THE FOUNDATION FOR SECURE MARKETS®

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February 6, 2026

Committee on Payments and Market Infrastructures,
Secretariat cpmi@bis.org

International Organization of Securities
Commissions, Secretariat GBRCP@iosco.org

VIA EMAIL

Re: **FMIs' management of general business risks and general business losses: Further guidance to the PFMI**

The Options Clearing Corporation ("OCC") appreciates the opportunity to comment on the Committee on Payments and Market Infrastructures and the International Organization of Securities Commissions ("CPMI- IOSCO") consultative report on Financial Market Infrastructures' ("FMIs") management of general business risk, entitled *FMIs' management of general business risks and general business losses: Further guidance to the PFMI* ("Consultation"). OCC has contributed to similar efforts previously by responding to the CPMI-IOSCO Survey on non-default losses ("NDLs") in January 2021, participating in CPMI-IOSCO workshops on NDLs in July 2021 and September 2022, and providing written comments on CPMI-IOSCO's 2022 Discussion paper on Central Counterparty Practices to Address Non-default Losses. In addition, OCC endorses and incorporates by reference the comments submitted by CCP Global and the World Federation of Exchanges.

OCC operates as a central counterparty ("CCP") under the jurisdiction of both the U.S. Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC"). As a registered clearing agency under the SEC's jurisdiction, OCC is the sole clearing agency for equity options listed on national securities exchanges. 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. OCC operates as an industry utility. OCC is owned by five options exchanges and governed by a Board of Directors that includes nine clearing member representatives, five exchange representatives, five public directors, and one management representative.

General Comments

OCC believes that the Principles for Financial Market Infrastructure ("PFMI") provide a robust framework for CCPs' management of general business risk and does not believe that further guidance or standards on the topic are necessary. Principle 3 of the PFMIs provides clear and sufficient guidelines for how CCPs should identify, monitor, and manage the risks they are exposed to, including general business risk. Further, the text and Key Considerations of Principle 15 provide a clear and sufficient framework for the management of general business risk as well

as the amount of liquid net assets funded by equity ("LNAFBE") that should be held to manage these risks. Taken together, the relevant principles in the PFMI create a comprehensive framework for managing general business risk. Further, the PFMI's principles and outcomes-based approach allows CCPs to individually tailor their risk management practices, including with respect to general business risks, in a way that is appropriate for the particular risks they face. Therefore, OCC does not believe that additional guidance is necessary to ensure CCPs sufficiently manage general business risk. Compliance with the PFMI is sufficient to achieve robust risk management of a CCP's general business risk.

The proposed guidance, while framed as "supplemental," contains numerous elements that could be interpreted as creating new standards beyond the existing PFMI requirements. OCC is particularly concerned that highly prescriptive requirements regarding LNAFBE calculation methodologies and plans for recapitalization could lead to a "one-size-fits-all" approach that does not account for material differences in FMI business models, products cleared, risk profiles, and corporate structures. The existing Principle 15 appropriately provides outcome-based standards while allowing flexibility in implementation. Any final guidance should maintain this flexibility and explicitly clarify that it describes acceptable approaches rather than mandatory requirements.

Furthermore, OCC notes that some aspects of the proposed guidance may be more appropriately addressed through supervisory dialogue rather than public guidance, particularly regarding highly technical aspects of capital adequacy that may vary significantly across jurisdictions and FMI types. For example, the Consultation seeks comment on whether the guidance should distinguish between operating losses and non-operating losses in determining minimum LNAFBE. Based on OCC's experience, we do not believe such a distinction would be helpful or practical. Further, the distinction would not meaningfully improve the framework and could create complexity without corresponding benefit. The nature of general business risk is that it encompasses a broad range of potential losses that could threaten an FMI's viability as a going concern. Attempting to categorize losses as "operating" or "non-operating" could create artificial distinctions that do not reflect the reality of how such losses affect an FMI's financial position. From a risk management perspective, what matters is the total amount of LNAFBE needed to ensure recovery or orderly wind-down of critical operations, regardless of the source of the loss.

OCC's Management of General Business Risk

The Consultation proposes guidance for financial market infrastructure, including CCPs, to comply with Principle 15 of the PFMI. It focuses on three areas: 1) Identifying, Monitoring, and Managing General Business Risks; 2) Determining the Minimum Amount of LNAFBE; and 3) Governance and Transparency. OCC identifies, monitors and manages its general business risk in line with PFMI guidance and publishes information about OCC's management of its general business risk in its public PFMI Disclosure.

Identifying, Monitoring, and Managing General Business Risk

OCC identifies the risks, including general business risk, that would impede its ability to perform services as expected, and the process for identifying such risks relevant to the Consultation takes

a broad view to include (i) direct financial and operational risks that may prevent the smooth functioning of CCP services, (ii) reputational risks that could undermine the perception of OCC as a sound pillar in the financial market, and (iii) the risks OCC faces from third parties, such as custodians and settlement banks, that are critical to the design and operation of OCC's infrastructure and risk management.[1]

OCC monitors its financial resources on an ongoing basis in order to be able to quickly adapt if general business losses occur. To estimate the size of potential losses from identified risks, OCC conducts an Operational Risk Quantification annually using two methodologies. It conservatively selects the higher outcome as its Risk Capital.[2] The first approach applies the Basel III Standardized Measurement Approach. The second is a scenario-based approach that defines the Risk Capital as the amount sufficient to cover OCC's top three losses at a 99.9% confidence level. OCC uses the results of this exercise to help determine the amount of LNAFBE it will hold. OCC maintains 110% of its required LNAFBE as an early warning threshold. If LNAFBE falls below the early warning threshold, OCC management will report the breach to the OCC Board of Directors ("Board") and provide a recommendation on whether OCC should implement a fee increase to bring LNAFBE above the early warning threshold.

