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**By Electronic Mail**

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Deputy Secretary  
U.S. Securities and Exchange Commission  
100 F. Street, N.E.  
Washington, DC 20549  
[rule-comments@sec.gov](mailto:rule-comments@sec.gov)

Re: *Proposed Rule Change by The Options Clearing Corporation to Reflect the Elimination of a Discount to the Clearing Fee Schedule; Release No. 34-71769; File No. SR-OCC-2014-05*

On March 21, 2014, The Options Clearing Corporation (“OCC”)<sup>1</sup> filed a proposed rule change<sup>2</sup> (the “Proposal”) with the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) to reinstate its permanent clearing fee schedule for securities options and securities futures that became effective May 1, 2007 (the “Permanent Fee Schedule”).<sup>3</sup> Since 2007, OCC has provided a discounted schedule of fees that, as discussed in the Proposal, OCC has now determined is necessary and appropriate to discontinue (the “Discounted Fee Schedule”)<sup>4</sup> to promote OCC’s ability to meet current and reasonably projected operating costs.

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<sup>1</sup> OCC is a registered clearing agency with the SEC and a registered derivatives clearing organization (“DCO”) with the Commodity Futures Trading Commission (“CFTC”). The Financial Stability Oversight Council (“FSOC”) has also designated OCC as a systemically important financial market utility (“SIFMU”).

<sup>2</sup> See Exchange Act Release No. 71769 (March 21, 2014), 79 FR 17214 (March 27, 2014) (SR-OCC-2014-05).

<sup>3</sup> See Exchange Act Release No. 55709 (May 4, 2007), 72 FR 26669 (May 10, 2007) (SR-OCC-2007-05).

<sup>4</sup> See Exchange Act Release Nos. 56386 (September 11, 2007), 72 FR 53273 (September 18, 2007) (SR-OCC-2007-09); 57192 (January 24, 2008), 73 FR 5618 (January 30, 2008) (SR-OCC-2007-17).

OCC appreciates the opportunity to respond to comments questioning the Proposal's regulatory sufficiency.<sup>5</sup> For the reasons set forth below, we believe these comments are misplaced.

The Securities Exchange Act of 1934, as amended ("Exchange Act"), Commodity Exchange Act ("CEA"), Payment, Clearing and Settlement Supervision Act ("Clearing Supervision Act") and the collective requirements thereunder obligate a systemically important clearing agency like OCC to be able to facilitate prompt and accurate clearance and settlement of securities transactions,<sup>6</sup> be well designed and operated in a safe and sound manner<sup>7</sup> and to otherwise meet certain standards of financial and operational wherewithal, including but not limited to having the ability to hold sufficient liquid assets to cover potential general business losses so that it can continue operating as a going concern.<sup>8</sup> The FSOC highlighted the systemic importance of OCC's meeting these standards in its finding that "a failure or disruption to OCC could increase the risk of significant liquidity or credit problems spreading among financial institutions or markets and thereby threaten the stability of the financial system of the United States."<sup>9</sup> As noted by commenters, OCC is also obligated by the Exchange Act to have rules that provide for the equitable allocation of reasonable dues, fees and other charges among its participants. OCC appreciates and is mindful of this obligation and carefully considers it when making changes to its fee schedule, such as the changes OCC proposed in 2007 to implement the Permanent Fee Schedule that would now be reinstated. We note that the SEC found no grounds under the Exchange Act at that time on which to suspend the effectiveness of the filing or to otherwise disapprove it.

We continue to believe that the immediate effectiveness of the Proposal and its reinstatement of OCC's Permanent Fee Schedule to help meet current and projected operating costs is entirely consistent with the Exchange Act.

