THE FOUNDATION FOR SECURE MARKETS®

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Via Electronic Submission

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

Ms. Vanessa Countryman
Secretary of the Commission
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-2000

Re: **Joint Request for Comment on Further Implementation of Portfolio Margining and Cross-Margining of Securities and Derivatives (RIN 3038-AF72 and File Number S7-2026-23)**

The Options Clearing Corporation ("OCC") appreciates the opportunity to provide comment on the Commodity Futures Trading Commission's ("CFTC") and Securities and Exchange Commission's ("SEC") (together "the Commissions") joint request for comment on their Joint Request for Comment on Further Implementation of Portfolio Margining and Cross-Margining of Securities and Derivatives ("Request"). OCC commends the Commissions for their continued work on coordination and harmonization between the two Commissions. Portfolio margining is a topic well-suited for the Commissions' harmonization efforts and offers a concrete opportunity to deliver measurable capital efficiency and risk-management benefits to market participants. To facilitate these benefits, OCC encourages the Commissions to engage in a joint rulemaking to establish a process under which futures customer positions and securities customer positions can be comingled in an account that complies with either Commission's customer protection rules.

OCC operates as a central counterparty ("CCP") under the jurisdiction of both the CFTC and the SEC. As a registered Subpart C derivatives clearing organization ("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. OCC has been designated by the Financial Stability Oversight Council as a systemically important financial market utility under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and is therefore subject to prudential regulation by the Federal Reserve Board. OCC operates as a market utility and is owned by five options exchanges.

Benefits of Portfolio Margining

Portfolio margining is widely recognized as an improvement over position-by-position margining because it aligns collateral requirements with the actual net risk of an account. When a CCP, broker-dealer ("BD"), or futures commission merchant ("FCM") can measure risk across a customer's portfolio of correlated or offsetting positions, the net margin required more accurately reflects the true economic exposure of a customer's positions. This risk-based approach reduces the amount of capital that must be posted as collateral, allowing assets to be put to other uses without sacrificing risk management standards.

The generally accepted benefits of portfolio margining by either a clearinghouse or intermediary include: (1) more efficient use of capital, since customers are not forced to over-collateralize hedged or offsetting positions that present less net risk; (2) improved incentives for prudent risk management, as market participants are rewarded with lower margin costs for constructing hedged portfolios; (3) enhanced market liquidity, because capital that would otherwise be allocated to meet separate margin requirements can be redeployed to other productive uses; and (4) a more accurate and holistic view, for both the firm and its regulators, of the risk actually embedded in a customer's account, which can strengthen the overall risk management and default-management frameworks when the underlying netting and legal certainty of close-out rights are sound. These efficiencies are the principal reason portfolio margining has been extended, in various forms, to combined securities-derivatives accounts approved by the SEC and CFTC over time, and they are the same considerations that support a joint rulemaking to facilitate additional portfolio margining.

OCC's Portfolio Margining Programs

As a registered DCO and clearing agency, OCC clears products that fall under the jurisdiction of both the CFTC and SEC. OCC operates or participates in a number of portfolio margining programs. Under a cross-margin agreement with CME Group ("CME"),[1] equity and index options are held in cross margin accounts with futures cleared by CME. OCC and CME maintain separate cross margin accounts for Clearing Member and customer positions. For each type of account, OCC and CME calculate a single margin requirement based on the economically related positions from both clearing houses. Similarly, OCC's internal cross margin program allows for proprietary futures positions to be held in an account with proprietary equity and index options and allows the account to receive a positive margin offset for correlated positions. Further, OCC has received approval from the SEC to operate a customer portfolio margin account, which

[1] Second Amended and Restated Cross-Margining Agreement Between The Options Clearing Corporation and The Chicago Mercantile Exchange, Release No. 34-90464; File No. SR-OCC-2020-011 (Nov. 19, 2020).

currently allows customer positions in various types of equity and index options to receive margin offset benefits. As part of the risk management for portfolio margin accounts, OCC's TIMS methodology establishes the minimum margin requirement a BD must collect from retail customers who have elected portfolio margining. For professional market participants, OCC administers the risk-based haircut program that establishes the minimum margin requirement a BD must collect from the trader.

Additionally, OCC has worked with Cboe Global Markets, which operates both National Securities Exchanges as well as a Designated Contract Market ("DCM") to request an exemption under Section 4(c) of the Commodity Exchange Act ("CEA") from the CFTC to permit customer positions in VIX futures and VIX index options to be jointly held in a securities portfolio margin account. Portfolio margining of VIX futures and VIX index options would provide capital efficiency by allowing the natural offsets of the contracts to drive a lower margin requirement without sacrificing risk management.

Portfolio Margining Framework

OCC believes that a formalized process for permitting portfolio margining of customer positions across futures and securities would be beneficial. As it stands, the process of obtaining approval for portfolio margining can be time-consuming and opaque, requiring filings with both Commissions and subject to often uncertain timelines. The current process delays the enhanced risk management and capital efficiency benefits of portfolio margining, even though the resulting customer protections under portfolio margining are comparable.

