THE FOUNDATION FOR SECURE MARKETS

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October 7, 2022

VIA CFTC PORTAL

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: RIN 3038-AF15 Governance Requirements for Derivatives Clearing Organizations

Dear Mr. Kirkpatrick:

The Options Clearing Corporation ("OCC") appreciates the opportunity to submit these comments on the above-reference proposal ("Proposal" or "Proposed Rules")[1] under the Commodity Exchange Act ("Exchange Act"). The Proposal would establish new requirements on derivatives clearing organizations ("DCOs") for risk management committee composition, the consultation process with the board and the risk management committee, and the role of risk advisory working groups.

Summary

OCC believes that robust and transparent governance arrangements with relevant stakeholder input is necessary for effective DCO risk management. Over the last several years, OCC has taken steps to help ensure its governance framework provides robust management oversight and sound corporate decision-making in consideration of diverse viewpoints representing relevant stakeholders and informed by independent judgment.

As such, we generally support the Commodity Futures Trading Commission's ("CFTC" or "Commission") objective of codifying clearing standards for DCO governance and ensuring that viewpoints of relevant stakeholders are considered as part of the DCO's governance process. We believe the Commission's stated objective can be achieved by adopting, with certain slight modifications detailed below, the provision of the Proposal that would impose requirements for the establishment of: (i) a risk management committee with which the board must consult according to written policies; (ii) one or more participant risk advisory groups with representation from a diverse cross-section of clearing members and their customers; (iii) fitness standards for risk management committee members; and (iv) policies designed to enable members of the risk management committee to provide independent, informed opinion on all matters presented to it.[2] However, as detailed below, we do not support the elements of the Proposal regarding: (i) documentation of the board's consideration of and response to risk management committee

[1] RIN 3038-AF15 Governance Requirements for Derivatives Clearing Organizations General Provisions and Core Principles (Jul. 29, 2022), 87 FR 49559 (Aug. 11, 2022).

[2] By way of example, OCC believes the Proposal's requirement for "expert" opinion should be revised to a requirement for "informed" opinion.

recommendations; (ii) mandatory inclusion of clearing member customers on the risk management committee; and (iii) mandatory rotation of the composition of the risk management committee. Our specific comments and request for clarification of the language and intent of certain of the Proposed Rules are provided in more detail below.

About OCC

OCC, founded in 1973, is the world's largest equity derivatives clearing organization. OCC operates under the jurisdiction of both the CFTC and the Securities and Exchange Commission ("SEC"). As a registered derivatives clearing organization ("DCO") under CFTC jurisdiction, OCC clears transactions in futures and options on futures. As a registered clearing agency under SEC jurisdiction, OCC clears transactions for exchange-listed options. OCC also provides central counterparty ("CCP") clearing and settlement services for securities lending transactions. In addition, OCC has been designated by the Financial Stability Oversight Council as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). As a SIFMU, OCC is also subject to oversight by the Board of Governors of the Federal Reserve System. OCC operates as a market utility and is owned by five exchanges.[3]

OCC is governed by a Board of Directors ("Board") that is composed of nine directors representing OCC participants ("Participant Directors"), five directors representing OCC's owners ("Owner Directors"), and no less than five directors who are not affiliated with any national securities exchange, national securities association, designated contract market, futures commission merchant, or broker or dealer in securities ("Public Directors").[4] The Board may also include one employee of OCC ("Management Director"). The Governance and Nominating Committee is responsible for evaluating the candidacy of all Participant Directors and Public Directors nominated[5] to the Board. In conducting its evaluation of candidates for the Board, the Governance and Nominating Committee will consider: (i) characteristics it deems essential for effectiveness as a director, including such factors as integrity, independence, objectivity, sound judgment, and leadership; (ii) relevant expertise and experience in the skillsets approved by the Board from time to time; (iii) board-level experience; (iv) industry affiliations; (v)the standards set forth in OCC's Fitness

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[3] OCC's owner exchanges are the Chicago Board Options Exchange, Inc., International Securities Exchange, LLC, NASDAQ OMX PHLX, LLC, NYSE MKT LLC, and NYSE Arca, Inc. The NYSE exchanges are owned by a common parent and the International Securities Exchange is owned by NASDAQ. As a result, ownership is essentially consolidated to three entities, though each owner exchange appoints one director to the Board.

[4] See Board of Directors and Corporate Governance Principles, available at https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf; and Fitness Standards for Directors, Clearing Members, and Others, *available at* https://www.theocc.com/getmedia/40ab0b06-5e8a-441e-97e3-fab85d3cfe0b/fitness_standards.pdf (last accessed October 7, 2022). "Public Directors" are defined as directors who "are not affiliated with any national securities exchange, national securities association, designated contract market, futures commission merchant, or broker or dealer in securities." References to "Public Directors" throughout this comment will be capitalized to distinguish them from "independent directors" as defined in the Proposal.

[5] Under OCC's By-Laws and Stockholders' Agreement, Owner Directors are appointed to the Board by the respective owner. As such, the Governance and Nominating Committee does not conduct an evaluation of these candidates before their join the Board, but the electing owner is required to consider OCC's Fitness Standards when making the appointment.

Standards for Directors, Clearing Members, and Others;[6] and (vi) education or other certifications. The Board also strives to ensure diversity of representation among its members. When considering candidates for the Board, the Governance and Nominating Committee reviews available information about the expertise, qualification, attributes, and skills of prospects, as well as their gender, race, ethnicity, and other diversity characteristics.

The Board maintains six standing committees: (i) Audit; (ii) Compensation and Performance; (iii) Governance and Nominating; (iv) Regulatory; (v) Risk; and (vi) Technology. Each of the standing committees of the Board is composed of directors of the Board, must be chaired by a Public Director, and has been explicitly delegated the oversight of specific risks by the Board.[7] OCC also maintains additional stakeholder venues to share information and solicit input from relevant stakeholders. One of these venues, the Financial Risk Advisory Council ("FRAC"),[8] is a forum for discussion of proposed financial risk management initiatives, including proposed changes related to models, stress testing, and backtesting, and default management testing results with participants and participants' customers. The Risk Committee charter codifies the feedback loop between the FRAC and the Board.[9] A more detailed explanation of OCC's current governance structure is provided in Appendix A.

