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Kevin M. O'Neill
Deputy Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: File Number SR-OCC-2014-05

Dear Sir or Madam:

The Options Clearing Corporation ("OCC") has submitted a proposed rule change ("Proposal" or "filing") to the Securities and Exchange Commission ("SEC" or "Commission") to raise current OCC fees significantly on OCC participants.[1] I am writing again on behalf of a group of options market makers ("MMs") to express our concerns about a letter from OCC to the SEC dated April 17, 2014 ("OCC Letter") that attempts to respond to an earlier comment letter ("Kramer Letter") we submitted to the SEC on the proposed rule change.

In the Kramer Letter, we noted our concerns about the extreme size and nature of the fee increases and their likely harmful effect on the options markets. We questioned OCC's assertion that the new fees would be equitably allocated among its clearing members and other market participants, not only because such costs are generally passed through the clearing members to the end-users (i.e. options buyers and sellers) but also because the owners of OCC (the major options exchanges) were not being asked to absorb or finance any of these new expenses. The Kramer Letter focused on the fee filing being imposed largely as a matter of meeting increased operating expenses, since that is largely the way it was described in the filing. Indeed, the OCC memorandum to clearing members (March 10, 2014) explained the reason for the new fee structure, as follows: "OCC's current and projected operating expenses have increased because of current and anticipated regulatory requirements". The OCC Letter continues this theme by stating in the opening paragraph that the purpose of the fee change is "to promote OCC's ability to meet current and reasonably projected operating costs."

Upon review of the OCC Letter, however, it is evident that the vast majority of the proceeds from the fee increase will be used not to cover operating expenses but rather to increase

[1] Securities Exchange Act Release No. 71769 ((March 21, 2014) (the "Release").

"liquid net assets" for a rainy day account. This being the case, OCC is not being equitable in its efforts to raise such assets from third parties rather than OCC's own stockholders given that such a rainy day account will be an OCC asset directly benefitting its stockholders rather than being primarily used to cover increased operating expenses. Given OCC's status as the sole, common clearer for all listed options, the SEC should give additional scrutiny to fee increases of the size being proposed by OCC that will fall on end-users.

While the OCC Letter was somewhat helpful in discerning the underlying basis for the enormous fee increase, it was disappointing in its avoidance of the substantive points in the Kramer Letter and its brief dismissals of the noted concerns in the Kramer Letter. Thus, more strongly than before, we continue to believe justification for the new fee structure to be unsubstantiated. Also, we note that some of our concerns have now also been raised by the SIFMA Options Committee as stated in the SIFMA comment letter of April 17, especially the point that there is insufficient information on why the fee filing was chosen over other alternatives. Given OCC's unwillingness to provide the necessary details for a fully informed decision on this proposal, we believe the Commission is required to suspend the effectiveness of the Proposal and we urge it to do so promptly.

In the Kramer Letter, we noted that the Proposal is severely lacking in detail in key areas, such as:

(i) why OCC has determined to meet new regulatory costs solely by imposing exponentially higher clearing fees rather than alternative means of raising funds,
(ii) how OCC determined it needed to raise its fees by the amounts in the Proposal, and
(iii) how the proposed SEC rule referenced in the Proposal would lead to such huge increases in OCC fees[2].

Our concern as to why OCC determined to meet new regulatory costs solely by imposing dramatically higher clearing fees, rather than alternative means of raising funds, has increased significance given the revelations of the OCC Letter that the majority of the increased fee revenue will fund an asset rather than cover expenses. The Kramer Letter asked the question of choosing a fee over alternative financing methods after review of the SEC's Proposed Rule, which seemed to contemplate OCC raising funds through capital contributions and equity issuances rather than fee increases. The OCC's sole response to this question, that the "stockholders of OCC have equity investments that do not pay them dividends" is woefully inadequate. Regardless of the OCC's dividend structure, the $100 million or more that will be deposited in the rainy day account will be an OCC asset of sole benefit to the OCC stockholders. To require others to provide those funds would be inappropriate, which makes for an insufficient basis to justify the proposed fee increase.

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[2] Securities Exchange Act Release No. 71699 (March 12, 2014) ("Proposed Rule").