In addition, OCC performs a monthly analysis of projected financial resources compared to its projected operating expenses, and the Board reviews the schedule of fees on a quarterly basis to determine whether changes need to be made. This process helps ensure revenue derived from clearing fees is sufficient to cover OCC's operating expenses and helps OCC maintain reserves the Board deems reasonably necessary to provide facilities for the conduct of OCC's business and to conduct development and planning activities.

Determining the Minimum Amount of LNAFBE

OCC maintains robust processes and complies with applicable regulations on LNAFBE. Each year under its Capital Management Policy, OCC sets a Target Capital Requirement defined as the amount of LNAFBE recommended by Management and approved by the Board to ensure compliance under both the SEC and CFTC rules and to keep such additional amount the Board may approve for capital expenditures. The Target Capital Requirement is set at a level sufficient to maintain LNAFBE at least equal to the greater of: (1) six months of OCC's current operating expenses; (2) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services ("RWD Amount"); and (3) the amount determined by the Board to be sufficient for OCC to continue operations and services if general business losses materialize.[3] OCC's Capital Management Policy requires LNAFBE to be held in cash and cash equivalents. OCC considers all highly liquid investments with an initial maturity of three

[1] Under OCC Rule 1006(c), OCC would cover custodial or investment losses using resources from its Clearing Fund. OCC therefore does not consider these losses to be operational or cover the losses with the same OCC policies and procedures as general business risks.

[2] OCC uses Risk Capital as input to size its LNAFBE

[3] The Board uses the Risk Capital calculated during the Operational Risk Quantification to inform the amount needed for OCC to continue operations and services if general business losses materialize.

months or less from the date of purchase to be cash equivalents. For 2025, cash equivalents are comprised of investments in reverse repurchase agreements with major banks and broker dealers, which mature on the next business day.

As is suggested in the Consultation, OCC takes into consideration the costs and time of implementing its recovery and wind-down plan when determining the amount LNAFBE to hold. Specifically, the RWD Amount is one of the factors that can drive the sizing of the Target Capital Requirement. The RWD Amount is calculated on an annual basis pursuant to OCC's Capital Management Procedure based on the assumptions in OCC's Recovery and Orderly Wind-down Plan. Starting from the annual budget, OCC staff determines the weekly cost of critical functions identified in the Recovery and Wind-Down Plan. The weekly cost is multiplied by the timeframe specified in the plan to conduct the recovery or orderly wind-down to determine the RWD Amount.

As is discussed above, OCC maintains 110% of its Target Capital Requirement as an early warning threshold. OCC also maintains plans for raising additional capital if LNAFBE falls below 90% of the Target Capital Requirement. OCC would first use any unvested balance in its Executive Deferred Compensation Plan. If OCC still remains under 90% of the Target Capital Requirement, OCC will implement its operational loss fee, which is charged in equal share to each Clearing Member and payable within five business days. The operational loss fee is based on the RWD Amount and is filed annually with the SEC to reflect changes to OCC's current operating expenses.

OCC notes that the Consultation may introduce new prescription levels that may establish de facto capital expectations for a CCP's financial resources that go beyond PFMI guidance. Specifically, paragraph 4.2.11 in the Consultation may be interpreted as stating that CCPs should hold resources to absorb potential custody and investment losses beyond the minimum LNAFBE calculated. OCC believes this may set expectations beyond PFMIs' Principles 15 and 16, neither of which we interpret to require specific dedicated resources solely for absorbing custody and/or investment losses. Since the 2017 CCP Resilience Guidance and the Consultation are not intended to establish additional requirements beyond the established PFMIs, we recommend the final guidance remove language that is inconsistent with Principles 15 and 16 of the PFMI or, at a minimum, acknowledge that the approach to custody and investment risk management should be left to CCPs' discretion.

Governance and Transparency

OCC has clear governance arrangements around general business risk and its capital management process. The Board reviews and annually approves OCC's risk management framework, which governs general business risk. Further, the Board sets and reviews the Target Capital Requirement and makes any decision regarding replenishing LNAFBE if necessary. OCC's Capital Management Policy, which is reviewed and approved by its Board, has been filed with its regulators through proposed rule changes, notices of which are available on its regulator's public websites and/or in the *Federal Register*. Any amendments to the Policy would require further rulemaking subject to public notice and comment.

In addition, OCC includes information about its management of general business risk in its public PFMI Disclosure and includes details about its Target Capital Requirement, early warning threshold, and operational loss fee on its schedule of fees web page, updated quarterly, and in its annual report.

Conclusion

OCC appreciates CPMI-IOSCO's efforts to provide greater clarity regarding the PFMI principles concerning general business risk and looks forward to continued engagement on these topics, OCC reiterates its position that the existing PFMI framework is sufficiently robust and that additional prescriptive guidance risks undermining the principles-based approach that allows FMIs to tailor their risk management practices to their specific risk profiles.

Sincerely,



Megan Malone Cohen
General Counsel