Regulatory Context of the Proposal

The genesis for the Proposal was a series of recommendations made by the Central Counterparty (CCP) Risk and Governance Subcommittee ("Subcommittee") and approved by the Market Risk Advisory Committee ("MRAC")[10] on February 23, 2021.[11] These recommendations were themselves informed by recommendations for DCO governance requirements drafted by representatives of clearing members and end users.[12] After much discussion, the DCOs, clearing members, and end users on the Subcommittee and

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[6] See The Options Clearing Corporation: Fitness Standards for Directors, Clearing Members, and Others, *available at* https://www.theocc.com/getmedia/40ab0b06-5e8a-441e-97e3-fab85d3cfe0b/fitness_standards.pdf (last accessed October 7, 2022).

[7] The Board and all committee charters, each filed as rules with the Commission and the SEC, are available at: https://www.theocc.com/company-information/documents-and-archives/board-charters (last accessed October 7, 2022).

[8] As of September 22, 2022, representatives from thirty-two firms, comprised of twenty-four OCC participants, four customers of participants (i.e., market-making or proprietary trading firms), and four exchanges. Interested parties may contact OCC for participation in the FRAC.

[9] See OCC Risk Committee Charter. ("From time to time, the Committee may receive reports and guidance relating to financial risk issues from, among others, the OCC Financial Risk Advisory Council and, in the exercise of its fiduciary judgment, shall take such guidance into account in the performance of its functions and responsibilities.").

[10] The Market Risk Advisory Committee is a discretionary advisory committee established by the CFTC in accordance with the Federal Advisory Committee Act.

[11] MRAC CCP Risk and Governance Subcommittee, Recommendations on CCP Governance and Summary of Subcommittee Constituent Perspectives, *available at* https://www.cftc.gov/media/6201/MRAC_CCPRGS_RCCOG022321/download (last accessed October 7, 2022) ("MRAC Recommendations").

[12] See "A Path Forward for CCP Resilience, Recovery, and Resolution," *available at* https://www.jpmorgan.com/content/dam/jpm/cib/complex/content/news/a-path-forward-for-ccp-resilience-recovery-and-resolution/pdf-0.pdf (last accessed October 7, 2022). See also MRAC Recommendations ("Recommendations for improving DCOs' governance arrangements were initially drafted by a subset of MRAC

the MRAC as a whole agreed on the two primary recommendations: the establishment by each DCO of (i) a risk management committee and (ii) a risk management forum. The Subcommittee did not reach agreement on several other recommendations put forth by the clearing members and end users, a number of which have been incorporated for comment in the Proposal.

Because we believe the genesis of the MRAC Recommendations related primarily to DCOs with governance structures that differ from OCC's,[13] we believe it is important to emphasize the distinctions between OCC's governance structure and that of other DCOs. Unlike other DCOs, board-level "risk management committees" are an integral part of OCC's current governance framework, as are additional stakeholder venues for participants and their customers to provide meaningful feedback to OCC on critical risk management issues. For example, OCC's Risk Committee has responsibility delegated to it from the Board to assist the Board with overseeing OCC's financial, collateral, risk model, and third party risk management.[14] This Risk Committee – as all OCC Board Committees are – is composed of OCC directors, chaired by a Public Director, and is established as a rule of OCC under the Exchange Act and the Securities Exchange Act of 1934. Because it is a formal part of the OCC governance framework, the Board must consult with the Risk Committee on matters to which it has delegated oversight responsibility to that Committee. In fact, the governance model is premised on the notion that the Committee with delegated authority over the specific risk area will first evaluate a proposal that implicates that risk area and make a formal recommendation to the Board whether to approve the matter.

The SEC has also proposed[15] governance requirements for registered clearing agencies. While different than the Proposal in many respects, there are some common themes, including a proposed requirement for clearing agencies to maintain a risk management committee (i) with which the Board will consult, (ii) that is informed by independent opinion, and (iii) that includes representatives from stakeholders. As a dually regulated DCO and registered clearing agency that would be required to comply with both the Proposal and the SEC Proposal, we strongly encourage the Commission to collaborate with the SEC to avoid possible inconsistent interpretations and ensure DCO governance is both robust and efficient.

Proposed Rule 39.24(b)(11): Risk Management Committee Establishment, Consultation, and Composition

Proposed Rule 39.24(b)(11) would require a DCO to maintain governance arrangements that establish one

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members representing clearing members and end-users . . . ." OCC published its own white paper to further the dialogue on OCC governance titled "Optimizing Incentives, Resilience, and Stability in Central Counterparty Clearing: Perspectives on CCP Issues from a Utility Model Clearinghouse," available at https://www.theocc.com/getmedia/8583ada4-22fd-4f2a-a0de-1dd97d3a347f/GeneralUse_OCC_Whitepaper_Final-4_Sept22.pdf (last accessed October 7, 2022).

[13] See e.g., A Path Forward for CCP Resiliency, Recovery, and Resolution," *available at* https://www.jpmorgan.com/content/dam/jpm/cib/complex/content/news/a-path-forward-for-ccp-resilience-recovery-and-resolution/pdf-0.pdf (last accessed October 7, 2022) ("Together, these recommendations form a path forward to aligning incentives and enhancing financial stability through even stronger CCPs. Unlike most for-profit shareholders, most CCP owners bear only a small portion of the CCP's losses because the [default fund] and recovery tools available to a CCO serve to externalize a large portion of a CCP's losses to clearing members and end users. As a result, for-profit CCP incentives have the potential to be materially misaligned.").

[14] OCC Risk Committee Charter, *available at* https://www.theocc.com/getmedia/e71a4c1d-52dc-4c95-aeb1-98dab9159f41/risk_committee_charter.pdf (last accessed October 7, 2022).