We also noted that while OCC claims that the fee increases are needed for current and anticipated regulatory requirements such as SEC's Proposed Rule, costs associated with the engagement of outside professionals to address regulatory issues under the Dodd-Frank Act, and additional employee costs, the Proposal is lacking in details as to how these three new regulatory requirements create the need for OCC to raise fees by over $100 million in additional revenue for OCC, and perhaps as much as $140 million per year. As a result, the only quantification of increased costs provided to date continues to be the general reference in Footnote 7 of the Proposal of a 9% annual increase, which appears to be only a fraction of the amount to be garnered by the new fees. We respectfully submit that such a lack of detail requires additional inquiry. Further, although OCC indicates that the fees will be reevaluated at the end of the year, it is clear that OCC does not believe the fees are extreme to begin with. Thus, there may be little willingness by OCC to revert fees to a much lower level in future years.

The Kramer Letter also stated that, if OCC needs to raise funds for regulatory requirements, there are other approaches it could use that would have a less harmful impact on the options markets, such as collecting funds from member exchanges or raising revenue through public or private investment. There is no discussion in the Proposal about the rationale for imposing fees only on clearing participants, and by extension those transacting in the options markets, rather than consideration of other sources to raise funds. The Kramer Letter also notes that the Proposal's fee increases would potentially cause great harm to options customers by significantly raising the cost of liquidity, and that the fee increases were determined without sufficient input from the participants in the options industry most affected by the Proposal, such as options market makers and retail broker-dealers. The OCC Letter did little to address these two points.[3]

We disagree with the OCC Letter's characterization of the Proposal as merely a "reinstatement" of its permanent fee schedule. The discounted fee schedule has been in place for seven years, so it is not accurate to call it a temporary discount. Retracting discounts that have existed for seven years so that clearing fees are doubled overnight is not simply eliminating discounts as OCC claims. Such a characterization avoids the fact that the Proposal is increasing dramatically the level of clearing fees that have existed for seven years. OCC apparently believes that regressing to a dramatically higher fee schedule from many years ago – when market competition was less intense and volume was much lower – does not merit an open discussion with MMs and other market participants to whom these fees will directly affect the most.

The OCC Letter is devoid of detail on the causes of OCC's increased costs of operation that compel it to raise clearing fees so substantially other than restating in general terms the three increased costs stated in the Proposal. Instead, the OCC Letter invokes Freedom of Information Act ("FOIA") protection to avoid describing how it arrived at the increase in anticipated operating costs. That is not an answer to a reasonable request for an explanation as to how OCC

[3] The OCC Letter's statement that "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 the filing the Proposal" reinforces our contention that OCC did not discuss the increases with the industry at large but merely ran it through a few clearing members and sent notices to clearing members shortly before submitting the Proposal to the SEC.

determined that it needed to raise clearing fees by well over $100 million. Without relinquishing any necessary FOIA protection, OCC easily can provide greater explanation on why it needs to raise this much revenue. Without such an explanation, the Proposal clearly violates the requirement of Section 17A(b)(3) of the Securities Exchange Act of 1934 ("Exchange Act") that OCC's fees be reasonable and meet the objectives of the Exchange Act.

The discussion of how the Proposal meets the standard of equitable allocation of reasonable fees, dues, and other charges among its participants is also severely lacking in the OCC Letter. The failure of the Commission to raise objections to the so-called Permanent Fee Schedule in 2007 is irrelevant as to whether removal of discounts seven years later so that clearing fees increase from 60% to over 200% is reasonable or equitable. The OCC Letter's statement that the fee increase applies uniformly is not correct, as clearing firms typically pass such fees through to the end users – the buyers and sellers As previously noted, OCC owner-exchanges will not bear the costs of funding OCC's increased regulatory costs, even though those entities own OCC and will reap the economic benefits of the new multi-million dollar rainy day account.

As stated in the OCC Letter, the Commission staff has an expectation that "in instances of significant fee change proposals a clearing agency will apprise its participants of such proposals and the underlying reasons therefore...".[4] As noted above, the OCC Letter concedes that OCC met only with *some* clearing participants. Moreover, a fee increase of this magnitude should have been described in advance to market participants beyond a few clearing firms to gauge its fairness and impact on the market. This was not done for the Proposal.

