Joseph P. Kamnik
Senior Vice President
and General Counsel

December 20, 2017

FEDERAL EXPRESS AND E-MAIL

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street N.E.
Washington, D.C. 20549-1090

RE: The Options Clearing Corporation's Reply to Petitioners' Submission on Remand and in Further Support of the Re-Approval of the Capital Plan, File No. SR-OCC-2015-02

Dear Secretary Fields:

The Options Clearing Corporation ("OCC") hereby files the enclosed *The Options Clearing Corporation's Reply to Petitioners' Submission on Remand and in Further Support of the Re-Approval of the Capital Plan* via electronic mail. The OCC is sending the original document and three copies via Federal Express.

The enclosed *The Options Clearing Corporation's Reply to Petitioners' Submission on Remand and in Further Support of the Re-Approval of the Capital Plan* has been served by Federal Express on each party to the proceeding in accordance with 17 C.F.R. § 201.150, and as reflected in the included Certificate of Service.

Sincerely,

Joseph P. Kamnik
Senior Vice President & General Counsel

Enclosures

cc: Counsel for Petitioners (by Federal Express)

SECURITIES AND EXCHANGE COMMISSION

In the Matter of the The Options Clearing Corporation **For an Order Granting the Approval of** Proposed Rule Change Concerning a Proposed Capital Plan for Raising Additional Capital That Would Support The Options Clearing Corporation's Function as a Systemically Important Financial Market Utility (File No. SR-OCC-2015-02)	File No. SR-OCC-2015-02

THE OPTIONS CLEARING CORPORATION'S REPLY TO PETITIONERS' SUBMISSION ON REMAND AND IN FURTHER SUPPORT OF THE RE-APPROVAL OF THE CAPITAL PLAN

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The Options Clearing Corporation ("OCC") hereby submits this reply to Petitioners' Submission on Remand and in further support of the Securities and Exchange Commission's ("Commission") orders dated March 6, 2015 and February 11, 2016 approving the proposed rule change (together, the "Approval Orders") concerning OCC's Capital Plan (the "Capital Plan").

PRELIMINARY STATEMENT

Petitioners' submission is long on rhetoric, but short on substance. Petitioners ignore that OCC faced a mandatory capital raise, guided by and ultimately required by the Commission, to ensure its ability to perform its vital function as a systematically important financial market utility ("SIFMU").

At its heart, Petitioners' principal criticism is that OCC's stockholders, in Petitioners' arbitrary judgment, have been compensated too highly for their $150 million capital contribution and $200 million capital commitment. But nothing in the Exchange Act prohibits an equity stockholder from earning a return on an investment, much less regulates the amount of that return. Petitioners must therefore stretch the Exchange Act beyond all recognition to suggest that OCC's agreement to pay dividends to its stockholders in exchange for their substantial and illiquid investment somehow burdens competition, discriminates against the rest of the world who were not offered the same investment, and hurts investors.

None of those things is true. OCC did what it was required to do to meet its regulatory obligations and thus ensure its financial stability, obligations which are unquestionably designed to protect investors and serve the public interest. Petitioners' conclusory assertions aside, no basis exists to suggest that OCC stockholders' expected dividends impose any burden on competition. Inter-exchange competition for order flow has not been altered in favor of the Stockholder Exchanges one bit by the payment of dividends under the Capital Plan and, after more than two years, Petitioners have yet to furnish any supporting evidence to the contrary.

Nor does the Capital Plan discriminate against anyone. And finally, there is no basis to conclude that collecting too much money violates the Exchange Act, as Petitioners' wrongly suggest by misreading Oliver Wyman's and Barclays' analyses.

Put simply, the Capital Plan complies with all the requirements of the Exchange Act and, OCC respectfully submits, should be approved for a fourth, and final, time.

ARGUMENT

A. The Capital Plan Is Designed, In General, To Protect Investors And The Public Interest.

As discussed previously, OCC has been designated as a SIFMU by the Financial Stability Oversight Council and is therefore required to satisfy specific regulatory requirements, including Rule 17Ad-22(e)(15) which is modeled after Principle 15 of the *Principles for Financial Markets Infrastructure*.[1] These requirements are designed to ensure that, notwithstanding shocks to the financial markets and other business risks, OCC can continue to perform its essential role in the options and all other markets for which it clears trades.

