including the defined terms “AAA,” “Affiliated Clearing Member,” “CME Clearing Member,” “CME Rules,” “Confidential Information,” “Indemnitor,” “Indemnified Party,” “Losses,” “OCC Clearing Member,” and “OCC Rules.”

The non-definitional changes or additions reflecting already-existing practices include the following: (1) removing references to X-M Pledge Accounts and Section 3 of the Existing X-M Agreement, entitled “Establishment of X-M Pledge Accounts,” as these accounts are no longer in use; (2) revising Section 5 of the Existing X-M Agreement to reflect that the amount of collateral to be deposited with regard to an X-M Account would be determined using OCC’s approved margin methodology, because CME already elects to use the margin requirements calculated by OCC; (3) stating that OCC and CME would each be permitted to invest any cash deposited as collateral in their joint margin cash accounts overnight in certain eligible investments and with certain custodians, depositories, and counterparties, as OCC and CME may mutually agree, with each clearinghouse sharing equally in any proceeds received or losses incurred from such overnight investments, to formalize the existing practice of equally sharing proceeds or losses from the investment of X-M cash margin; (4) modifying Section 7 and the relevant definitions in Section 1 to reflect that the “Margin and Settlement Report” would become

the “Account Summary by Clearing Corporation Report” provided by OCC to Clearing Members, as only OCC has provided the current Margin and Settlement Report to Clearing Members in practice; (5) revising Section 8 of the X-M Agreement to clarify that each clearinghouse will follow its own rules for the default of a Clearing Member, while using best efforts to coordinate with the other clearinghouse regarding liquidation or transfer of accepted transactions; (6) clarifying the requirement that one clearinghouse must notify the other when subjected to a court order to disclose confidential information, only to the extent permitted by law; (7) clarifying that while OCC and CME are not permitted to reject any transaction effected in an X-M Account without the other’s express consent, this condition would not interfere with their respective abilities to implement recovery and orderly wind-down plans under their own rules; (8) adding electronic mail and removing facsimiles as acceptable forms of communication for notice requirements, in conformance with current communication standards; and (9) adding Section 17 to clarify that each clearinghouse is responsible for obtaining its own regulatory approval in connection with the implementation of the Proposed X-M Agreement.

Changes to the X-M Program

The second category, modifications to the X-M Program (i.e., changes to both the Existing X-M Agreement and related processes), includes the following updated definitions: (1) “Losses,” which is revised to include claims and other potential loss events; (2) “Affiliate,” which is revised to no longer state that 10% ownership of common stock would be deemed *prima facie* control of that entity for purposes of determining whether an entity is under direct or indirect control of a Clearing Member,

but rather that the clearinghouses would make a facts-and-circumstances determination; and (3) “Business Day,” which is revised to state that when one or more markets on which cleared contracts trade are closed but banks are open, OCC and CME would each make their own determination regarding whether and to what extent to treat any such day as a Business Day for purposes of Section 7 of the Proposed X-M Agreement regarding daily settlements.

The non-definitional modifications to the cross-margining arrangement include the following: (1) in Section 5 of the Proposed X-M Agreement, adding a requirement for OCC to provide 30 calendar days’ prior notice to CME of any proposed changes to OCC’s margin methodology, and any changes to the way collateral requirements are calculated with respect to X-M Accounts would be required to be agreed upon in writing in advance by OCC and CME; (2) in Section 5, requiring OCC and CME to each determine net amount of premiums, exercise settlement amounts, and variation margin due for its respective products (newly defined as “Net Pay/Collect”) because the determination is made based upon the products cleared by OCC and CME, and to notify each other of the Net Pay/Collect amount in accordance with the SLA; (3) to the extent the two clearinghouses impose different concentration limits for eligible margin, requiring the use of the more conservative limits; (4) amending Section 7 to permit 30 minutes, rather than 15 minutes, for OCC and CME to approve or disapprove of revised Settlement Instructions to all for a full review of such instructions, to provide additional time during the process of performing a full review of such instructions; (5) amending Section 7 to provide for the communication of intra-day instructions to X-M clearing banks to facilitate the deposit of collateral in response to an intra-day margin call from

CME or OCC, and amending Section 1 to include the term “Intra-day Instruction;” (6) amending Section 8 to include new language regarding the manner in which OCC and CME would prepare for and manage a Clearing Member default, including the establishment of liquidation plan for the transfer or liquidation of the Clearing Member’s Accepted Transactions, the execution of liquidity agreements to ensure that the clearinghouses can obtain liquidity during a default scenario and will be jointly and equally responsible for providing liquidity, the potential use of a joint liquidating auction with respect to X-M Accounts during a Clearing Member default scenario, and joint default management testing for the X-M accounts at least annually; (7) amending Section 13 to change the process and timing related to termination of the agreement because OCC and CME believe the revised language would reduce risk in the event of a termination;¹² and (8) streamlining and consolidating six current Clearing Member template agreements into three templates, so that Joint Clearing Members and Affiliated Clearing Members would use the same template agreement for the appropriate account type (i.e., proprietary, non-proprietary, or market professional).

