THE FOUNDATION FOR SECURE MARKETS

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June 13, 2023

By Electronic Submission

Vanessa Countryman, Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: RIN 3235-AN25 Regulation Systems Compliance and Integrity

Dear Ms. Countryman:

The Options Clearing Corporation ("OCC") welcomes the opportunity to comment on the Securities and Exchange Commission's (the "SEC" or the "Commission") proposed amendments to Regulation Systems Compliance and Integrity ("Regulation SCI") under the Securities Exchange Act of 1934 (the "Proposal").[1]

Founded in 1973, OCC is the world's largest equity derivatives clearing organization. OCC operates under the jurisdiction of both the SEC and the Commodity Futures Trading Commission (the "CFTC"). As a registered clearing agency under the SEC's jurisdiction, OCC clears and settles transactions for exchange-listed options. OCC is subject to Regulation SCI as an SCI entity. As a registered derivatives clearing organization under the CFTC's jurisdiction, OCC clears and settles transactions in futures and options on futures. 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 CCP established in third countries under Article 25 of the European Market Infrastructure Regulation. OCC operates as a market utility and is owned by five exchanges.

OCC supports the Commission's desire to enhance Regulation SCI to address the novel challenges and risks arising from the increased use of third-party providers by SCI entities and the reliance on new and evolving technology by market participants. The increasingly complex nature of technology integral to the securities markets creates new areas of potential risks, including increased exposure to cybersecurity events and the potential market disruption associated with such events. As a SIFMU, OCC is committed to the implementation and maintenance of best-in-class risk management practices in the areas of technology and cybersecurity.

[1] RIN 3235-AN25 Regulation Systems Compliance and Integrity (April 13, 2023).

As an SCI entity on the cusp of moving its core clearing and settlement systems to the cloud, as well as a significant user of third-party services to support its core functions, we offer the following comments on the Proposal for the Commission's consideration.

I. The definition of systems intrusion and the application of the de minimis exception to systems intrusions are sufficient in their current form under Regulation SCI.

The Proposal would amend the definition of systems intrusion to include two additional types of cybersecurity events. As proposed, a systems intrusion means any:

> (1) Unauthorized entry into the SCI systems or indirect SCI systems of an SCI entity; (2) Cybersecurity event that disrupts, or significantly degrades, the normal operation of an SCI system; or (3) Significant attempted unauthorized entry into the SCI systems or indirect SCI systems of an SCI entity, as determined by the SCI entity pursuant to established reasonable written criteria.

By scoping in significant *attempted* entries, clause (3) in the new definition of systems intrusion would substantially increase the number of systems intrusions to be monitored, identified, resolved, and reported to the Commission. Furthermore, the Proposal would create a huge volume of burdensome event reporting, including detailed analysis as to which market participants were affected, the actual and planned steps the SCI entity will take to respond to the event, resolution details, policy and procedure modifications, and any other details deemed relevant by the SCI entity. The notification requirement to members or participants of the SCI entity that the responsible SCI personnel has reasonably estimated "may have been affected by the SCI event"[2] could result in a flood of event information to the securities markets for lower-risk threats.

In addition, the Proposal would remove the de minimis exception for systems intrusions, resulting in every systems intrusion being immediately reportable under Rule 1002 of Regulation SCI. Currently, SCI entities are required to report de minimis systems intrusions to the Commission on a quarterly basis. We believe the notification obligations currently required by Regulation SCI provide the Commission with sufficient and timely information on the cybersecurity landscape of SCI entities and appropriately prioritize immediate notification to the Commission of high-risk systems intrusions over low-risk systems intrusions. OCC respectfully requests that the Commission continue to permit systems intrusions that have no or de minimis impact on the SCI entity's operations or on market participants to be reported to the Commission on a quarterly basis as is currently required by Rule 1002(b)(5).

Accordingly, we believe that Regulation SCI as currently in effect is properly scoped to impose monitoring, reporting, and resolution obligations on the riskiest systems intrusions, thereby best supporting the maintenance of fair and orderly markets.