Petitioners do not, and cannot, deny that OCC is a SIFMU and thus required to maintain sufficient capital funded from equity to comply with Rule 17Ad-22(e)(15) and to satisfy domestic and international standards. Pursuant to Rule 17Ad-22(e)(15), the amount of that capital must be sufficient "to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize."[2] In addition, although largely ignored by Petitioners, OCC must also have a viable plan "for raising additional equity should its equity fall close to or below" this amount.[3]

Nor do Petitioners dispute that OCC's Board in fact determined, based on Oliver

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[1] OCC Post-Remand Br. at 3-4.
[2] 17 C.F.R. 240.17Ad-22(e)(15) (emphasis added).
[3] *Id.*

Wyman's analysis, that OCC needed to maintain $247 million in capital funded from equity.[4] Instead, Petitioners erroneously focus on Barclays' (and OCC's) computation of six months of operating expenses only—*i.e.*, $106 million.[5] This ignores that the Board was specifically authorized by the Commission to determine the amount of capital required "to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize" and it did just that. Indeed, although not mentioned by Petitioners, Barclays also reported, based on Oliver Wyman's work (about which Petitioners can only nitpick) that "[a]nalysis at a 99.9% confidence interval resulted in a need of $247mm of capital."[6] Petitioners also ignore that Barclays provided data showing that OCC's maintaining $247 million in capital is consistent with how "[f]ellow SIFMUs and CCPs" were approaching the capital requirement based on how much capital "above the regulatory capital requirement" they were maintaining.[7]

Accordingly, consistent with Rule 17Ad-22(e)(15), OCC's Board determined that OCC needed to maintain $247 million in capital funded from equity to ensure that it would be able to continue to perform its crucial functions for the investing public, especially under severe economic conditions. **There can be no question that maintaining adequate capital protects investors and is in the public interest.**

Petitioners do not and cannot assert otherwise. Rather, they cherry pick—and quote out

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[4] OCC Post-Remand Br. at 5-9, 14.

[5] Petitioners' Br. at 18-19 (citing Barclays Capital Inc. Project Optimal Third Update: Ad Hoc Strategic Advisory Group Discussion at 13 (Sept. 30, 2014) ("Barclays Sept 30 presentation"). Barclays made clear on pages 9 and 13 of this presentation that $106 million equated only to six months of OCC's operating expenses. Barclays also made clear on those same pages that $247 million would be required to provide confidence at the 99.9% level to protect against "General Business Loss."

[6] 17 C.F.R. 240.17Ad-22(e)(15); Barclays, Project Optimal: Third Update – Ad Hoc Strategic Advisory Group Discussion (Sept. 30, 2014) at 12.

[7] Barclays, Project Optimal: Third Update – Ad Hoc Strategic Advisory Group Discussion (Sept. 30, 2014) at 15 (showing OCC's $247 million capital determination was 133% above six months of operating expenses compared with 229% for Clearstream, 234% for CLS, 100% for DTCC, 215% for Eurex, and 238% for LCH.Clearnet).

of context—a single statement in Barclays' list of the pros and cons for the Capital Plan, namely that the Capital Plan alters "OCC's 'zero profit' operating model."[8] But Barclays made clear that this adjustment was needed to provide a "reasonable IRR on contributed capital" and that returns would be "effectively capped."[9] Barclays also pointed out that obtaining capital from OCC's stockholders would provide "immediate capital injection and replenishment commitment [to] ensure timely compliance with SEC requirements," that "refunds [would be] restored for 2014 and beyond," that "fees [would be] normalized beginning in 2015," that there would be "no need for incrementally higher fees or outside equity capital in order to bridge OCC's compliance prior to 2016/17," and that "exchange owners and clearing member users [would be] better aligned on expense discipline given sharing of excess operating income."[10] Tellingly, Petitioners omit all these "pros" supporting the OCC Board's decision to adopt the Capital Plan.