[15] See Clearing Agency Governance and Conflicts of Interest, Securities Exchange Act Release No. 34-95431 (Aug. 8, 2022), 87 FR 51812 (Aug. 23, 2022).

or more risk management committee(s) and require a DCO's board of directors to consult with, and consider and respond to input from, its risk management committee(s) on all matters that could materially affect the risk profile of the DCO. Proposed Rule 39.24(b)(11)(i) would require the DCO to maintain written policies and procedures that describe the consultation process in detail and that include requirements for the DCO to document the board's consideration of and response to risk management committee input. Proposed Rule 39.24(b)(11)(ii) would require the risk management committee to include representations from clearing members and customers of clearing members, and Proposed Rule 39.24(b)(11)(iii) would require the membership of the risk management committee to rotate on a regular basis.

I. The Commission Should More Precisely Define the Proposed Risk Management Committee and its Role within the Governance Framework of a DCO

OCC supports a requirement that a DCO shall have one or more risk management committee(s) that considers all matters that could materially affect the risk profile of the DCO, including any material change to the DCO's margin model, default procedures, participation requirements, and risk monitoring practices. We note, however, that a DCO may decide to delegate oversight of risk management of certain risks to a committee with a name other than a "Risk Committee." For example, while OCC maintains a Board-level Risk Committee, the Board currently delegates oversight of compliance and legal risks to the Audit Committee[16] and oversight of information technology and security risks to the Technology Committee.[17] OCC requests the Commission clarify that the "risk management committee(s)" required by Proposed Rule 39.24(b)(11) need not be labeled a "risk management committee," and that as long as the body satisfies the composition requires of Proposed Rule 39.24(b)(11)(ii) and (iii) and the DCO maintains policies designed to enable the members of the body to provide independent, *informed* opinions on all matters presented to it as required by Proposed Rule 39.24(c)(3), the body qualifies as a "risk management committee" for purposes of Proposed Rule 39.24(b).

II. A Prescriptive Requirement that OCC's Board "Consult With" and "Respond" to Risk Management Committee(s) Input is Inconsistent with OCC's Governance Framework

OCC also shares the Commission's apparent view that the risk management committee's input should be solicited by the board, and the risk management committee's recommendation should be afforded appropriate weight when the board is considering a matter that the risk management committee also considered. For that reason, such a requirement is already a core tenet of our governance framework. However, OCC does not believe the Commission should adopt a requirement specifying the manner in which a board should be required to "respond to" risk management committee input or requiring a DCO to document the board's consideration of and response to the risk management committee input.

As stated above, OCC maintains several Board-level Committees that may qualify as "risk management committees" under the Proposed Rule. OCC's Board has delegated explicit authority to these Committees to act on behalf of the Board in several circumstances and has also delegated authority for these Committees to oversee the management of risks that align with the purpose of each such Committee.[18]

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[16] OCC Audit Committee Charter, *available at* https://www.theocc.com/getmedia/0a3ccbce-4481-42c5-86b1-8f44b50c0727/audit_committee_charter.pdf (last accessed October 7, 2022).

[17] OCC Technology Committee Charter, *available at* https://www.theocc.com/getmedia/aa0b642e-9032-4723-b819-26548d50e667/technology_committee_charter.pdf (last accessed October 7, 2022).

[18] For example, OCC's Risk Committee Charter states: "[t]he Board . . . has established a Risk Committee to assist the Board in overseeing OCC's financial, collateral, risk model, and third-party risk management processes."

Matters within the ambit of each of these Committees must be brought to the Committee for consideration and recommendation to the Board before they are proposed to the Board. Ordinarily, the chair of the Committee then gives the recommendation of the Committee to the Board, either in conjunction with a presentation of the matter to the Board or not, and the Board votes on the matter informed by the Committee's recommendation. While the minutes of the appropriate Committee will reflect the Committee's recommendation and the minutes of the Board meeting will reflect the Board's decision, neither will necessarily memorialize the Board's consideration of the Committee's recommendation, and the Board will not *issue a response* to the Committee. We believe this relationship between our Board and the Board-level Committees achieves the standard of governance that the CFTC seeks. We also believe that imposition of a prescriptive requirement that the Board "consult with" and "respond to" the recommendation of these Board-level Committees would cause OCC and any other DCOs with similar governance frameworks to create documentation and unwieldy processes intended solely to comply with the letter of the Proposed Rule when the inherent nature of the governance framework necessarily achieves its objective. Further, while we appreciate that the proposed requirement for Board consideration and response is based on a desire for the perspective of risk management committee (as contemplated by the Proposal) members to be heard, we do not think that a mandatory administrative requirement will result in meaningful improvements in governance if a DCO is not committed to the spirit behind the requirement.

III. The Risk Management Committee Should not be Required to Provide Input on the Clearing of All New Products

The Proposed Rule (i) fails to recognize that not all "new products" would materially change the risk profile of the DCO and (ii) is incompatible with OCC's unique obligation as the only listed equity option clearinghouse to clear an option on an underlying equity within 1 day after receipt of notification of a registered options exchange's intent to list such option.[19] The Proposed Rule is also potentially inconsistent with existing governance-related aspects of current CFTC rules that require a DCO to have "appropriate requirements" for determining the eligibility of contracts for clearing, including the consideration of the "[o]rganizational capacity of the derivatives clearing organization and clearing members to address any unusual risk characteristics of a product."[20] For these reasons, we encourage the Commission to remove the reference to "new products" in a final rule, as we believe risks from new products or asset classes that should be considered by a risk management committee will be risks that are otherwise stated explicitly in Proposed Rule §39.24(b)(11). That is, OCC proposes that the risk management committee should consider those risks that "could materially affect the risk profile of the DCO" or that would require a material change to the DCO's "margin model, default procedures, participation requirements, and risk monitoring practices." If the Commission retains the explicit reference to "new products" in the final rule, we request the Commission limit the requirement to new "asset classes" or define a subset of "new products" that would be captured by the final rule to include only those that have margining, liquidity, default management, pricing, or other risk characteristics that differ ***materially*** from those currently cleared by the DCO.

