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February 20, 2015

**Via Electronic Mail (rule-comments@sec.gov)**

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

**Re: File No. SR-OCC-2015-02: Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a 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**

**and**

**File No. SR-OCC-2014-813; Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice, as modified by Amendment No. 1, 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**

SIFMA submits this letter to comment on the Proposed Capital Plan sought in the above-referenced Notice of Filing of a Proposed Rule Change and Notice of Filing of an Advance Notice (together, the “Notices”) filed by the Options Clearing Corporation (“OCC”). Although the term sheet and detailed terms of the OCC’s Proposed Capital Plan have been redacted from the OCC’s filings, thereby preventing any real analysis of the costs of the proposed plan, the Proposed Capital Plan’s structural terms that are disclosed indicate that the OCC would increase its capital through the contribution of additional equity capital by the options exchanges that already own equity in the OCC (the “Stockholder Exchanges”) and a commitment by the Stockholder Exchanges to contribute additional capital under certain circumstances (“Replenishment Capital”). In exchange for the additional capital and the commitment to provide a certain capped amount of Replenishment Capital, the Stockholder Exchanges would receive the right to receive *in perpetuity* dividends from the OCC generated from excess fees paid by Clearing Members and, ultimately, the end user investors whose transactions are cleared through the OCC.

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SIFMA understands and appreciates that the OCC has been designated as a systemically important financial market utility and that the SEC's proposed rule 17Ad-22(e)-(15) will require the OCC to obtain and maintain increased levels of liquid net assets funded by equity. SIFMA supports the greater capitalization of the OCC, but the OCC's Proposed Capital Plan risks converting the OCC from an industry utility model operated to serve and benefit the entire industry to a for-profit enterprise model operated to generate and maintain above-market returns for a few preferred Stockholder Exchanges. Accordingly, SIFMA believes that the Proposed Capital Plan should not be adopted and the OCC should seek to develop an appropriate Capital Plan through a more transparent and public process that would include the OCC's members, end user investors, and other non-stockholder exchanges. SIFMA believes that a more open process would allow the OCC to achieve the enhanced levels of capital sought in the Proposed Plan at better prices and without risking the loss of the public utility model that has worked so successfully to the benefit of the entire industry, including Members and their customers. Importantly, there is time. As the Notices acknowledge, the SEC's proposed Rule 17Ad-22 has not yet been adopted and, even when adopted, any capital enhancement requirements are unlikely to be immediately effective. SIFMA urges the SEC and the OCC to take this opportunity to implement a better, more transparent and fair process for developing a Capital Plan that, if at all possible, avoids the risk—or at least sunsets—converting the OCC into a profit center for the Stockholder Exchanges.

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**The Proposed Capital Plan risks converting the OCC from its traditional industry utility operating model to a for-profit model maximizing returns for the Stockholder Exchanges.** Historically and as recognized by the OCC in the Notices, the OCC has operated as a utility, refunding its earnings – effectively excess fees -- back to its Members through rebates. OCC Executive Director Craig Donohue recognized this model in a recent speech, noting that “it is our clearing members and their customers who receive pass through refunds who have benefited from OCC's strong financial performance.”<sup>1</sup> In the terms designed to provide and protect the dividend to be paid to the Stockholder Exchanges, however, the Proposed Capital Plan appears to abandon this model in favor of a profit-maximizing structure designed to enhance the future returns of the Stockholder Exchanges.

The most apparent element reflecting this structural change is the limitation of the refund to Members and their customers to 50% of excess fees. The remaining after-tax income of the OCC would then be reserved for payment of the dividends to the Stockholder Exchanges. The Proposed Capital Plan contains no sunset provision or

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<sup>1</sup> [http://www.optionsclearing.com/about/newsroom/releases/2014/05\\_01.jsp](http://www.optionsclearing.com/about/newsroom/releases/2014/05_01.jsp).  
“**Heightened Expectations for Systemically Important Clearing Houses: How OCC is Meeting the Challenge,**” remarks of Craig Donohue at the Options Industry Conference in Austin, TX, on May 1, 2014.

other limitation on the amount or duration of the dividends, thus meaning that for their initial capital contribution, the Stockholder Exchanges are entitled in perpetuity to all after-tax income of the OCC net of the 50% refund to Members (or, as discussed below, potentially more). The Notices attempt to downplay the significance of this change, claiming that a reduction in the proposed Business Risk Buffer from its 10-year average of 31% to a fixed 25% and the payment of the reduced refunds will maintain the industry utility model at lower initial fees. The Notices fail to provide any financial analysis supporting this claim, and it is difficult to understand how one could conclude that a 6% fee reduction would compensate for, let alone offset, a 50% reduction in the refund. Indeed, the basic math of the Proposed Capital Plan is that net fees paid by Members and their end-user customers will increase to fund the Stockholder Exchanges' dividends.