## **I. REINSTATEMENT OF PERMANENT FEE SCHEDULE**

### **A. The Proposal Only Reinstates OCC's Existing Permanent Fee Schedule**

On April 11, 2007, OCC filed for immediate effectiveness with the SEC a proposed rule change, that, effective May 1, 2007, implemented the Permanent Fee Schedule for options and security futures used by OCC today.<sup>10</sup> As part of that filing, OCC also implemented certain

<sup>5</sup> See Letter from Howard L. Kramer, Partner, Willkie Farr & Gallagher LLP (March 26, 2014) (on behalf of options market maker firms Belvedere Trading, Citadel Group, CTC Trading Group, Group One Trading, LP, Integral Derivatives, Spot Trading, Susquehanna Investment Group and Wolverine Trading) (the "Kramer Letter").

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(A), (F).

<sup>7</sup> 12 U.S.C. 5461(a)(2).

<sup>8</sup> 17 C.F.R. 39.11(a)(2); *see also* proposed SEC Rule 17Ad-22(e)(15).

<sup>9</sup> 2012 Annual Report of the FSOC, Appendix A at 187, <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Appendix%20A%20Designation%20of%20Systemically%20Important%20Market%20Utilities.pdf>.

<sup>10</sup> *See supra* note 3.

discounts to the Permanent Fee Schedule until such time as further action was taken by OCC's Board. On December 7, 2007, OCC filed with the SEC amendments to those discounts to implement the Discounted Fee Schedule to the Permanent Fee Schedule, also until such time as further action by OCC's Board.<sup>11</sup> OCC's implementation of the Discounted Fee Schedule reflected strong contract volume experienced by OCC and OCC's belief that the discounted fees would benefit clearing members without adversely affecting OCC's ability to meet expenses and maintain an acceptable level of retained earnings.

The Discounted Fee Schedule remained in place until OCC filed on March 21, 2014, for immediate effectiveness, the Proposal to eliminate discounts and effectively reinstate OCC's Permanent Fee Schedule. Commenters now use an overly broad brush to describe this as potentially a perpetual fee increase by OCC that is excessive and disproportionate. To be clear, the Proposal simply eliminates *discounts* to the Permanent Fee Schedule that OCC filed with the Commission in 2007 and which only became effective, together with the Permanent Fee Schedule, after the normal periods for public notice and comment and opportunities for the Commission to suspend the effectiveness of the related filings. The Proposal does not increase OCC's Permanent Fee Schedule already in place today. We also reiterate, as explained in the Proposal, that OCC will monitor the elimination of these discounts and consider whether additional modifications to OCC's fees are appropriate.<sup>12</sup>

#### B. Reasons for OCC's Increased Costs of Operation

In the Proposal, OCC set forth several factors that have caused OCC's increased costs of operation and that are expected to continue in the near term. For example, we explained that, among other things, OCC faces a proposed regulatory obligation to cover potential general business losses so that it can continue operating if such losses materialize by holding liquid net assets funded by equity equal to the greater of six months operating expenses *or* an amount determined by OCC's Board to be necessary to recover or wind down OCC's critical operations and services necessitated by credit losses, liquidity shortfalls, losses from general business risk or any other losses.<sup>13</sup> The Proposal also identified the significant effect on OCC's operating expenses of the need to engage outside professionals to address various regulatory issues arising under the Dodd-Frank Act, including OCC's designation as a SIFMU, and costs related to assessing compliance with international standards applicable to clearing agencies, on which the SEC's recently proposed rules for covered clearing agencies, like OCC, are based. Increased employee costs are also an important factor contributing to operating costs as OCC enhances its resources to respond to increased requests from regulators.

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<sup>11</sup> See *supra* note 4.

<sup>12</sup> We explained in the Proposal that changes in revenues as a result of significant fluctuations in future cleared volume may prompt a re-assessment of the Permanent Fee Schedule, upwards or downwards, and that cleared volumes will also be evaluated in connection with considering 2014 refunds.

<sup>13</sup> See SEC proposed Rule 17Ad-22(e)(15) (incorporating by reference costs associated with recovery and orderly wind-down identified in proposed Rule 17Ad-22(e)(3)(ii)).