[2] 17 CFR 240.1002(c)(3)

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II. We request that the Commission consider a more flexible and risk-based approach to third-party requirements.

As an SCI entity and SIFMU moving its core clearing and settlement systems to the cloud, as well as a significant user of third-party services to support its core functions, OCC acknowledges that the role of risk management of third-party service provider relationships is a critical component of an SCI entity's resilience.

A. The scope of third-party providers required to be monitored by SCI entities is ambiguous, overly broad, and overly burdensome.

The Proposal would require SCI entities to maintain a program to manage and oversee "third-party providers that provide functionality, support or service, directly or indirectly," for any SCI systems and indirect SCI systems. Rather than defining what is captured by the term "third-party provider," the Proposal uses the terms "functionality, support or service" to better clarify the universe of providers subject to oversight by SCI entities. Unfortunately, the scope of third parties captured by the Proposal – particularly when considered in combination with the requirement to monitor 4th and nth parties discussed below – would cast an overly broad net and include service providers that pose minimal risk to SCI systems. For example, third-party providers that provide routine software support services for SCI systems would be captured by such a program, even though such service providers typically do not have access to the SCI systems they support. If this type of third party failed to fulfil its obligations to the SCI entity, the markets would continue to function in a fair and orderly manner. Requiring this type of third party to be captured by the oversight and management obligations of Regulation SCI would result in an unreasonable burden on SCI entities to monitor and manage third parties that do not pose a risk to the maintenance of fair and orderly markets.

Furthermore, as mentioned above, the Proposal would apply the monitoring and oversight obligation to third-party providers that provide support "directly or indirectly" to the SCI entity, whether they are "affiliated" or "unaffiliated" with the SCI entity. The placement of the word "indirectly" implies that 4th- and nth-party providers are subject to monitoring and oversight by SCI entities. These 4th- and nth party providers may include a broad range of third parties under the current Proposal, such as third-party development services, off-the-shelf software licensors, or maintenance and support services. To continue the example set forth in the preceding paragraph, if an SCI entity's cloud service provider utilizes 4th parties for routine software support services, the SCI entity would be required to include each such 4th party in its oversight and monitoring program, regardless of the level of risk such 4th party poses to its SCI systems.

In addition, as currently drafted the Proposal states that SCI entities must perform an "initial and periodic review of contracts" with third-party providers included in its monitoring and oversight program. However, given that the Proposal implies that 4th and nth parties must be included within the scope of such program, it is unclear what type of contract the Commission expects SCI entities to have with entities that indirectly provide functionality, support, or service for SCI systems. We

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request that the Commission clarify this ambiguity because a requirement that SCI entities contract directly with all 4th and nth parties would be administratively difficult to achieve.

For the reasons set forth above, the Proposal would significantly increase the number of entities subject to monitoring and oversight by the SCI entity. The benefits of such an approach would be significantly outweighed by the operational burden and feasibility of identifying and tracking all such third parties. Although we agree with the Commission that discipline in contracting, oversight, and management of third-party providers is essential for SCI entities, we request that the obligations imposed by the Proposal be limited to those third-party providers that are operating SCI systems or indirect SCI systems on behalf of the SCI entity, as is currently required under Regulation SCI. If the Commission nevertheless believes that a broader oversight program should be included within the final rule, we request that the Commission apply a risk-based approach to ensure that SCI entities are not subjected to undue costs and administrative burdens from monitoring and overseeing third-, 4th-, and nth-party providers that pose minimal risk to SCI systems.

B. The Proposal is too prescriptive to be successfully applied to third-party providers.

The Proposal introduces expanded obligations that are not only overly burdensome for SCI entities but would also be commercially unreasonable to secure from third-party providers. Specifically, the expanded definition of systems intrusion would require SCI entities to obtain notification of <u>all</u> attempted unauthorized entry into an SCI system or indirect SCI system operated by third parties on behalf of the SCI entity. In addition, in order to allow the SCI entity to determine the universe of in-scope 4th and nth parties that must be subject to the monitoring and oversight program discussed above, an SCI entity's third-party providers would be required to disclose extensive information to the SCI entity about their own service providers that provide "functionality, support or service" to SCI systems.