Petitioners also assume, without providing any evidence and contrary to actual experience over two years, that OCC will increase fees to drive up dividends to OCC's stockholders.[11] As previously discussed, that makes no sense for several reasons. The entire premise of this argument is that OCC's management—which does not include stockholders—would artificially inflate expenses and raise fees so that shareholders will earn higher profits. No basis exists for Petitioners to make this accusation. It is also backwards. OCC's incentive is to keep operating expenses, and hence fees, low. Finally, and in any event, the Commission maintains continuing oversight authority to review and approve fee changes by OCC, thereby removing any doubt that OCC will be able to start charging fees at a level that violates the

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[8] Petitioners' Br. at 28 (quoting Barclays, Project Optimal: Analysis of Capital Raise Alternatives (Dec. 8, 2014) at 2).
[9] Barclays, Project Optimal: Analysis of Capital Raise Alternatives (Dec. 8, 2014) at 2.
[10] *Id.* Petitioners also question Barclays' independence on the supposition that it might have "loaned the shareholder exchanges proceeds for making their $150 million contribution toward the capital target." (Petitioners' Br. at 2 n.8.) Barclays did no such thing.
[11] Petitioners Br. at 28-33.

Exchange Act and is contrary to the public interest.

Likewise, and for similar reasons, there is no foundation for Petitioners' assumption that, even though the risk buffer used to establish fees has been reduced from 31% to 25%, net fees will increase because refunds have been reduced. As stated previously, OCC's understanding is that some clearing members pass those refunds to end users, while others do not. This evidence is entirely within Petitioners' control—not OCC's—yet Petitioners remain curiously silent as to their own practices in this regard. If Petitioners actually passed refunds to their own end users—the factual predicate for their argument that net fees to end users will increase under the Capital Plan—one would have expected them to say so. That they did not suggests they retain the refunds for themselves and that their own end users would in fact only experience a *reduction* in fees under the Capital Plan.

In short, OCC has demonstrated that the Capital Plan—which raised $150 million in additional capital from equity and established a viable plan should this capital be depleted—is in the public interest and protects investors by ensuring that OCC satisfies its regulatory obligations and will continue to perform its vital role in the options markets. Petitioners do not contest these fundamental and undeniable facts and their speculative concerns miss the mark.

B. The Capital Plan Does Not Impose Any Burden On Competition Not Necessary Or Appropriate In Furtherance Of The Purposes Of The Act.

Petitioners' main objection to the Capital Plan is that OCC's stockholders will be compensated 17% or more per year (based on Petitioners' calculations) for making a $150 million capital contribution to OCC and for agreeing to provide replenishment capital should those funds not be sufficient. In Petitioners' view, that level of compensation is "unreasonable"—though they offer no objective basis for why that is so.[12] They also ignore that

[12] Petitioners' Br. at 11.

OCC was required to raise capital from equity and establish a replenishment plan (both of which unavoidably have a price) and the dividend rate was established by an Advisory Group made up predominantly of OCC Board members who were not representatives of Stockholder Exchanges.

Regardless, nothing in the Exchange Act prohibits Stockholder Exchanges from earning returns on their capital. Nothing in the Exchange Act regulates what shareholders can, and cannot, earn on investments in SROs. Were that the case, then the Commission would be required to review the impact on shareholder returns for virtually every proposed rule change proffered by a SRO.

For OCC's stockholder dividends to be an issue, Petitioners must show that they impose a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act or that they run afoul of one of the other requirements of the Exchange Act. They have not and cannot do so. Indeed, Petitioners' submission devotes little attention to the actual competitive dynamics that they claim are "burdened" by the Capital Plan. That is not surprising given their admission that competition for order flow among options exchanges is "concededly 'fierce' and 'intense.'"[13] This was the case before the Capital Plan was implemented, and Petitioners have offered no reasons, let alone any evidence, that this intense competition has been burdened or otherwise diminished in any way by the Capital Plan. Nor could they because even after two years since the Capital Plan was implemented:

- there is no indication that prices for execution or other exchange services have been affected at all by the receipt of dividends by OCC's shareholders;
- there is no indication that any options exchanges have introduced, or failed to introduce, any new services or other offerings in response to or because of the

[13] Petitioners' Br. at 10.

receipt of dividends by OCC's shareholders; and

- there is no indication that options exchanges have altered their competitive behavior in any way in response to or because of the receipt of dividends by OCC's shareholders;

To the contrary, even after two years of operating under the Capital Plan, Petitioner KCG Holdings continues to represent in its SEC filings that "competition for order flow in the U.S. equity markets continues to be intense."[14]

That competition for order flow has not been affected in the slightest is not surprising. The Stockholder Exchanges' receipt of returns on their capital contributions to OCC for clearing services does not have anything to do with competition for order flow among options exchanges. In any event, as discussed previously, the dividends paid to the Stockholder Exchanges amount to a few million dollars per year per stockholder—an insignificant sum when compared to the overall, multi-billion-dollar market for options execution services. This does not give Stockholder Exchanges any advantage over non-Stockholder Exchanges when competing for order flow or along any other dimension. Exchanges spend billions of dollars on infrastructure, acquisitions, marketing and other things—the dividends are merely a rounding error on their books. Petitioners offer no response to this point.

In addition, Petitioners strangely assert that the Capital Plan "burdens" competition because OCC raised more capital than Petitioners believe is required.[15] Petitioners, however, make no attempt to explain how OCC's raising more capital, and thereby providing more stability in the market, could possibly "burden" competition.

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[14] KCG Holdings, Inc., Form 10-K, at 8 (Feb. 24, 2017) https://www.sec.gov/Archives/edgar/data/1569391/000156939117000003/kcg1231201610k.htm.
[15] Petitioners' Br. at 18.

Finally, even if the Capital Plan did impose some burden on competition—and it does not—any such burden is "necessary" and "appropriate" in furtherance of the purposes of the Exchange Act. OCC was required to raise capital to shore up its financial position. Any burden on competition is easily justified by "the importance of OCC's ongoing operations to the U.S. options market and the role of the Capital Plan in assuring its ability to facilitate the clearance and settlement of securities transactions in a wide range of market conditions."[16] Petitioners have no answer. OCC submits for all of the reasons stated above and in OCC's Post-Remand Submission that the dividend does not impact competition, and any theoretical concerns (which are neither supported nor explained by Petitioners) are more than justified to protect OCC and the investment community that it serves.

C. The Capital Plan Was Not Designed To Permit Unfair Discrimination Among Participants In the Use Of The Clearing Agency.

The notion that the Capital Plan discriminates against anyone is absurd. The Capital Plan is simply a plan to raise money and establish a replenishment plan for OCC. It does not result in disparate treatment for clearing members, exchanges, or anyone else. All similarly situated parties are treated alike.

In response, Petitioners argue that the Capital Plan is discriminatory because it provides Stockholder Exchanges "with a lucrative investment opportunity that it denies to the nonshareholder exchanges and all other participants."[17] But nothing in the Exchange Act requires OCC to offer "investment opportunities" to anyone, "lucrative" or otherwise. Nor does it require the Stockholder Exchanges to admit new equity owners. Not surprisingly, Petitioners offer no authority for their remarkable proposition.

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[16] 2015 Approval Order, 80 Fed. Reg. 13058,13068 (Mar. 12, 2015).
[17] Petitioners' Br. at 23.

Nor do retained earnings that might otherwise have been distributed as refunds constitute an "investment" by clearing members, as Petitioners oddly suggest.[18] Putting aside that this is inconsistent with their assertions that net fees to end users increase under the Capital Plan because these same refunds supposedly are passed on to end users, no basis exists to characterize unpaid refunds as an "investment." Refunds do not become the property of clearing members unless and until they are declared. They hardly constitute an investment similar to the $150 million capital contribution made by Stockholder Exchanges, nor have clearing members accepted the same replenishment obligations as the Stockholder Exchanges.