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.¹³ After carefully considering the Proposed Rule Change, the Commission finds that the proposal is consistent with the

¹² See Notice of Filing, 85 FR at 63310.

¹³ 15 U.S.C. 78s(b)(2)(C).

requirements of the Exchange Act and the rules and regulations thereunder applicable to OCC. More specifically, the Commission finds that the proposal is consistent with Section 17A(b)(3)(F) of the Exchange Act¹⁴ and Rules 17Ad-22(e)(20) and (13) thereunder.¹⁵

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

Section 17A(b)(3)(F) of the Exchange Act requires, among other things, that the rules of a clearing agency be designed to remove impediments to and help perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions; and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.¹⁶ Based on its review of the record, and for the reasons described below, the Commission believes that the rule proposal as described above is consistent with the requirements of Section 17A(b)(3)(F).

The Commission continues to view cross-margining programs as consistent with clearing agency responsibilities under Section 17A of the Exchange Act. Cross-margining programs enhance clearing member liquidity and systemic liquidity both in times of normal trading and in times of market stress by reducing margin requirements for clearing members, which could prove crucial in maintaining Clearing Member liquidity during periods of market volatility, and enhancing market liquidity as a whole. By enhancing market liquidity, cross-margining arrangements remove impediments to and help perfect the mechanism of a national system for the prompt and accurate

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

¹⁵ 17 CFR 240.17Ad-22(e)(20) and 17 CFR 240.17Ad-22(e)(13).

¹⁶ 15 U.S.C. 78q-1(b)(3)(F).

clearance and settlement of securities transactions.¹⁷

The Commission believes that the proposed updates to the Existing X-M Agreement to conform to current practices provide additional clarity and certainty around the X-M Program to the relevant clearance and settlement topics, including the determination of the collateral requirement for the X-M Program, daily settlement, and suspension and liquidation. For example, replacing “Margin” or “Initial Margin” with “Posted Collateral” clarifies that STANS is the methodology used to determine the collateral requirement for the X-M Program and does not produce a separate initial margin requirement. This conforming change ensures that both clearinghouses are like-minded regarding the characterization of the margin requirement. Similarly, by updating the agreement to reflect that the amount of collateral to be deposited with regard to an X-M Account would be determined using OCC’s margin methodology, the change confirms the already-existing practice of CME using OCC’s margin calculation. Moreover, the proposed streamlining and consolidation of the Clearing Member Agreements would provide Joint Clearing Members and Affiliated Clearing Members with additional clarity with respect to the X-M Program. Reducing the number of available templates from six to three by having both Joint Clearing Members and Affiliated Clearing Members use the same three templates eliminates redundancy and makes the preparation of Clearing Member Agreements more efficient. In this manner, the proposed changes to conform the terms of the Existing X-M Agreement to already-existing practices and to consolidate the Clearing Member Agreements would be consistent with the removal of impediments

¹⁷ Securities Exchange Act Release No. 38584 (May 8, 1997), 62 FR 26602, 26604-05 (May 14, 1997) (File No. SR-OCC-97-04) (establishing a cross-margining agreement with OCC, CME, and the Commodity Clearing Corporation).

to and help perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions.

The Commission believes that the Proposed Rule Change is also consistent with the fostering of cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. Based on a review of the documents provided by OCC, the Commission believes that the SLA presents operational details, such as those related to daily settlement procedures, more clearly than the Existing X-M Agreement. By moving Sections 6, 7, and 15 of the Existing X-M Agreement to a separate and newly-created SLA, OCC will be able to modify specific terms regarding forms of collateral, daily settlement, and information-sharing provisions without having to modify the language of the Proposed X-M Agreement. The Commission believes that clarifying operational details and reducing the cost of updating such details would foster cooperation and coordination between OCC and CME.

Similarly, the proposed changes to the X-M Program reflected in the Proposed X-M Agreement would modify certain program details that would augment the existing cooperation and coordination between OCC and CME. For example, OCC has proposed to amend Section 7 to facilitate the deposit of collateral in response to an intra-day margin call from CME or OCC by providing for the communication of intra-day instructions to X-M clearing banks with respect to the X-M Account. The non-definitional modifications that are new to the X-M Program would also serve to enhance the already existing cooperation between the two clearinghouses. For example, the proposed addition of the 30-calendar day notice period for changes to OCC's margin methodology would provide CME with additional time to understand and address the

implications of the methodology changes. The Commission believes, therefore, that the proposed changes to the X-M Program reflected in the Proposed X-M Agreement would be consistent with the fostering of cooperation and coordination between OCC and CME in the settlement of securities transactions.