This level of information sharing, and the operational burden it would impose, has the potential to discourage third-party providers from entering or remaining in the market to provide critical services to SCI entities. Based on OCC's experience in negotiating with sophisticated service providers, we believe many third-party providers will likely be reluctant to provide such transparency to SCI entities, as this would provide the SCI entity access to the third-party provider's security, operations and/or business continuity and disaster recovery programs beyond what most third-party providers are willing to share even with the most commercially significant counterparties.

C. Subjecting third-party providers to onerous and prescriptive obligations raises concentration risk and the benefits do not outweigh the costs.

The Proposal's requirement to contractually obligate third-party providers to enter into agreements consistent with an SCI entity's obligations under Regulation SCI would create potentially significant disincentives for service providers to service the U.S. securities markets. As

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discussed above, the Proposal would require contractual commitments from third-party providers imposing financial and operational requirements that third parties may be unwilling to agree to, particularly if SCI entities do not constitute a meaningful portion of their overall customer base. Rather than this one-size-fits-all approach, SCI entities should be allowed to take a risk-based approach to effectively oversee and manage their third-party providers. By imposing burdensome, prescriptive requirements for SCI entities' agreements across such a broad group of third-party providers, irrespective of the relative risk presented by that relationship, the Proposal fails to meaningfully balance the benefits of these prescriptive oversight obligations against the administrative, financial, and operational costs to apply these standards.

As drafted, the Proposal does not recognize the need for organizations to use third-party providers to access services and expertise that would neither be financially feasible for an SCI entity to maintain internally, nor likely possible due to competition for limited talent pools. Moreover, the Commission appears not to have considered the negotiating power of these valuable third-party providers. As a result, if adopted as proposed, the Proposal could have the unintended effect of forcing SCI entities to assume the responsibility for performance of services that would be better performed by third parties that have specialized expertise. The Proposal may also limit the population of third parties willing and able to do business with SCI entities, potentially resulting in concentration risk for access to certain services within the securities markets. SCI entities – like other private entities and the Commission itself – use third-party providers to leverage best-in-class tools for the benefit of stakeholders, allowing the SCI entity itself to focus its expertise on its core competencies. OCC recommends the Commission consider the potential impact on these important relationships and adopt a risk-based approach in its final rule that weighs the benefit of requiring these contractual, oversight, and monitoring requirements with the cost of narrowing the universe of third parties that may be able to meet such stringent requirements.

D. If the Commission chooses to retain the provisions on contractual obligations for third parties, any final rule should include a phased implementation to allow sufficient time for responsible renegotiation of contracts.

If the Commission's final modifications to Regulation SCI include any new requirements that will necessitate modified contractual terms with third-party providers, it is essential that the Commission provide an extended implementation period for this aspect of the Proposal to allow SCI entities to incorporate such changes. OCC suggests a minimum of two years. Such a phase-in would facilitate negotiating and adding compliant language to existing agreements and enable SCI entities to transition to alternate third-party providers in the event they are unable to secure required contractual terms from existing third-party providers. We expect that these time-consuming negotiations will result in a cost increase to SCI entities both from the need to add internal staffing to negotiate and oversee these relationships and from the inevitable higher pricing from third-party providers to reflect the increased management, oversight, and contractual liability associated with each transaction. An extended phase-in period is necessary to permit SCI entities to negotiate with third-party providers in a methodical fashion and upon renewal of established agreements, if applicable, rather than requiring SCI entities to prematurely reopen private, commercial contractual

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relationships between SCI entities and third-party providers in a rushed manner, which could jeopardize the SCI entity's access to essential services which have already proven to be robust.

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OCC thanks the Commission for the opportunity to comment on the Proposal and we look forward to a continued dialogue on the topic.

Sincerely,

Megan Malone Cohen

Megan Malone Cohen
General Counsel and Corporate Secretary