It is important to note that, in addition to the above factors, toward the end of 2011, OCC became subject in its capacity as a DCO to significant responsibilities to maintain liquid assets to cover operating costs. Similar but not identical to proposed SEC Rule 17Ad-22(e)(15) is current CFTC regulation 39.11(a)(2), which requires OCC to maintain financial resources to cover its operating costs for a period of at least one year on a rolling basis. These financial resources are further required to be comprised of liquid financial assets, *i.e.*, cash and/or highly liquid securities, equal to at least six months' operating costs. Maintaining continued compliance with these obligations also has materially affected OCC's operating costs.

Commenters assert that it is hard to fathom how any new regulatory requirements justify fee increases of the magnitude being contemplated by OCC and that a much more detailed explanation of OCC's costs is critical.<sup>14</sup> As emphasized above, however, the Proposal does not propose any fee increases but rather discontinues certain discounts and reinstates OCC's Permanent Fee Schedule. With regard to the claim that OCC should provide further details and data to commenters underpinning OCC's existing explanation in the Proposal of its current and reasonably anticipated operating costs, OCC provided certain more detailed data to the SEC on these matters in connection with the Proposal and did so under the operative protections of the Freedom of Information Act for this type of confidential and proprietary information. As explained by the Commission in adopting Rule 17Ad-22(d)(9), the nature and extent of information required to be provided to participants should be tailored to the needs of the market participants based on the risks and costs to which they are exposed. Consistent with this obligation, OCC's Permanent Fee Schedule, along with the discounts, has been publicly available in full since 2007. Moreover, OCC met with clearing members likely to be most affected by the Proposal and also published to all clearing members two Information Memos in advance of filing the Proposal to notify them of the likely effect on refunds, including an explanation that the effect on refunds is not expected to extend beyond 2014 based on current projections.

As evidenced by the above measures, OCC is committed on an ongoing basis to meeting its obligations to participants and the public under the Exchange Act to help them understand the risks and costs of OCC's services. At the same time, OCC is also properly protected by law from having to publish certain proprietary commercial and financial information which would likely cause harm to OCC. Any suggestion by commenters that this level of information should be published in connection with the Proposal misconstrues the Exchange Act requirements applicable to clearing agencies.

### C. Equitable Allocation of Reasonable Dues, Fees and Other Charges

Section 17A(b)(3)(D) of the Exchange Act requires the rules of a clearing agency to provide for the equitable allocation of reasonable dues, fees, and other charges among its participants.<sup>15</sup> As explained in interpretive guidance from the SEC staff in its Announcement of Standards for the Registration of Clearing Agencies, the Commission has a duty to ensure that such fees are reasonable, are allocated among participants on an equitable basis and meet the

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<sup>14</sup> Kramer Letter at 2.

<sup>15</sup> 15 U.S.C. 78q-1

other objectives of Section 17A(b)(3) of the Exchange Act.<sup>16</sup> The interpretive guidance also notes the Commission staff's expectation that "in instances of significant fee change proposals a clearing agency will apprise its participants of such proposals and the underlying reasons therefor and that clearing agency participants will be allowed to give their views to the clearing agency regarding the determinations affecting fees prior to the filing of the proposals pursuant to Rule 19b-4 under the [Exchange] Act."<sup>17</sup>

OCC believes its actions regarding the Proposal are consistent with all of these regulatory considerations. The Commission raised no objections under the Exchange Act, including with regard to any potential failure of the Permanent Fee Schedule to equitably allocate fees among clearing members in connection with OCC's 2007 filing implementing the Permanent Fee Schedule. Moreover, as explained in the Proposal, the reinstatement of the Permanent Fee Schedule applies uniformly. Therefore, it does not disadvantage or favor any particular user in relationship to another user and does not work an impermissible burden on competition under the Exchange Act. Regarding the opportunity for comment by OCC's participants in advance of OCC filing the Proposal, and as detailed above in the discussion of OCC's increased operating costs, OCC solicited input from clearing members in several ways in advance of submitting the Proposal, including discussing the reinstatement of the Permanent Fee Schedule with clearing members most affected by it and providing notice to all clearing members through two separate Information Memos.