The OCC Letter states that no quantitative basis is provided for our claims that the fee increases will impact options prices negatively. The Kramer Letter provided reasonable forecasts of the likely effect of the large fee increases on quoted markets. Moreover, it is widely understood that increases in transaction fees for listed options will harm market liquidity.[5] Indeed, market quotes routinely adjust to reflect new transaction costs. Since the imposition of the Proposal, the market makers in this letter believe that the impact of the adjustment to these methodologies has been to force market makers to widen their quote spreads in those options series most likely to incur the bulk of the additional clearing fees. The market maker community's expectation is that the widening of spreads will result in decreased volume and liquidity, to the detriment of the market as a whole. Indeed, market maker quotes routinely adjust to reflect new transaction costs. For example, exchanges routinely offer transaction rebates to attract more business, which of course serves to tighten quotes. Thus, by the same token, wider quotes were an obvious result of the new, higher OCC fees. Thus, the OCC fee increases are not just an "incremental cost of the overall cost of an options trade" as suggested by the OCC Letter. With all other costs being held constant, an increase along the lines of the Proposal will impose a significant cost of providing liquidity, especially for actively-traded

[4] Securities Exchange Act Release 16900 (June 17, 1980).

[5] *See, e.g.*, Financial Transaction Taxes: Benefits and Costs, by Christopher Culp (March 16, 2010) as an example of a study of the impact of transaction costs on market liquidity. Although the study is on the impact of transaction taxes, its findings are equally relevant for the imposition of other transaction costs, such as clearing fees.

classes and series with tight bid-ask spreads. Consequently, the new higher fees are being paid almost entirely by the end-users.

The OCC Letter claims that OCC considered other methods to address its increase in operating costs but ultimately rejected all of them in favor of the fee increases. The OCC Letter, however, does not explain why the other approaches were rejected and why the fee increases are more fair and equitable, other than to state that it was the business judgment of the OCC Board. Moreover, the OCC Letter's claim that OCC has a low fee structure such that clearing members and their customers can not object when fees are increased 60% to 200% is without merit and has no basis in the Exchange Act. Otherwise, OCC could justify any fee increase it wanted to impose by invoking its "low-cost clearing services." Finally, OCC's not-for-profit basis is irrelevant as to the fairness and equitable nature of any fee proposals. OCC has many choices on how to raise equity regardless of its not-for-profit status, such as contributions from exchange members, which the OCC Letter dismisses too lightly. OCC also can determine to alter its structure by issuing preferred stock or accessing financing. It has chosen not to do so without any explanation as to why these approaches are less desirable than imposing huge increases in clearing fees.

We also strongly disagree that, merely because the Proposal is a fee increase, it should be eligible for immediate effectiveness under Section 19(B)(3(A) of the Exchange Act for the reasons noted in the Kramer Letter. Nevertheless, such eligibility is irrelevant as to whether the Proposal meets the standards of the Exchange Act and whether the Commission should suspend its effectiveness. The Proposal does not meet the requisite standards, and is void of meaningful explanation on why its enormous fee increases are consistent with the Exchange Act. The OCC Letter does not alleviate these deficiencies. Thus, the Commission should suspend the effectiveness of the Proposal.

In conclusion, we once again urge the Commission to suspend the effectiveness of the Proposal and take action to determine whether to disapprove the Proposal given the deficiencies in the Proposal described in this letter and the Kramer Letter as well as the enormous costs these potential fee increases would place on the options markets generally and on options market makers specifically. The group of market makers below wholeheartedly supports a strong and well-funded OCC. Our letter should not be construed as questioning that support. Rather, our letters raise the need for OCC to be transparent with the market regarding its enormous projected expenditures and fee increases. We and the public have a right to know in more detail why OCC needs this extra revenue and how it will be spent. As a clearing agency, OCC should be making efforts to provide transparency and build market participant support for large fee increases.

Invoking FOIA protections and business judgment rationales is not a means to adequately address the issues identified in the Kramer Letter and reinforces our belief that OCC's fee increases are neither reasonable nor equitable. Consequently, we believe the SEC should suspend the Proposal's effectiveness. To discuss this further, please contact me at (202) 303-1208.

Sincerely,

Howard L. Kramer

Howard L. Kramer, on behalf of

Belvedere Trading
Citadel Group
CTC Trading Group
Group One Trading, LP
Integral Derivatives
Spot Trading
Susquehanna Investment Group
Wolverine Trading

Cc: Joseph Kamnik, Securities and Exchange Commission
Susan Petersen, Securities and Exchange Commission