THE FOUNDATION FOR SECURE MARKETS®

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April 22, 2024

By Electronic Delivery

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st St. N.W.
Washington, DC 20581

Re: RIN 3038-AF21 Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants

Dear Mr. Kirkpatrick:

The Options Clearing Corporation ("OCC") appreciates the opportunity to submit these comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") on the above-referenced proposal ("Proposal" or "Proposed Rules")[1] under the Commodity Exchange Act ("CEA"). The Proposal would define the conditions under which a futures commission merchant ("FCM") could permissibly treat separate accounts of a single customer as accounts of separate legal entities for purposes of certain Commission regulations ("Separate Account Treatment").

As detailed below, OCC supports the Proposal with a minor modification to clarify the responsibilities of a DCO whose members offer Separate Account Treatment.

I. About OCC

Founded in 1973, OCC is the world's largest equity derivatives clearing organization. OCC operates under the jurisdiction of both the CFTC and the Securities Exchange Commission ("SEC"). As a registered Subpart C DCO under the CFTC's jurisdiction, OCC clears and settles transactions in futures and options on futures. As a registered clearing agency under the SEC's jurisdiction, OCC is the sole clearing agency for equity options listed on national securities exchanges. OCC also provides central counterparty 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. As a SIFMU, OCC is subject to prudential regulation by the Board of Governors of the Federal Reserve System. OCC is recognized by the European Securities and Markets Authority as a Tier 1 central counterparty clearinghouse established in a third country under Article 25 of the European Market Infrastructure Regulation. OCC operates as a market utility and is owned by five exchanges.

[1] RIN 3038-AF21 Regulations to Address Margin Adequacy and to Account for the Treatment of Separate Accounts by Futures Commission Merchants, 89 FR 15312 (Mar. 1, 2024) ("Release").

II. Comment: OCC Supports the Codification of the Separate Account Rules in Part 1, but Requests That the Commission Clarify That the Rules Do Not Impose Strict Liability on DCOs If a Member Fails to Comply With Those Requirements

OCC commends the Commission's decision to withdraw its April 2023 notice of proposed rulemaking that would have codified the rules for Separate Account Treatment in Part 39 of the Commission's Regulations ("Withdrawn Proposal") and replace it with the Proposed Rules. As detailed by multiple DCO commenters, the Withdrawn Proposal would have imposed novel requirements on DCOs to examine FCMs for compliance with the prescribed conditions for offering Separate Account Treatment, including testing the effectiveness of several operational and risk management controls;[2] and would have made DCOs primarily responsible for enforcing FCMs' compliance with such conditions. In light of these concerns, and suggestions from commenters that the rules for Separate Account Treatment should be codified in Part 1 of the Commission's regulations, rather than Part 39, and the necessary examinations be conducted by an FCM's designated self-regulatory organization ("DSRO"),[3] we believe that the Commission appropriately chose not to finalize the Withdrawn Proposal, but instead to issue a new proposal that broadly followed the suggestions of commenters.

The Release makes clear that, in defining the conditions under which an FCM can offer Separate Account Treatment, the Commission intended to make compliance with the rules for Separate Account Treatment the responsibility of FCMs, and further, that the responsibility for *monitoring* for such compliance should fall to an FCM's DSRO, rather than to any DCO of which that FCM is a member. Consistent with that allocation of responsibility, the Proposal – unlike the Withdrawn Proposal – would not require an FCM to notify a DCO of which it is a member either of the FCM's initial election to offer Separate Account Treatment or, critically, of the occurrence of any "non-ordinary course" event requiring it to cease offering Separate Account Treatment. Eliminating these information requirements essentially removes DCOs' visibility into the Separate Account Treatment practices of their members.

