



Date: February 16, 2023

Subject: Proposed Changes to OCC's Clearing Membership Standards

The Options Clearing Corporation ("OCC") reviewed its existing clearing membership standards and determined it was necessary to amend certain provisions in OCC's By-Laws and Rules to enhance OCC's risk mitigation processes and comprehensively address heightened expectations around financial, operational and systems/data obligations. Please refer to the [proposed rule filing](#) for a detailed description of the changes.

The following is a summary of changes applicable to Clearing Members:

- ☐ Expanding the list of institutions that may be eligible for membership as a Clearing Member
- ☐ Amending the financial responsibility standards
- ☐ Streamlining the admissions process
- ☐ Amending Clearing Member staffing requirements
- ☐ Amending operational capability standards
- ☐ Amending the event-based and periodic reporting requirements for Clearing Members
- ☐ Revising the process by which OCC reviews a notification that a Clearing Member is subject to statutory disqualification
- ☐ Updating the minor rule violation disciplinary process
- ☐ Relocating provisions from OCC's By-Laws to OCC's Rules, and reorganizing OCC's Rules to increase efficiency and effectiveness

All clearing membership standards have been relocated from OCC's By-Laws and consolidated into OCC's Rules. As a result of these changes, rule numbers have also been modified. A summary of the proposed changes is described below.

Please note that upon SEC approval, Clearing Members and applicants must be in compliance with these rules. Upon approval by the SEC, OCC will provide a six-month grace period for Clearing Members to meet the financial responsibility standards outlined in the proposed changes.

List of Institutions Eligible for Clearing Membership (Rule 201)

- ☐ OCC will be expanding the list of eligible institutions for clearing membership to include certain banks including:
 - ☐ a U.S. national bank registered with the Office of the Comptroller of the Currency for full-service operations.
 - ☐ a U.S. state-chartered bank that is a member of the Federal Reserve System.

- a similar non-U.S. bank registered with its home country national regulatory authority that conducts its activity with OCC through a Federal or State Branch or Agency located in the United States.
 - Approved banks will only be allowed to clear products on a proprietary basis.
 - See proposed rule for specific requirements associated with bank clearing membership.
- OCC may admit Clearing Members which are domiciled outside of the U.S. and Canada from foreign jurisdictions which have been approved by OCC's Board Risk Committee.
 - After a bank or securities firm domiciled in the U.K., Germany, or France submits a Pre-qualification Application for clearing membership, OCC will begin a Jurisdiction Review.
 - OCC will consider expansion of the list of approved foreign jurisdictions after these jurisdictions have been reviewed by the OCC Board Risk Committee.
 - Non-U.S. Clearing Members must have effective operational, financial reporting, and risk management staff, with all communications (oral or written) requested by OCC in English, and to state monetary amounts in U.S. dollar equivalents indicating the conversion rate and date used.
 - See proposed rule for specific requirements associated with Non-U.S. Securities Firm clearing membership.
- Non-U.S. Clearing Members may participate in the Market Loan program. (Rule 302)
 - Canadian Clearing Members must maintain a sub-account in a CDS Clearing and Depository Services Inc. account at DTC and be a subscriber to Loan Market with full access and services while maintaining an agreement with DTC to honor securities lending instructions from OCC.

Financial Responsibility Standards

Clearing Members will be provided six months from SEC approval of the rule filing to become compliant with financial responsibility standards for minimum Net Capital Requirements, Net Capital Early Warning Thresholds, and Risk-Adjusted Capital Standards.

- U.S. Clearing Members are required to meet an initial and ongoing minimum net capital requirement of **\$10 million USD and standard minimum regulatory ratio standards**. (Rule 301)
 - OCC conducted analysis over the past several years taking into consideration the changes in market structure, enhanced risk management processes, and impact to the current clearing membership. OCC is raising Clearing Member net capital requirements to ensure Clearing Members maintain the financial ability to meet obligations arising from conducting business at OCC. OCC will be working directly with Clearing Members impacted by the higher minimum.
- U.S. Clearing Members will be monitored against a Net Capital Early Warning Threshold of **\$12 million USD**. (Rule 306)
 - In conjunction with the rise in minimum net capital requirement, OCC is raising the Net Capital Early Warning Threshold to \$12 million USD. Clearing Members must notify OCC by next day, prior to 3:00 pm CT (4:00 pm ET), of a Net Capital Early Warning Threshold breach.
- Canadian Clearing Members will be required to meet **Risk-Adjusted Capital Standards**. (Rule 301)
 - This standard has been enhanced from Early Warning Reserve Standards to ensure the Clearing Member maintains the financial ability to meet obligations arising from conducting business at OCC.
- The concept of Appointing and Appointed Clearing Members will remain in OCC's rules, but they will no longer be a distinct "membership type." Any Clearing Member serving in an Appointed Clearing Member capacity will be subject to the same minimum capital requirements as all other Clearing Members (i.e., \$10 million). (Rule 301).
- Capital Distribution Changes (Rule 307A)

- o OCC will have the ability to restrict capital distributions if a Clearing Member is subject to enhanced surveillance per OCC's internal monitoring process or if the distribution would result in increased liquidity risk to OCC. This ensures a Clearing Member maintains sufficient capital to meet obligations at OCC.
- o If a Clearing Member's capital disbursement would subject it to OCC's enhanced monitoring or cause a breach in early warning capital requirement, the Clearing Member will be required to request prior written authorization from OCC.