For the above reasons, the Commission believes that the Proposed Rule Change is designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts and transactions; and to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions. The Commission believes, therefore, that the Proposed Rule Change is consistent with the requirements of Section 17A(b)(3)(F) of the Exchange Act.¹⁸

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

Rule 17Ad-22(e)(20) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to identify, monitor, and manage risks related to any link the covered clearing agency establishes with one or more other clearing agencies, financial market utilities, or trading markets.¹⁹

One of the primary objectives of the Proposed Rule Change is to update the Existing X-M Agreement to bring it into conformity with current operational procedures

¹⁸ 15 U.S.C. 78q-1(b)(3)(F).

¹⁹ 17 CFR 240.17Ad-22(e)(20). For the purposes of Rule 17Ad-22(e)(20), the Commission defines a link, in part, as a set of contractual and operational arrangements between two clearing agencies that connect them for the purpose of cross-margining. 17 CFR 240.17Ad-22(a)(8).

and eliminate provisions that are out of date. Updating the terms of the X-M Program to reflect existing operational procedures ensures that the two clearinghouses may incorporate the latest considerations and any resulting updated practices for identifying, monitoring, and managing risks associated with the link between OCC and CME. Moreover, the Proposed Rule Change also includes changes to the Existing X-M Agreement to reflect changes in the X-M Program. Regardless of whether the additions or changes in the Proposed X-M Agreement conform to already-existing practices or if they are new to the X-M Program, the terms of the Proposed X-M Agreement are, as discussed above, clearer than those in the Existing X-M Agreement. This greater clarity serves to reduce risk related to the link between the two clearinghouses; specifically, the increased clarity reduces potential operational risks by promoting a common understanding between the two clearinghouses of the terms governing the X-M Program.

Further, the transfer of certain sections of the Existing X-M Agreement to a separate SLA would streamline the Proposed X-M Agreement and more clearly present operational details, such as those related to daily settlement procedures. The clearinghouses would also have the ability to review the service level details separately and modify them without requiring changes to the full agreement. Simplifying the presentation and maintenance of such operational details would serve to reduce risks associated with the link between OCC and CME.

The Commission believes, therefore, that the Proposed Rule Change is consistent with the requirements of Rule 17Ad-22(e)(20) under the Exchange Act.

C. Consistency with Rule 17Ad-22(e)(13) under the Exchange Act

Rule 17Ad-22(e)(13) under the Exchange Act requires that a covered clearing agency establish, implement, maintain, and enforce written policies and procedures

reasonably designed to ensure the covered clearing agency has the authority and operational capacity to take timely action to contain losses and liquidity demands and continue to meet its obligations by, at a minimum, requiring the covered clearing agency's participants to participate in the testing and review of its default procedures at least annually.²⁰ In recognizing that there may be a number of ways to address compliance with Rule 17Ad-22(e)(13), the Commission has stated that a covered clearing agency generally should consider, when establishing and maintaining policies and procedures that address participant-default rules and procedures: (1) whether it involves its participants and other stakeholders in the testing and review of its default procedures; and (2) whether such testing and review is conducted at least annually or following material changes to the rules and procedures to ensure that the testing and review are practical and effective.²¹

The Proposed X-M Agreement would require OCC and CME to conduct joint default management drills for the cross-margin accounts at least annually. The Commission believes that the adoption of rules requiring such joint default management tests on an at-least-annual basis is consistent with the involvement of stakeholders in default management testing as well as ensuring that such tests are conducted at least annually.

The Commission believes, therefore, that the Proposed Rule Change is consistent with the requirements of Rule 17Ad -22(e)(13) under the Exchange Act.

²⁰ 17 CFR 240.17Ad-22(e)(13).

²¹ See Securities Exchange Act Release 78961, 81 FR 70786, 70830 (Oct. 13, 2016) (File No. S7-03-14).

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 Act²² and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Exchange Act,²³ that the Proposed Rule Change (SR-OCC-2020-011) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁴

J. Matthew DeLesDernier,

Assistant Secretary.

[FR Doc. 2020-26012 Filed: 11/24/2020 8:45 am; Publication Date: 11/25/2020]

²² 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).

²³ 15 U.S.C. 78s(b)(2).

²⁴ 17 CFR 200.30-3(a)(12).