[19] See "Plan for the Purpose of Developing and Implementing Procedures Designed to Facilitate the Listing and Trading of Standardized Options Submitted Pursuant to Section 11A(a)(3)(B) of the Securities Exchange Act of 1934, *available at* https://ncuoccblobdev.blob.core.windows.net/media/theocc/media/clearing-services/services/options_listing_procedures_plan.pdf (last accessed October 7, 2022).

[20] See 17 CFR 39.12(b) ("A derivatives clearing organization shall have appropriate requirements for determining the eligibility of agreements, contracts, or transactions submitted to the derivatives clearing organization for clearing, taking into account the derivatives clearing organization's ability to manage the risks associated with such agreements, contracts, or transactions.")

IV. Risk Management Committees Should Not be Required to Include Customers of Clearing Members

"Risk Management Committees" might include all of OCC's Board-level Committees, each of which are required to be composed strictly of Board directors.[21] As noted elsewhere in this letter, OCC's Board is composed of Participant Directors, Owner Directors, Public Directors, and (optionally) a Management Director.[22] Even if not represented directly on the OCC's Risk Committee, customers of clearing members provide input and feedback on material risk management proposal to OCC's Risk Committee by way of participation in the FRAC. The Risk Committee receives reports from the FRAC, which body is composed of participant and customer of participant representatives, and which is sufficient to ensure that the perspectives of customers of participants that are not otherwise conveyed by the representatives of participants themselves are received by the Board.

OCC believes membership on the FRAC is an appropriate place for feedback on risk management initiatives from a group of stakeholders that (i) is not itself homogeneous and (ii) does not directly mutualize risk at OCC. To this end, we note customers of clearing members are a diverse group including pension plans, assets managers, market makers, corporate entities, and retail customers. Even if OCC's governance framework contemplated the appointment of customers of clearing members as a class of directors, it would not be possible to ensure each type of customer group is represented. Furthermore, customers of clearing members would not be subject to direct mutualization of risk at the DCO, and thus it may be difficult to ensure their viewpoints are not unduly motivated by their commercial interests. OCC believes its carefully calibrated feedback ecosystem that includes market participant input at two levels – through director representatives of participants on the Board or a Board committee or though reports of feedback provided by participant and customer of participant representatives on the FRAC – achieves the balance of providing a forum for feedback from customers of clearing members while insulating Board decision-making from viewpoints that might be motivated by commercial interests.

V. The Membership of a Risk Management Committee Should Not Be Required to Rotate on a Regular Basis

OCC is strongly opposed to the proposed requirement that a DCO rotate the membership of its risk management committee(s) on a regular basis.[23] Several DCOs that would be subject to the Proposed Rule are systemically important financial market utilities for which a failure or disruption to its functioning could create or increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the US financial system.[24] A DCO's risk management

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[21] See, e.g., OCC Risk Committee Charter, *available at* https://www.theocc.com/getmedia/e71a4c1d-52dc-4c95-aeb1-98dab9159f41/risk_committee_charter.pdf (last accessed October 7, 2022) ("Committee members will be selected by the Board from among the directors recommended by the then-constituted governance and Nominating Committee after consultation with the Chairman and shall serve at the pleasure of the Board.")

[22] While customers of clearing members are not part of a class from which directors are nominated for OCC's Risk Committee, they may from time to time have representation on OCC's Board and any Board-level Committees as Participant Directors (if the participant at which the director is employed also clears options transactions through other OCC participants) or Public Directors (if the employer of the Public Director qualifies as a Public Director and clears options transactions through an OCC participant).

[23] See Proposed Rule 39.24(b)(11)(iii).

[24] See Financial Stability Oversight Council Annual Report, Appendix A, *available at* https://home.treasury.gov/system/files/261/here.pdf (last accessed October 7, 2022).

ecosystem is detailed and complex and changes to it often are made only after significant development of initiatives at the management level, discourse with the industry, and further discussion with the Commission and the SEC. If all board-level committees are deemed to be "risk management committees" for the purposes of the Proposal, Proposed Rule 39.24(b)(11)(iii) could require multiple board-level committees to rotate membership on a regular basis. It is critical that members of these Board-level committees be equipped to discharge their functions appropriately, including that they have the requisite level of experience and depth of understanding of the DCO's risk management framework and any proposed changes thereto to provide informed guidance on pending matters. Given the complexity and importance of risk management topics that should be discussed at these board-level committees, a requirement to rotate membership of those committees could increase the risk DCOs transmit to the financial markets, substantially decrease the effectiveness of a risk management committee by making it nearly impossible for the risk management committee to render comprehensive and expert judgment, and countervail the positive aspects of the Proposed Rule.

If, notwithstanding these concerns, the Commission imposes a rotation requirement on "risk management committees," OCC urges the Commission to clarify the nature of rotation required so that it clearly states: (i) independent directors are not subject to the rotation requirement, and (ii) the rotation requirement applies to the persons representing participants and not the participants themselves.

Establishment of One or More Market Participant Risk Advisory Working Groups

Proposed Rule 39.24(b)(12) would require DCOs to establish one or more market participant risk advisory working groups as a forum to seek risk-based input from a diverse cross-section of the DCO's participants and customers of participants regarding all matters that could materially affect the risk profile of the DCO. Proposed Rule 39.24(b)(12) would also require DCOs to maintain written policies and procedures related to the formation and role of each risk advisory working group and require that each risk advisory working group meet quarterly. OCC supports Proposed Rule 39.24(b)(12) in principle, but requests the Commission delete the overly prescriptive requirement that the market participant risk advisory working groups meet at least quarterly.