Streamlining the Admissions Process (Rule 203)

- OCC's Board Risk Committee is responsible for approving or disapproving applications for clearing membership.
 - o This is a change from the current process which allows for delegation of authority to the CEO or COO.
 - o An applicant can be approved on an expedited basis under limited circumstances for the protection of investors and the public interest.
- The proposal allows business expansions for additional products or account types to be approved by the CEO or COO.
 - o The Board Risk Committee will be notified 10 business days in advance of any approval/disapproval to determine if it should be reviewed by the Board Risk Committee.
- Upon clearing membership approval, OCC has increased the time to activate membership from six to nine months unless an earlier date was prescribed at the time of approval. No extensions to this deadline will be permitted.

Clearing Member Staffing Requirements (Rule 303)

- Clearing Members can outsource back-office services for business activities conducted with OCC, such as balancing and trade reconciliation, to a non-member firm but must notify OCC of the arrangement upon initiation, revision, and termination. This removes OCC's Facilities Management Agreement ("FMA") requirement and associated "membership types" in current Rule 309, including the higher net capital requirement imposed on a Managing Clearing Member.
 - o The Clearing Member is required to maintain supervisory responsibility of the outsourced services at all times.
 - o Proposed arrangements must:
 - Describe services performed by the third-party.
 - Indicate the agreement will not be terminated until 30 days after written notice of such termination is provided by the Clearing Member to OCC.
 - Provide OCC with the authority and ability to perform initial and ongoing due diligence on the service provider.
 - o OCC will be working with Clearing Members impacted by this change to ensure the member has provided details to OCC with regard to the utilization of outsourcing services in order to comply with this rule.
- The proposal eliminates the need for staffing waivers, staffing exemptions, and the limitation of having full-time and directly employed staff. OCC has recognized changes in the industry with regard to how Clearing Members staff certain positions which supervise OCC-related business activities.
 - o Clearing Members must maintain supervisory responsibility over indirectly employed and third-party personnel for all OCC-related functions.
 - o Prompt notification will be required for changes to indirectly employed or third-party personnel who conduct business with a Clearing Member of OCC.
 - o OCC will assist any Clearing Member who indirectly employs personnel or third-party personnel subject to a waiver of OCC's current rule to ensure that Clearing Member achieves compliance with this rule change.

- In the proposed rule, OCC further specifies the requirement for Clearing Members to maintain personnel who are responsible for compliance with net capital requirements, recordkeeping, and other financial, operational, and risk management rules.
 - U.S. broker-dealers must employ an individual registered as “Limited Principal – Financial and Operations” (“FINOP”).
 - U.S. futures commission merchants, Canadian Clearing Members, and banks must employ a Chief Financial Officer (“CFO”), or similar qualified associated person.
 - Non-U.S. Securities Firm Clearing Members must employ a CFO or similar, qualified associated person.
 - If any changes occur to the CFO/FINOP position of a member, prompt notification to OCC is required.
 - OCC will be working with Clearing Members who maintain a FINOP or CFO under a waiver to ensure the member has provided confirmation of who will continue to be the member’s FINOP/CFO.
- OCC is proposing the requirement for each Clearing Member to submit and maintain contact information for operational and risk management personnel, financial reporting, and other key staff in a form acceptable to OCC including names, titles, email addresses, and business phone numbers.
 - Clearing members must maintain an appropriate number of risk management staff in addition to existing standards for operational and financial reporting staff. All staff must be acceptable to OCC and sufficient to discharge their functions in a timely and efficient manner (including appropriate levels and hours).
 - If changes occur to member contact personnel, prompt notification to OCC must be made by next day 3:00 pm CT (4:00 pm ET).
 - OCC will be working with Clearing Members to obtain the contact information of the proposed, required personnel as well as confirming current contact information of operational, financial, and other key staff.