To implement a formal process, the Commissions can rely on the authority granted by Congress in Section 713 of Dodd-Frank to issue exemptions from Section 4d of the CEA and Section 15(c)(3) of the Exchange Act respectively or promulgate rules that facilitate portfolio margining.[2] Section 713 amended Section 4d of the CEA and Section 15(c)(3) of the Exchange Act to authorize each Commission to permit a registered FCM that is also registered as a BD (when jointly registered "BD/FCM") to hold customer positions in an account subject to the other Commission's customer protection rules. The amendments require the Commissions to consult with each other to adopt rules to ensure that such transactions and accounts are subject to comparable requirements to the extent practical for similar products.

Customer Protection Regimes

OCC believes that the customer protection regimes established by each Commission offer comparable protection for customers and their assets. Crucially, the regimes are similar in two key areas, asset segregation and insolvency.

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[2] Pub. L. 111-203, § 713, 124 Stat. 1641 (2010).

a. *Asset Segregation*

The CFTC requires an FCM to segregate its customers' assets from its own. For futures contracts, Section 4d of the CEA and CFTC Rule 1.20 require an FCM to hold money, securities, and property received to margin, guarantee, or secure the trades or contracts of any customer of the FCM to be held in a segregated account separate from the FCM's assets.[3] CFTC rules further require an FCM to obtain a written acknowledgement letter from each custodian of customer funds stating that the funds are customer property and not the FCM's property.[4] The CFTC's customer protection regime extends to registered DCOs and OCC holds futures customer funds in a manner consistent with Section 4d of the CEA and the Commission's regulations.[5]

Similarly, Exchange Act Rule 15c3-3 provides for the segregation of assets belonging to a BD's customer from the BD's own assets. Specifically, Exchange Act Rule 15c3-3 requires BDs to maintain possession and control of a customer's securities held by the BD.[6] Rule 15c3-3 further requires that customer funds be held in a bank account (defined as a "Reserve Bank Account") that is separate from accounts holding the BD's own funds.[7] The SEC has established a Reserve Formula, set forth at Exhibit A to Exchange Act Rule 15c3-3, that a BD uses to determine the amount of funds that must be held for a customer. The formula allows a BD to deduct funds deployed elsewhere by the BD on the customer's behalf from the total amount that must be held for a customer in the Reserve Account. The SEC has stated the purpose of the formula is to "ensure that customers' funds held by a BD are deployed only in areas of the BD's business related to servicing its customers (reflected as debits in the Reserve Formula) or, to the extent that the funds are not deployed in these limited areas, that they are deposited in a Reserve Bank Account."[8] Further, the BD must obtain a written notification from each bank that it maintains a Reserve Bank Account with stating that the bank was informed that all cash and/or qualified securities deposited therein are being held by the bank for the exclusive benefit of the customers and are being kept separate from any other accounts maintained by the BD with the bank.[9] At the clearing agency level, OCC segregates margin assets from its own proprietary funds and its rules ensure securities customer funds can only be used to cover obligations arising from the securities customers' account.[10] OCC's agreement with its custodians recognizes that the accounts exist to hold pledged Clearing Member and customer assets and makes clear that the funds belong to

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[3] 7 U.S.C. § 6d(a); 17 C.F.R. § 1.20.
[4] 17 C.F.R. § 1.20(a).
[5] See 17 C.F.R. § 1.20(g); 17 C.F.R. § 39.15(b).
[6] This applies to securities owned outright and excess margined securities. In general, margined securities are treated differently and to the extent that a customer is indebted to the BD, the BD may encumber that customer's securities that are not fully paid or excess margin securities.
[7] 17 C.F.R. § 240.15c3-3(e)(1) ("Every [BD] shall maintain with a bank or banks at all times when deposits are required or hereafter specified a 'Special Reserve Bank Account for the Exclusive Benefit of Customers' . . . and it shall be separate and apart from other bank accounts of the [BD].").
[8] Customer Protection Rule, Exchange Act Release No. 34-22499, 50 Fed. Reg. 41,337 at 41,338 (Oct. 10, 1985).
[9] See 17 C.F.R. § 240.15c3-3(f).
[10] See OCC By-Laws Article VI, Section 3.