A DCO's market participants form an important part of their governance arrangements. OCC currently maintains two bodies that it believes would be qualify as "market participant risk advisory groups" under this Proposal: the FRAC and the Operations Roundtable. Both bodies are composed of a diverse cross-section of participants and participants' customers. We believe the information flow from these groups has been an effective mechanism for OCC to receive risk-based feedback from a diverse cross-section of participant and participant customers on critical proposals, and we look forward to enhancing this feedback mechanism going forward. It should be emphasized, however, that while these feedback mechanisms are critical for a DCO's board to understand risk-based viewpoints of relevant stakeholders, final decision-making authority must vest with the board of the DCO consistent with well-established corporate law principles and requirements.

OCC believes there may be circumstances in which either or both bodies need not meet quarterly. To avoid a situation where DCOs must convene one or more market participant risk advisory groups and occupy the time and resources of potentially several dozen representatives from market participants simply to meet a prescriptive requirement, OCC requests the Commission require the market participant risk advisory groups to meet at a frequency determined solely by the DCO. OCC believes that a DCO that does not convene its market risk advisory group when needed to satisfy the substantive aspect of the Proposed Rule – namely, when needed to solicit risk-based input on a matter that could materially affect the risk profile of the DCO – then the DCO would be in violation of the Proposed Rule irrespective of whether there were a prescriptive meeting frequency requirement.

Policies for Risk Management Committee to Provide Independent, Expert Opinions

Proposed Rule 39.24(c)(3) would require DCOs to maintain policies designed to enable members of the risk management committee(s) to provide independent, expert opinions in the form of risk-based input on all matters presented to the risk management committee for consideration and to perform their duties in a manner that supports the safety and efficiency of the DCO and the stability of the broader financial system. OCC supports the principle behind Proposed Rule 39.24(c)(3), but requests the Commission to revise "expert opinion" to "informed opinion" and to clarify the meaning of "independent."

We believe the objective of the Proposed Rule could be achieved by replacing the word "expert" with "informed," and such a change would also prevent possible misinterpretation about whether the person providing the opinion must have a specific degree, certification, accreditation, or license to demonstrate her expertise. This would also align the Proposal with a similar provision in the SEC Proposal that requires "risk-based, independent, and informed" opinion from risk management committee members.[25]

While not specifically included in the text of the Proposed Rule, the Proposal contains language regarding the nature of the relationship between members of the proposed risk management committee and the DCO that raises significant concerns for OCC and appears to defeat the Commission's goals for establishing risk management committees. The Proposal states that members of the risk management committee(s) should be "neither beholden to their employers' particular interests nor acting as fiduciaries of the DCO."[26] As noted throughout this comment, it is possible to interpret the Proposal such that each of OCC's Board-level Committees are risk management committees. Under general corporate law principles, directors on those committees *necessarily* are fiduciaries of the company for which the committee is constituted. This fiduciary relationship does not cause a director to lose her independence; in fact, OCC Public Directors, who otherwise are independent from OCC, are fiduciaries to OCC by virtue of their service as OCC directors. OCC requests the Commission clarify in the adopting release that a director's fiduciary duty to the DCO does not render that director non-independent and does not violate Proposed Rule §39.24(c)(3). Absent such a clarification, it may be impossible for a director of a DCO to serve on a risk management committee at all.

Request for Comment

The Commission requested comment on two specific items it might address in a future rulemaking related to (i) market participant consultation prior to a proposed rule change of the DCO and (ii) risk management committee member information sharing. OCC is strongly opposed to rulemaking that would impose a requirement on DCOs to consult with market participants prior to submitting a proposed rule change with the Commission. OCC generally supports allowing risk management committee members to share information regarding OCC initiatives with other employees of the risk management committee member's employer, with a few conditions noted below.

I. DCOs should not be Required to Consult with Market Participants Prior to Submitting a Proposed Rule Change with the Commission

OCC believes current CFTC requirements are sufficient to ensure DCOs elicit and consider input from market participants prior to submitting proposed rule changes with the Commission. Commission rules

[25] See SEC Proposed Rule 17Ad25-(d)(2) (emphasis added).

[26] See Proposal, *supra* note 1 at 49561-62 (emphasis added).

require DCOs to post notices of proposed rules on their website and to explain substantive opposing views expressed by market participants to DCOs that were not incorporated into the proposed rule.[27] While Commission regulations permit DCOs to self-certify proposed rule changes in certain circumstances, it also provides that the Commission may stay certification of a proposed rule change and provide notice of a 30-day public comment period on the Commission's website.[28] Commission regulations also permit Commission staff to request additional information that would assist in ascertaining a DCO's compliance with any of the requirements of the Exchange Act or Commission regulations or policies.[29] This standard is common across most, if not all, categories of registrants that submit rule changes to the Commission and has been deemed sufficient by the industry as a whole for over two decades.

We also question whether a consultation requirement would have a practical benefit and whether such a requirement could potentially infringe upon a DCO's ability to execute its self-regulatory authority. For example, if a DCO self-certifies a rule that otherwise comports with the Exchange Act and regulations thereunder, but a market participant asserts it hasn't been adequately consulted prior to the submission or adequately briefed as to why its viewpoints were not incorporated into the proposed rule, would the Commission stay the certification for 90 days, and then object to the proposed certification "on the grounds that the proposed rule or rule amendment is inconsistent with the Act or the Commission's regulations"?[30] If so, the Commission would be in the undesirable position of navigating a dispute between a DCO and a market participant or making a facts-and-circumstances decision about the adequacy of the consultation or response for the purposes of removing its objection to the self-certification of a rule which is otherwise consistent with the Exchange Act and regulations thereunder. For these reasons, we urge the Commission not to adopt additional, prescriptive requirements for consultation specific only to DCOs.

We also note that systemically important derivatives clearing organizations ("SIDCOs") and dually registered DCOs must file proposed rule changes or advance notices with the SEC that are subject to a public notice and comment period for virtually all of their rule filings, providing an additional avenue by which market participants may comment on a DCO proposal before a DCO may implement it.[31]

II. Risk Management Committee Members Should be Permitted to Share Limited Information with an Expert Colleague

We assume the "risk management committee(s)" required by the Proposal would be board-level committee(s), and as such the members on the risk management committee(s) would be OCC directors. As fiduciaries of OCC, directors are required to keep in strict confidence the information they receive in their capacity as directors unless they have express authority from OCC to do otherwise, the information is in the public domain, or otherwise is in possession of the director without restriction. OCC currently

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[27] See, e.g., 17 CFR § 40.6(a)(7)(vi).