#### D. Claims Concerning the Overall Impact on Options Markets

Commenters claim that OCC's reinstatement of the Permanent Fee Schedule will result in large cost increases for listed options trades and that market makers' costs of executing trades would increase—widening quote spreads, decreasing quote depth and making it more costly for investors to transact. No quantitative basis is provided by commenters for these claims, and we do not believe the drastic consequences predicted by the commenters are likely to materialize.

The percentage increases in fees cited by the commenters suggest a dramatic increase in costs associated with options trading. Even if these projections are assumed to be accurate, they apply to only one component of the total cost of trading and clearing options. As part of OCC's recent process of evaluating and considering alternative ways to meet OCC's operating expenses, we have investigated the incremental cost of clearing fees as part of the overall cost of a listed options trade and determined that they make up a very small percentage of the total cost of the trade.<sup>18</sup> Based on the differences between the Permanent Fee Schedule for securities options and securities futures and the Discounted Fee Schedule, OCC estimates that reinstating the Permanent Fee Schedule likely results in most instances in overall cost increases of no more than two cents on a per contract basis (and less than two cents for larger contracts with the capped

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<sup>16</sup> Exchange Act Release No. 16900 (June 17, 1980), 45 FR 41920 (June 23, 1980).

<sup>17</sup> *Id.* at 41930.

<sup>18</sup> The total cost of a trade for this purpose is assumed to also include capital costs, options regulatory fees, certain exchange fees, the bid/offer spread and broker commission. It does not, however, include the option premium.

fee). This increase does not represent a dramatic increase in the total costs associated with an options trade. In addition, even after elimination of the discount, OCC believes that its clearing fees will remain lower than or comparable to fees charged by other clearing organizations.

#### E. OCC Is An At-Cost Market Utility

OCC's revenue, like that of most other registered clearing agencies, is principally derived from clearing fees charged to clearing members. Commenters assert that, rather than reinstating the Permanent Fee Schedule, there are other approaches OCC could use that would have a less harmful impact on the options markets, such as collecting funds from stockholder exchanges or raising capital through public or private investment.<sup>19</sup>

We agree that to best serve the markets for which it clears, it is critically important for a clearing agency to thoroughly consider and understand the impact of its fee structure. Accordingly, in connection with the Proposal, OCC studied and carefully developed alternative methods to potentially address the increase in operating costs and presented those methods to the Performance Committee of the Board along with a recommendation that the most cost-effective and efficient solution would be to remove the Discounted Fee Schedule. All of the potential solutions developed by OCC were evaluated by the Performance Committee, including but not limited to issuing capital stock, securing capital contributions from stockholder exchanges and issuing certain shares of preferred stock. The Performance Committee chose to recommend to the Board that the Permanent Fee Schedule should be reinstated, and, ultimately, it was the business judgment of the Board to remove the Discounted Fee Schedule, effective April 1, 2014, and to form an ad hoc group of directors who will further oversee the development of a longer term capital plan.

OCC operates as a market utility and essentially on a not-for-profit basis. For many years, OCC's clearing members and their customers have benefitted from one of the lowest fee structures among all U.S. derivatives clearing organizations. As explained in the Proposal, the method of determining the level of OCC's clearing fees is set forth in Article IX, Section 9 of OCC's By-Laws. This section of the By-Laws, which has been approved by the SEC, provides that clearing fees are to be set at a level sufficient to cover operating expenses, maintain reserves reasonably necessary to the conduct of OCC's business and to accumulate such additional surplus as the Board deems advisable for OCC to meet its obligations to clearing members and the general public. Having enjoyed the benefits from the low-cost clearing services provided under OCC's industry utility model, clearing members and their customers cannot reasonably object when increased operating costs and capital requirements necessitate that discounts should be suspended, as is now proposed.

The not-for-profit model that benefits options market participants also constrains OCC's potential sources of additional funds—particularly in the short term. In respect of commenters' specific suggestion that OCC should collect funds from stockholder exchanges, and as we noted in our comment letter on proposed standards for Financial Market Utilities by the Board of

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<sup>19</sup> Kramer Letter at 2.