Clearing Members and their securities customers and cannot be used for OCC's own purposes. In addition, the custody agreements governing the custodial accounts provide an acknowledgement by the custodian to OCC that the collateral in custody is not subject to any right, charge, security interest, lien or claim of any kind in favor of the custodian or any person claiming through the custodian other than in limited instances, in respect of custodial fees relating to the relevant securities and cash account held by OCC on behalf of the Clearing Members.

b. *Insolvency Regimes*

FCMs and BDs are also subject to comparable insolvency regimes. An FCM is liquidated in accordance with the provisions of Subchapter IV of Chapter 7 of the Bankruptcy Code ("Code") and Part 190 of the CFTC regulations,[11] while a BD is generally liquidated in accordance with the provisions of the Securities Investor Protection Act ("SIPA").[12] Both regimes provide that customers have priority status during an insolvency, and that customer funds cannot be used to cover the intermediary's obligations or losses. Further, under both regimes, in the event an insolvent firm is unable to return all customer property, the shortfall is shared pro rata among customers. The two regimes, however, are not identical and the procedures to be followed in the insolvency of a BD or FCM differ. For example, in the case of a BD insolvency, there is $500,000 per customer protection (which includes a $250,000 limit for cash) under SIPA.[13] Futures contracts held in a portfolio margined account approved by the SEC would be covered by the SIPA insurance fund.[14] There is no insurance coverage, however, for an FCM insolvency proceeding under Part 190 of the CFTC's rules. Additionally, the CFTC Part 190 Rules, applicable to FCM insolvency, contemplate (and prefer) portability of non-defaulting customer positions and funds to other solvent FCMs. SEC regulations also contemplate expeditious transfer of customer accounts in a bulk transfer process if the books and records of the insolvent BD are in order and the customer accounts are properly margined.[15]

In the unlikely event of an OCC insolvency, OCC would likely be resolved as a debtor in a liquidation proceeding under Chapter 7 of the Code, including subchapter IV thereof, which applies to the liquidation of a commodity broker.[16] The CFTC's Part 190 Rules, in turn, apply to "a proceeding commenced under subchapter IV of chapter 7 of the [Code] in which the debtor is a clearing organization," and would therefore also apply—including all relevant protections for futures customer property—to any liquidation of OCC. With respect to property of securities customers, OCC's limited property interest in Clearing Member and customer accounts would prevent collateral from being available to OCC's general creditors. Section 541(a)(1) of the Code notably provides that the debtor's *interest* in property becomes property of the estate, rather than

[11] 11 U.S.C. § 761 et seq; 17 C.F.R. 190.00 et seq.
[12] 15 U.S.C. § 78aaa et seq.
[13] 15 U.S.C. § 78fff-3.
[14] 15 U.S.C. § 78lll(2)(B).
[15] 15 U.S.C. § 78fff-2.
[16] Section 101(6) of the Code defines "commodity broker" to include, among other things, a clearing organization.

the property itself becoming property of the estate.[17] OCC does not maintain an ownership interest in margin collateral. Under OCC's By-Laws, OCC's interest is limited to a restricted lien on customer margin that only allows OCC to use the collateral to cover obligations arising from the customers' account the collateral is held for. Therefore, margin collateral held for Clearing Members and their customers would not become part of the bankruptcy estate and would be maintained separately for Clearing Members and their customers.

Proposed Framework

OCC believes that the Commissions should undertake a joint rulemaking, as authorized by Section 713 of Dodd-Frank, to establish the requirements for holding futures customer positions in a securities account and securities customer positions in a futures customer account. OCC believes that rules should lay out the requirements a DCO/clearing agency and a BD/FCM would need to meet in order to implement the program, as well as a harmonized timeline for Commission approval. The requirements should focus on risk management, such as high-level standards for the margin model that the clearinghouse or intermediary will apply, backtesting results, and the suitability of the products to receive margin offsets. As described above, whether products are held in a futures or securities account, the products would be subject to a comprehensive and effective risk management and customer protection regulatory regime. Therefore, the framework would not need to establish new requirements for the treatment of portfolio margined products and could instead rely on the existing regulatory requirements of the relevant account. Further, the new framework can rely on the existing account types and would not need to establish additional account types or customer protection requirements that would be needed to support a new account type. Absent a rulemaking, OCC believes that a clear set of conditions that can be met to obtain an exemption permitting portfolio margining would be beneficial to the markets.

In the Request, the Commissions asked about alternative insolvency regimes, including Article 8 of the Uniform Commercial Code ("UCC"). OCC does not believe such alternatives are necessary. As described above, the insolvency regimes under both Commissions' rules offer comparable priority for customers and can effectively resolve a portfolio margined account holding products regulated by both Commissions. Further, OCC believes that any regime should not prioritize some customers over other customers and should be carefully designed so that portfolio margined customers, futures customers, and securities customers receive equal treatment in an insolvency.

[17] 11 U.S.C. § 541(a)(1).

Conclusion

OCC appreciates the opportunity to provide comment and commends the Commissions for seeking input regarding portfolio margining. OCC appreciates the continued efforts towards harmonization of Commissions' regulatory regimes and believes that portfolio margining is an ideal topic for these efforts. OCC remains available to provide additional information or perspective that may assist the Commissions in their important work.

Sincerely,

Megan Malone Cohen

Megan Malone Cohen
General Counsel