Other terms of the Proposed Capital Plan strongly suggest a shift towards maximizing and preserving the Stockholder Exchange's returns rather than protecting the interests of the Members and their customers. For example, in calculating excess fees available for the refund, the Proposed Capital Plan further reduces the amount available for a refund by deducting amounts needed to fund increases in the OCC's capital requirements. Members and their customers earn no return on this additional contribution of capital from their excess fees and, if the OCC were to liquidate or dissolve, none of this amount would be returned to the Members or their customers under the proposed revisions to the OCC's Certificate of Incorporation.<sup>2</sup> In addition, if the Stockholder Exchanges' Replenishment Capital is called, no refunds are paid to Members and their customers while any portion of that Replenishment Capital remains outstanding and, significantly, refunds are discontinued permanently if the Replenishment Capital remains outstanding for two years, regardless of whether it is repaid at some later point. There can be little question that these provisions seek to maximize and prioritize the dividends payable to the Stockholder Exchanges, and at the expense of the amount of fees paid by and other interests of the Members and their end-user customers. Contrary to the assertions in the Notices, the Plan is wholly inconsistent with the OCC's role as a utility.

**The absence of a competitive offering process or transparent pricing data raises significant questions as to the fairness and efficiency of the returns provided to the Stockholder Exchanges under the Proposed Capital Plan.** As noted above, the OCC's filings redacted all detailed information on the terms of the Proposed Capital Plan. Additionally, there was no public market process in which other potential sources of equity capital, including the Members, were permitted to express an interest in, and expectations of returns for, providing the additional equity the OCC seeks. Absent a process through which a competitive, efficient price and terms could be established or any information against which the dividend return and

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<sup>2</sup> See Securities Exchange Act Release No. 34-74136 at pp. 24-25 (January 26, 2105), 80 FR 5171, 5177 (January 30, 2015).

other terms can be measured, there is a substantial likelihood that the Stockholder Exchanges are receiving both preferred terms and above-market returns for their contributions of equity.

There are essentially three types of capital provided for in the Proposed Capital Plan: (i) the initial capital increase contributions to be made by the Stockholder Exchanges; (ii) the additional capital to be provided from excess Member fees; and (iii) the Replenishment Capital commitment. In exchange for providing two of these, the Stockholder Exchanges receive a perpetual dividend right at least equal to all after-tax income net of the 50% refund to Members and a preference for (if not exclusive rights to) any distributions on liquidation or dissolution of the OCC. The closest the Notices come to any sort of analysis of the reasonableness, efficiency and fairness of these terms is a conclusory statement that the policies in the proposal:

effectively cap the dividends to be paid to the Stockholder Exchanges at a level that the Board (with the advice of outside financial experts) has determined results in a reasonable rate of return on contributed capital, particularly in comparison to the implied cost of capital to the clearing members and their customers of instead pursuing an approach which required the accumulation of retained earnings through higher fees and no refunds for several years.

The Notices fail to acknowledge that the OCC already raised fees by 70% in 2014, providing \$112 million in fees and increasing retained earnings by \$72 million above the \$25 million held at the start of 2014. If the \$40 million proposed to be returned as a refund for 2014 were added to these retained earnings, the OCC would have succeeded in raising more than one-half of the initial capital increase the Proposed Capital Plan asserts is required from the Stockholder Exchanges. The OCC offers no explanation or analysis of how a permanent 50% reduction in refunds, even combined with slightly lower fees, amounts to a more cost-effective, efficient, fair, or reasonable source of funding, particularly when all additional required capital would then be provided out of excess Member and end-user fees. It is clear how this structure provides significant returns for the Stockholder Exchanges, but not how it more effectively or efficiently meets the public interests or serves the interests of the Members or their customers.

Furthermore, when examined closely the terms of the Replenishment Capital, discussed above, make clear that this element of the OCC's capital requirements is, at the same time, both limited and highly compensated for what it provides. Not only is the commitment capped at the lesser of the current Baseline Capital Requirement (\$117 million at present) or \$200 million, but the proposed amendments to Article VIII, Section 5(d) of the OCC By-Laws would allow the Stockholder Exchanges to manage the risk of their Replenishment Capital being required by determining whether retained earnings could be used to compensate for a loss or deficiency in the Clearing Fund. Armed with this unilateral right, the Stockholder Exchanges could easily

determine to fund Clearing Fund deficiencies through additional retained Member and end-user fees rather than risk having to fund their required Replenishment Capital commitment. Combining this ability to control the timing and risks associated with providing the Replenishment Capital with the potential for receiving dividends equal to all after-tax income when the Replenishment Capital is required, makes that feature of the capital structure very expensive. It is difficult to understand how one could conclude that no other, less expensive sources of this preferred equity could be obtained.

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As noted above, SIFMA fully supports the need for the OCC and other systemically important financial market utilities to be appropriately capitalized. SIFMA believes, however, that it is vital that the enhancements to the OCC's capital structure not detract from or destroy OCC's successful history of operating as an industry utility for the benefit of the market participants who use the OCC's clearing services. As described in the Notices, the Proposed Capital Plan risks just that and should not be approved. Instead, the OCC should be encouraged to engage in a public and transparent process to ensure that it is able to obtain and maintain additional capital on terms and at prices that are fair, reasonable, and efficient.

Thank you for your consideration of our comments. If you have any questions or require further information, please contact me at [REDACTED].

Sincerely,



Ellen Greene  
Managing Director  
Financial Services Operations

cc: The Honorable Mary Jo White, Chair  
The Honorable Luis A. Aguilar, Commissioner  
The Honorable Daniel M. Gallagher, Commissioner  
The Honorable Kara M. Stein, Commissioner  
The Honorable Michael S. Piwowar, Commissioner

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