Governors of the Federal Reserve System,<sup>20</sup> the options exchanges that are stockholders of OCC have equity investments that do not pay them dividends. Therefore, because OCC's services to the options markets as a utility means that stockholder exchanges do not profit from OCC's activities, additional capital contributions from them are unlikely absent significant changes related to the utility model – changes that would increase OCC's cost of doing business and themselves would necessitate the elimination of discounts to the Permanent Fee Schedule.

## **II. IMMEDIATE EFFECTIVENESS IS CONSISTENT WITH THE EXCHANGE ACT**

The provisions of the Exchange Act and related SEC rules governing proposed rule changes by self-regulatory organizations (“SROs”) have long recognized that certain types of proposed rule changes are entitled to take effect upon filing with the Commission.<sup>21</sup> This expressly includes a proposed rule change establishing a due, fee or other charge. Accordingly, commenters' assertions that OCC's Proposal, which concerns its clearing fees, is somehow ineligible for immediate effectiveness because in the view of commenters it will have a material effect on clearing costs is incorrect as a matter of law. This procedural standard is not in the SRO rule filing framework and is at odds with the well-established rule filing practices of registered clearing agencies.

Congress provided in Section 19(b)(3)(A)(ii) of the Exchange Act that a proposed rule change shall take effect immediately upon filing if designated by an SRO as establishing or changing a due, fee or other charge imposed by the SRO on any person, whether or not the person is a member of the SRO. SEC Rule 19b-4(f)(2) further clarifies that a proposed rule change may take effect upon filing if it establishes or changes a due, fee or other charge applicable only to a member. These are the clear and operative provisions under which OCC filed the Proposal to remove discounts to the Permanent Fee Schedule. We also note that immediately effective filings are subject to the exact same 21 calendar day comment period as “regular way” filings identified by commenters. In the case of immediately effective filings, the Commission, as the expert regulator of the securities markets, may summarily temporarily suspend a filing and institute proceedings to disapprove if, in its judgment, the filing is inconsistent with the requirements of the Exchange Act, the public interest and the protection of investors.

## **III. CONCLUSION**

As a utility model clearing agency that is also a SIFMU, OCC is fundamentally and continually concerned with providing a high level of clearing services and risk management at a fair price to the options market participants that it serves. In their letter, commenters express concern that the costs they project in respect of the Proposal have the potential to significantly decrease the quality of the options markets. As noted above, we disagree with these projections and also with assertions that the Proposal may be insufficient as a matter of law. At the same

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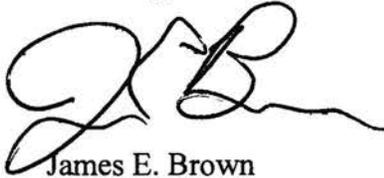
<sup>20</sup> See OCC comment letter on proposed Reg. HH Section 234.3(a)(15) at 9, [http://www.federalreserve.gov/SECRS/2014/April/20140401/R-1477/R-1477\\_033114\\_112201\\_564063302897\\_1.pdf](http://www.federalreserve.gov/SECRS/2014/April/20140401/R-1477/R-1477_033114_112201_564063302897_1.pdf)

<sup>21</sup> See 15 U.S.C. 78s(b)(3)(A); 17 C.F.R. 240.19b-4(f).

time, however, OCC appreciates and takes very seriously commenters' concerns regarding the impact of clearing fees on market participants. After careful consideration, the business judgment of OCC's Board is that the Proposal represents the best overall approach to management of OCC's operating costs at the present time. However, OCC will continue to monitor its expenses and the related fees that it imposes with the goal of discharging its obligations as a SIFMU while providing robust and cost-effective clearing services.

No basis exists on which to summarily temporarily suspend the Proposal. It is entirely consistent with the Exchange Act and the rules and regulations thereunder applicable to OCC as well as with the public interest and protection of investors. It should therefore remain effective as filed.

Sincerely,

A handwritten signature in black ink, appearing to read 'JEB', with a long horizontal flourish extending to the right.

James E. Brown  
General Counsel