[28] See 17 CFR § 40.6(c).

[29] See 17 CFR § 40.6(a)(8) "The registered entity shall provide, if requested by Commission staff, additional evidence, information, or data that may be beneficial to the Commission in conducting a due diligence assessment of the filing and the registered entity's compliance with any of the requirements of the Act or the Commission's regulations or policies thereunder.").

[30] 17 CFR § 40.6(c)(3).

[31] See generally 15 U.S.C. § 78(s).

allows directors to share information marked confidential with colleagues at the director's employer on the following conditions: (i) before sharing the information, the director consults with OCC's Chief Legal Officer and considers potential harm to OCC from sharing the information and (ii) the director will use reasonable care to protect the information from further dissemination or disclosure by (a) limiting to the smallest number possible the persons with whom she shares the information, (b) only sharing the information with colleagues who themselves are subject to a duty (through express agreement or firm policy) to keep the information confidential, and (c) informing the recipients of the confidential and sensitive nature of the information and the recipients' obligation to treat the information as confidential and protected and to limit their use of it to assisting the OCC director in her service on the OCC Board. Directors may share non-confidential information with a limited number of persons in their firm who have expertise on the matter to be considered by the Board if the director believes sharing such information would not harm OCC and the recipient of the information agrees to protect it from further dissemination or disclosure. Finally, to the extent confidential information is erroneously shared with others in the firm beyond the expert for the purposes of enhancing the risk management committee member's oversight of OCC risk management, the risk management committee member shall notify OCC as soon as practicable.

Dual Registrant Concerns

As noted above, there are circumstances in which the Proposal and the SEC Proposal appear to rely on contradictory premises and in which compliance with both would be impossible without construction of a cumbersome and inefficient governance structure[32] that could inhibit – rather than promote – furtherance of the sound principles on which each proposal is based. We encourage the Commission and the SEC to collaborate to help ensure that governance for dual registrants remains efficient and that DCOs and registered clearing agencies are subject to similar requirements. Some of the areas in which there may be misalignment between the Proposal and the CFTC Proposal that could cause inefficient governance arrangements at DCOs are:

Topic	CFTC Proposed Rule	SEC Proposed Rule	Potential Conflict
Role of the Risk Management Committee(s)	"Establish one or more risk management committees and require the board of directors to consult with, and consider and respond to input from, the risk management committee(s) . . ." Proposal, 39.24(b)(11).	"Each registered clearing agency must establish a risk management committee (or committees) <u>to assist the board of directors in overseeing</u> the risk management of the registered clearing agency." SEC Proposal, 17Ad-25(d).	The Proposal appears to assume the risk management committee will be a body outside of the board governance framework (" . . .require the board of directors to consult with . . . ") whereas the SEC Proposal appears to assume the risk management committee will be a committee of the Board ("to <u>assist the board of directors</u> in overseeing . . .").

[32] We note that Commission regulation requires clearing agencies to establish, implement, maintain, and enforce written policies and procedures reasonably designed to "provide for governance arrangements that are clear and transparent [and] clearly prioritize the safety and <u>efficiency</u> of [the clearing agency]" (emphasis added). 17 CFR § 240.17Ad-22(e)(2)(i)-(ii).

Risk Management Committee Composition	"A risk management committee includes representatives from clearing members and customers of clearing members." Proposal, 39.24(b)(11)(ii).	"The membership of each risk management committee must . . . include representatives from owners and participants." SEC Proposal, 17Ad-25(d)(1).	While not directly inconsistent, this distinction supports the view that the intended meaning and role of the risk management committee amongst the regulators is inconsistent.
Risk Management Committee Reconstitution/Rotation	"Membership of a risk management committee is rotated on a regular basis." Proposal, 39.24(b)(11)(iii).	"The membership of each risk management committee must be reconstituted on a regular basis . . ." SEC Proposal, 17Ad-25(d)(1).	If dual registrants were required to rotate membership of their Risk Committee, they would not be able to ensure adequate representation on the Committee for all stakeholders at any given point in time.

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We thank the Commission for the opportunity to provide comments on the Proposal. If you have any questions, please do not hesitate to contact Megan Cohen at 312.322.4467 or mcohen@theocc.com. We would also be pleased to provide the Commission with any additional information or analyses that might be useful in determining the content of the final rules.

Sincerely,

Joseph P. Kamnik
Senior Special Advisory and Regulatory Counsel

Appendix A: OCC's Governance Structure

Board Duties and Oversight Responsibility

The Board maintains six standing committees: the Audit Committee, the Compensation and Performance Committee, the Governance and Nominating Committee, the Regulatory Committee, the Risk Committee, and the Technology Committee. Each committee is responsible for specific oversight functions outlined in the committee charter, each of which is reviewed annually by the respective committee, the Governance and Nominating Committee, and the Board and filed with the CFTC and the SEC as a rule. OCC's management is ultimately accountable to the Board. OCC's internal audit and compliance functions report directly to the Audit Committee, and the corporate risk function reports directly to the Risk Committee, ensuring those critical second- and third-line functions are independent from management. The Board composition is intended to ensure consideration of all interested stakeholders, and OCC's nominating process for potential new directors reflects this goal.