This is simply not unfair discrimination "among participants in the ***use*** of the clearing agency."[19] As OCC explained in its opening brief, the Capital Plan does not discriminate against any participants within the meaning of the Exchange Act because the Capital Plan does not impact how participants use OCC's clearing services.[20] The use of OCC's clearing services under the Capital Plan remains identical to the usage of OCC's clearing services prior to the Capital Plan's implementation. No unfair discrimination is present here.

D. OCC Complied With Its Own Rules In Developing And Approving The Capital Plan.

Petitioners' opposition confirms that they are not asserting that any aspect of the Capital Plan itself violates OCC's bylaws. Rather, they only challenge the process by which OCC adopted the Capital Plan. That is dispositive. OCC's process is not under review; the Capital Plan is. Because the Capital Plan does not violate Exchange Act Section 19(b)(2)(C)—a statute that concerns substance, not process—Petitioners' objections about OCC's compliance with its

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[18] Petitioners' Br. at 26 ("While the shareholder exchanges have been handsomely rewarded for their investment, the clearing members received nothing whatsoever in return for theirs.").
[19] 15 U.S.C. § 78q-1(b)(3)(F) (emphasis added).
[20] OCC Post-Remand Br. at 22.

bylaws are therefore misplaced. To the extent a bylaw violation has occurred (and there has not) rejecting the Capital Plan is clearly not the remedy.

In any event, OCC did not violate its own bylaws. Notably, Petitioners have now abandoned their assertion that all information of competitive significance must be provided to the non-stockholder exchanges pursuant to OCC's bylaws. Instead, they now concede that only information that the "Executive Chairman considers to be of competitive significance" must be provided.[21] As discussed previously, OCC's Executive Chairman, Craig Donohue, detailed his involvement in the deliberative process to design the Capital Plan and stated that he "never considered the Capital Plan to be of competitive significance to the Non-Equity Exchanges."[22] And, for the reasons discussed above, he was correct—the Capital Plan has no impact on inter-exchange competition. OCC's bylaws, accordingly, did not require disclosure to the non-stockholder exchanges.

Nor do OCC's bylaws guarantee non-stockholder exchanges the "right to participate in the deliberative process" of OCC's management.[23] Absent a determination by OCC's Executive Chairman that information is competitively significant, OCC's bylaws do not require notification or participation for non-stockholder exchanges. Nothing in OCC's bylaws is to the contrary. And, to the extent non-stockholder exchanges wished their voices to be heard about the Capital Plan, they have had more than ample opportunity to speak their minds over the last three years.

CONCLUSION

For the reasons discussed above and in OCC's Post-Remand Submission, OCC respectfully submits that the Commission should re-approve the Capital Plan.

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[21] Petitioners' Br. at 6.
[22] Declaration of Craig S. Donohue, dated Oct. 13, 2017 ("2017 Donohue Decl.") ¶¶ 4, 22.
[23] Petitioners' Br. at 9.

Dated: December 20, 2017

Respectfully submitted,

THE OPTIONS CLEARING CORPORATION

By: _____

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CERTIFICATE OF COMPLIANCE

I, Joseph P. Kamnik, General Counsel of The Options Clearing Corporation (OCC), hereby certify that the foregoing Reply to Petitioners' Submission on Remand and in Further Support of the Re-Approval of the Capital Plan complies with the word limitation provided in 17 C.F.R. § 201.450(c). Exclusive of the exempted portions of the brief, as provided by 17 C.F.R. § 201.450(c), the Submission includes 3, 078 words. The undersigned relied upon the word count function of Microsoft Word in preparing this certificate.

Dated: December 20, 2017

Joseph P. Kamnik

CERTIFICATE OF SERVICE

I, Joseph P. Kamnik, General Counsel of The Options Clearing Corporation (OCC), hereby certify that, on December 20, 2017, I caused to be served copies of the attached Reply to Petitioners' Submission on Remand and in Further Support of the Re-Approval of the Capital Plan by way of Federal Express on the parties and sent the original and three copies via Federal Express to the Secretary at the following addresses:

Brent J. Fields
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Dated: December 20, 2017

Joseph P. Kamnik