In order to implement the contemplated Separate Account Treatment regime, however, the Proposal would still include certain changes to Part 39. Specifically, the Proposal would amend Regulation

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[2] *See, e.g.,* Letter from CME Group dated June 30, 2023, at 4 ("full-scale financial and customer protection examinations of FCMs are conducted pursuant to Regulation § 1.52 by DCMs in their capacity as an SRO. . . . The DCO does not conduct a full-scale examination of clearing members to determine its own compliance with Part 39, nor does it review FCMs for compliance with the types of conditions set forth in proposed Regulation § 39.13(j)"); Letter from Intercontinental Exchange, Inc. dated June 9, 2023, at 2-3 ("DCOs are not engaged in supervising, examining or surveilling the relationship of FCMs with their customers and do not have the personnel or infrastructure dedicated to these functions. Instead, these functions are typically performed by the DSRO for the FCM pursuant to the requirements of Commission Rule 1.52.") *Comment letters available at* https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7379.

[3] The Joint Audit Committee similarly observed that it would be positioned to examine FCM compliance with Part 1 obligations. *See,* Letter from Debra K. Kokal dated June 30, 2023, at 3 ("Accordingly, the JAC's supervisory program monitors FCMs for compliance with certain CFTC Part 1 regulations, as well as the customer protection rules within Parts 22 and 30 and does not include examining for compliance with DCO rules.")

§ 39.13(g)(8)(iii) to provide an exception to the "Margin Adequacy Requirement"[4] when an FCM offers Separate Account Treatment, to the extent it does so in conformance with proposed Regulation § 1.44. As proposed, the text of Regulation § 39.13(g)(8)(iii) would read:

> A derivatives clearing organization shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are cleared by the derivatives clearing organization**, except as provided for in § 1.44 of this chapter**. (emphasis added).

The requirements for offering Separate Account Treatment under proposed § 1.44 are multi-pronged and complex. Determining whether an FCM is operating in compliance with those provisions would require detailed knowledge of an FCM's operational and risk management practices on an ongoing basis, including, but not limited to, the identity of each customer and each account accorded Separate Account Treatment; whether the FCM has received certain communications from its customer, regulator, DSRO, or other SRO; and whether the CCO or other executive(s) of the FCM has made certain determinations as to the financial condition and risk presented by a given customer. In addition, it would require real-time knowledge of the timing of each such customer's margin posting to the FCM and, if there was a delay in that margin posting, the exact cause of the delay. As noted above, the placement of the conditions in Part 1 of the Commission's regulations represents a recognition that FCMs and their DSROs should be responsible for monitoring and ensuring compliance with these complex requirements.

We are concerned, however, that without clarification in the rule text, § 39.13(g)(8)(iii) could be interpreted as imposing strict liability on DCOs for their members' compliance with the terms of § 1.44. Such an outcome would expose DCOs to unwarranted risk for actions outside of their control or even reasonable control. We do not believe it is the Commission's intent to do so, as such an outcome would be inconsistent with the Commission's apparent intentions in making the new proposal. Nevertheless, we believe a relatively minor change to the rule would be appropriate and sufficient to clarify that the inclusion of the phrase "except as provided for in § 1.44" in § 39.13(g)(8)(iii) is intended solely as a reference to the relevant provision for Separate Account Treatment, and not to create any substantive obligations for DCOs. Specifically, we recommend that, in any final rule, § 39.13(g)(8)(iii) should be revised as follows:

> (iii) *Withdrawal of customer initial margin.*
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> (A) A derivatives clearing organization shall require its clearing members to ensure that their customers do not withdraw funds from their accounts with such clearing members unless the net liquidating value plus the margin deposits remaining in a customer's account after such withdrawal are sufficient to meet the customer initial margin requirements with respect to all products and swap portfolios held in such customer's account which are

[4] Release at 15313 (defining "Margin Adequacy Requirement" as the requirements under existing Regulation § 39.13(g)(8)(iii)).

cleared by the derivatives clearing organization, except as provided for in § 1.44 of this chapter.

(B) For the avoidance of doubt, a derivatives clearing organization shall not be liable for violating this subsection [39.13(g)(8)(iii)] on the basis of any failure by any clearing member to comply with any requirement or requirements of § 1.44 of this chapter.

III. Conclusion

We thank the Commission for the opportunity to provide comment on the Proposed Rules. If you have any questions, please do not hesitate to contact Andrew Feller, Associate General Counsel, at 202.971.7238, or afeller@theocc.com. We would 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,

Megan Malone Cohen

Megan Malone Cohen
General Counsel and Corporate Secretary