OCC is owned equally by five of the options exchanges for which it provides clearance and settlement services. OCC's ownership structure and its diverse Board representation – which includes Participant Directors, Owner Directors, Public Directors, and possibly Management Directors – ensures the consideration of a diverse and wide range of perspectives on OCC's Board that covers the viewpoints of all interested stakeholders of the clearinghouse. The oversight of OCC's business and affairs is vested in the Board, which has specific oversight responsibilities described in the Board Charter and Corporate Governance Principles.[33] The Board may discharge these responsibilities directly or indirectly by delegating it to one of six standing Board committees. These functions include:

- Overseeing OCC's governance structure and processes to ensure that the Board is positioned to fulfill its responsibilities effectively and efficiently, including by regularly assessing the performance of the Board and of each director;
- Overseeing OCC's processes and framework for comprehensively managing the range of risks that arise in or are borne by OCC, including risk management policies, procedures, and systems designed to identity, monitor, and manage such risks consistent with the risk appetite and risk tolerances approved by the Board;
- Overseeing OCC's technology infrastructure, resources, and capabilities to ensure resiliency with regard to OCC's provision of its clearance, settlement, and risk management services;
- Overseeing OCC's business strategies, including the expansion of clearance and settlement services to new business lines and product types, to ensure they reflect the interests of stakeholders and are consistent with the public interest;
- Reviewing and approving major corporate plans and actions, including capital expenditures, the annual budget and corporate plan, financial objectives, operating capital and capital structure, and fee structure;
- Ensuring that the Board and senior management have the appropriate experience and skills to discharge their respective responsibilities;
- Ensuring clear and direct lines of responsibility and communication between the Board and senior management;
- Ensuring risk management and internal audit personnel have sufficient authority, resources, independence from management, and access to the Board;
- Overseeing management's activities in managing and operating OCC;

[33] The Options Clearing Corporation Board of Directors Charter and Corporate Governance Principles, *available at* https://www.theocc.com/getmedia/99ed48a4-aa44-45ac-8dee-9399b479a1c8/board_of_directors_charter.pdf (last accessed October 7, 2022).

- Assigning responsibility and accountability for risk decisions and overseeing the establishment of policies addressing decision-making in crises and emergencies; and
- Determining disqualifications from Board service and making appointments to fill Board vacancies.

Board Committees

Audit Committee

The Audit Committee assists the Board in overseeing OCC's financial reporting process, system of internal control, compliance and legal risks, and auditing, accounting, and compliance processes. The Audit Committee is also responsible for overseeing the facilitation of open communication amongst the external auditors, OCC's corporate finance department, OCC's compliance department, and the Board.

Compensation and Performance Committee

The Compensation and Performance Committee assists the Board with overseeing OCC's general business, regulatory capital, investment, corporate planning, compensation and human capital risks, as well as executive management succession planning and performance assessment. The Compensation and Performance Committee is also responsible for overseeing the annual corporate performance report and corporate budget, including their alignment with OCC's business strategy.

Governance and Nominating Committee

The Governance and Nominating Committee assists the Board in overseeing OCC's corporate governance processes, including: (i) assessing that OCC's governance arrangements are clear and transparent; (ii) establishing the qualification necessary for Board service to ensure the Board is able to discharge its duties; (iii) identifying and recommending to the board candidates eligible for service as Public Directors and participant directors; and (iv) resolving certain conflicts of interest. The Governance and Nominating Committee also regularly reviews and, as necessary, recommends to the Board improvements to the Board's Code of Conduct, including the conflict of interest policy therein.[34]

Regulatory Committee

The Regulatory Committee assists the Board in overseeing OCC's compliance with its regulatory obligations and adherence to applicable regulatory guidance and standards. The Regulatory Committee also oversees OCC's Regulatory Compliance Oversight Group, an OCC management-level working group.

Risk Committee

The Risk Committee assists the Board in overseeing OCC's financial, operational, risk model, and third-party risk management. The Risk Committee oversees OCC's overall corporate risk management framework, including: (i) membership criteria and financial safeguards; (ii) member and other counterparty risk exposure assessment; (iii) liquidity requirements and maintenance of financial resources; (iv) risk modeling and assessments; and (v) default management planning. It also reviews the performance of (i) OCC's corporate risk management and model validation programs and (ii) OCC's Chief Risk Officer, who reports directly to the Risk Committee.

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[34] Code of Conduct for OCC Directors, available at https://www.theocc.com/getmedia/2e042613-d3b3-40b6-b10a-80bd9e3baffb/director_code_of_conduct.pdf.

Technology Committee

The Technology Committee assists the Board overseeing OCC's information technology and operational strategy, infrastructure, resources, and risks. This includes: (i) overseeing major information technology and operational related strategies, projects, and technology architecture decisions; (ii) monitoring whether OCC's information technology programs effectively support OCC's objectives and strategies; and (iii) monitoring OCC's information technology and operational risk management efforts, the security of OCC's information systems, and the physical security of information security assets.

Director Independence Assessments and Board Self-Assessments

OCC conducts independence assessments of all directors other than Management Directors (if any are serving on the Board) on an annual basis.[35] Relationships between directors, as well as relationships between directors and OCC, are considered by the Board in its independence assessments. OCC currently maintains a robust process to identify relationships between a director or a nominee and OCC or an affiliate that would preclude the director or nominee from being an independent director. This process includes a the requirement that nominees complete a questionnaire ("Director Independence Questionnaire") eliciting information that is generally aligned with director independence standards of registered listing stock exchanges and related Commission rules for independent audit committees.[36] Existing directors are required to: (i) provide responses to the Director Independence Questionnaire on an annual basis and (ii) identify and disclose matters that may involve conflicts of interest or that may be reasonably perceived by others to raise questions about conflicts of interest on an ongoing basis.[37]

Director Obligations and Fitness Standards

Each director is required to act with due care, honestly, in good faith, and in the best interests of OCC and follow guidelines agreed on by the board regarding how it will govern and conduct itself.[38] Each director has a responsibility to be reasonably well-informed about the activities of OCC and to exercise independent judgment on all decisions. Directors are expected to regularly attend meetings of the board and of the committee(s) on which the director sits and may attend meetings by video or teleconference if unable to attend in person. Directors are expected to have read materials provided in advance of a meeting and are entitled to reasonably rely on briefing materials and reports provided by management, a board committee, OCC's independent auditors, and any other advisors retained by OCC, the Board, or a Board committee.