Operational Capability Standards

- In addition to requiring Clearing Members to participate in business continuity and default management testing, OCC is proposing to require Clearing Members participate in operational and connectivity testing, and provide related reporting deemed necessary by OCC when notified. (Rule 304).
 - OCC wants to ensure participation in business continuity testing, and other operational testing, to ensure connectivity and processing are uninterrupted.
 - OCC wants to ensure Clearing Members are aware of the default process and are educated on how to participate in a default auction.
- OCC will be retiring the use of stamps since transactions are submitted electronically.
- Clearing Members must maintain an alternate settlement arrangement. (Rule 301)
 - Currently, Clearing Members must have access to sufficient financial resources to meet obligations arising from clearing membership in extreme but plausible market conditions, and maintain adequate procedures, including but not limited to contingency funding. This rule was revised to clarify that contingency planning includes maintaining alternate settlement bank arrangements.

Event-Based and Periodic Reporting Requirements (Rule 306A and Rule 306B)

- Required Early Warning Notice reporting period has been shortened from 30 days to next day, prior to 3:00 pm CT (4:00 pm ET), if the member were to:
 - Experience operational difficulties or is non-compliant with operational capability requirements.

- o Provide any notice, written or other, from a regulatory organization informing the Clearing Member it has failed to be in compliance with financial responsibilities and net capital requirements.
- o Broker-dealer, futures commission merchant, Non-U.S. Securities Firm Clearing Members will be required to file an Early Warning Notice if it breaches the Net Capital Early Warning Threshold of \$12 million USD; or Bank member breaches \$600 million Tier 1 Capital or Tier 1 Capital Ratio of 7%.
- OCC has expanded the provision to provide next day, prior to 3:00 pm CT (4:00 pm ET), written notification of Material Changes to include:
 - o Change in location of clearing operations.
 - o New or revoked stock settlement relationship with another Clearing Member or CDS.
 - o Changes in the Clearing Member's independent public accountant.
 - o Changes in non-U.S. Clearing Member's regulatory capital standards.
 - o Current or hindsight customer reserve or customer segregation deficiencies.
 - o Changes in registration status or regulatory authorization.
 - o Current or hindsight net capital deficiencies.
 - o Changes in date for its fiscal year-end.
 - o If a Canadian Clearing Member participating in the Stock Loan/Hedge Program knows or reasonably expects that CDS will cease, or if CDS has ceased, to act on behalf of the Canadian Clearing Member with respect to effecting delivery orders for stock loan and stock borrow transactions.
- The monthly financial reporting rule for broker-dealers, futures commission merchants, Canadian investment dealers, and Non-U.S. Securities Firms has been standardized to the later of 20 OCC business days or the regulatory filing deadline. This is a change from the current deadlines of (a) 17 business days plus a four business day grace period for U.S. members, and (b) 30 calendar days for Canadian members.
- Clearing Members will be required to notify OCC within 30 days of its independent auditor providing a qualified opinion or material weakness with regard to internal control over financial reporting.

Statutory Disqualification (Rule 306A)

- The proposed rule requires notification to OCC within 20 days of a member's Statutory Disqualification rather than five days. A minor rule violation will be applied if OCC is not notified within 20 days of the Statutory Disqualification.
 - o Proposal will require the Clearing Member to provide to OCC regulatory notification, judgement, letter of acceptance, waiver and consent, or further evidence delineating cause of the of statutory disqualification as well as amended Form BD or response to a NFA Rule 504 Notice of Intent.
 - o Updated rule provides a process by which an applicant may not be approved when a Statutory Disqualification exists.

Protective Measures

- Under Rule 307, OCC has consolidated and updated its authority to impose restrictions and/or protective measures on a Clearing Member posing elevated risk to OCC including the following changes.
 - o Rule 307B allows OCC to impose restrictions on a Clearing Member with respect to prohibiting or limiting the ability to clear transactions; reduce, hedge or eliminate positions; transfer position and accounts to another Clearing Member; or restrict a Clearing Member's outsourced agreements.
 - o Rule 307C allows OCC to impose protective measures in the form of maintaining additional financial resources, operational, personnel, or risk management requirements.

Minor Rule Violation (Rule 1203)

- Modifications to the number of minor rule violations allowed within a 24-month period and the associated fines.
 - o Limit Clearing Members to two minor rule violations rather than three in a rolling 24-month period.
 - o The revised fine schedule is:
 - First rule violation - \$1,500
 - Second rule violation - \$2,500
 - o Fees associated with minor rule violations are due immediately upon notice, rather than within 5 days following the end of the calendar month.
- A disciplinary proceeding will be initiated for a third instance in the rolling 24-month period.

If you have questions or concerns regarding this memo, please contact your Credit Risk Analyst. Clearing Members may also e-mail: creditriskanalysts@theocc.com.

For Clearing Members which request further information with regard to outsourcing agreements, staffing arrangements, and the proposed notification requirements, please contact your Member Services Representative or email: memberservices@theocc.com.