Directors are also required to act in good faith, in the best interests of OCC, and not in their own interests or the interests of another entity or person (including their employer). Directors must strictly avoid using OCC assets or opportunities for their own benefit or the benefits of others if such use is not also in OCC's best interests.

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[35] Management directors are known not to be independent from OCC.

[36] In some cases, OCC's questions are stated more broadly than applicable independence tests to help ensure they capture all potentially relevant information to enable to the board to make an informed judgment about director independence.

[37] See Code of Conduct for OCC Directors, *available at* https://www.theocc.com/getmedia/2e042613-d3b3-40b6-b10a-80bd9e3baffb/director_code_of_conduct.pdf (last accessed October 7, 2022).

[38] Id.

As fiduciaries of OCC, directors are required to keep in strict confidence the information they receive in their capacity as directors unless they have express authority from OCC to do otherwise, the information is in the public domain or otherwise in possession of the director without restriction. Before sharing materials marked confidential and received in conjunction with their role as an OCC director with colleagues within their firm, directors should consult with the OCC Chief Legal Officer and consider potential harm to OCC from sharing the information, including whether sharing the information might present a risk that an attorney-client privilege could be waived. If authorized to share confidential information with colleagues at their firm, OCC directors must use reasonable care to protect the information from further dissemination or disclosure by (i) limiting to the smallest number possible the persons with whom they share the information, (ii) only sharing the information with colleagues who themselves are subject to a duty (through express agreement or firm policy) to keep the information confidential, and (iii) informing the recipients of the confidential and sensitive nature of the information and the recipients' obligation to treat the information as confidential and protected and to limit their use of it to assisting the OCC director in her service on the OCC Board. Directors may share non-confidential information with a limited number of persons in her firm who have expertise on the matter to be considered by the board if the director believes sharing such information would not harm OCC and the recipient of the information agrees to protect it from further dissemination or disclosure.

No director may serve on the Board who: (i) is subject to a statutory disqualification under Section 3(a)(39) of the Exchange Act; (ii) may be refused registration under Section 8a(2) of the Commodity Exchange Act; or (iii) has a history of serious disciplinary offenses, including but not limited to those that would be disqualifying under Commodity Futures Trading Commission Rule 1.63.

Addressing Director Conflicts of Interest

Each director is required to appropriately address actual, potential, or apparent conflicts of interest and promptly report any violations of the Code of Conduct for OCC Directors to the Chairman of the board or OCC's Chief Legal Officer.[39] A conflict of interest is present whenever the interests of OCC compete with the interests of a director (or nominee), the director's employer, or any other party with which a director is affiliated. A conflict of interest is also present whenever a director's corporate or personal interests are such that they could be reasonably viewed as affecting the director's objectivity in fulfilling her duties to OCC. Conflicts between the best interests of OCC and the direct or indirect personal or financial interests of a director may arise from time to time. Neither OCC nor any director may enter into any transaction or arrangement that involves a conflict of interest except per OCC's Code of Conduct for OCC Directors and its Related Party Transactions Policy. OCC will not enter into or continue to proceed with a transaction giving rise to a conflict of interest unless the transaction has been approved or ratified by the Governance and Nominating Committee.

When entering into business relationships, OCC directors must consider whether a conflict of interest may arise that could be avoided. Public Directors, specifically, are counseled to avoid entering into business relationships that could give rise to conflicts of interest or could be perceived to undermine their objectivity or independence. This limitation on direct business relationships does not extend to arms-length relationships with an entity with which another director is affiliated as an employee, officer, or director that OCC's Governance and Nominating Committee determines poses an immaterial risk of conflict. OCC may enter into a transaction or other arrangement, and the Board may otherwise approve any other matter that requires Board approval, when a director has a conflict of interest providing the nature and relevant facts regarding the conflict known at the time are disclosed at a duly held meeting of the Board or a Board

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[39] See Code of Conduct for OCC Directors, *available at* https://www.theocc.com/getmedia/2e042613-d3b3-40b6-b10a-80bd9e3baffb/director_code_of_conduct.pdf (last accessed October 7, 2022).

committee at which a quorum is present and a majority of directors who have no conflict of interest in the transaction or arrangement approve the transaction or arrangement.

Directors are expected to err on the side of caution and immediately bring to the attention of the Chairman of the Board and to OCC's Chief Legal Officer any matters that may involve conflicts of interest or that may be reasonably perceived by others to raise questions about potential conflicts of interest. Directors are required to disclose relationships that may arise with OCC due to business affiliations or business or family relationships with OCC's officers, employees, and other directors that could give risk to a conflict or to a perception of a conflict. Finally, directors are required to complete an annual questionnaire that elicits information to disclose relationships that may give rise to conflicts of interest. Responses to these questionnaires are reviewed by OCC's Chief Legal Officer. Directors are required to promptly disclose for review any relevant change in circumstances, such as a change in employment or acceptance of a position on another board that could give rise to conflicts of interest or to the perception of conflicts of interest.

The Chairman of the Board and OCC's Chief Legal Officer will evaluate conflict disclosures and make other necessary inquiries to determine the extent and nature of any conflicts of interest. If any director believes she may have a conflict of interest in a matter to be acted upon by the Board or a Board committee on which she sits, the director shall disclose the conflict to the Chairman and OCC's Chief Legal Officer prior to discussion or presentation of such matter and where possible in advance of the meeting. The director should also consider whether it is advisable under the circumstances to recuse herself from the discussion and/or vote and shall recuse herself if requested by the Chair of the meeting. The Governance and Nominating Committee considers all facts regarding a conflict of interest and, in consultation with the Chairman and the Chief Legal Officer, shall resolve any questions or disputes regarding a conflict of interest, including any question or dispute about whether a recusal is appropriate. The Governance and Nominating Committee also has the authority to raise and address any issue related to the identity and handling of a conflict of interest involving a member of the board, whether or not that issue has been raised by anyone else.