By Electronic Mail

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Re: *Notice of Filing of a Proposed Rule Change and Advance Notice by The Options Clearing Corporation Related to the Adoption of an Options Exchange Risk Control Standards Policy; Release Nos. 34-77358, 77628; File Nos. SR-OCC-2016-004, 801*

The Options Clearing Corporation ("OCC")[1] submits this letter in response to comments of market participants on its recent proposal[2] regarding the adoption of an Options Exchange Risk Control Standards Policy ("Policy"). OCC's Policy would address risks from erroneous transactions that are executed on an options exchange that has not demonstrated the existence of certain risk controls ("Risk Controls") that are consistent with a set of principles-based risk control standards ("Risk Control Standards") developed by OCC in cooperation with the options exchanges. For any options contract cleared by OCC that is executed on an options exchange that has not demonstrated Risk Controls consistent with the Risk Control Standards, OCC would charge and collect from the Clearing Members[3] a fee of two cents on each side of the contract ("Fee").

The Fee is intended to (i) incentivize all options exchanges to adopt satisfactory Risk Controls and (ii) provide a fund to offset losses that may be incurred by OCC and its clearing members to the extent that trading continues to be conducted on an exchange without satisfactory Risk Controls. The Proposal seeks to control risks presented to OCC from renegade algorithms that can and have created severe market disruptions as described below. OCC seeks to protect

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[1] OCC is a registered clearing agency with the Commission, a registered derivatives clearing organization with the Commodity Futures Trading Commission, and a designated systemically important financial market utility ("SIFMU") by the Financial Stability Oversight Council. OCC clears and settles all listed options transactions on the U.S. options exchanges.

[2] The proposal ("Proposal") was filed as a proposed rule change under the Securities Exchange Act of 1934, as amended ("Exchange Act") and as an advance notice under the Payment, Clearing, and Settlement Supervision Act of 2010. See Exchange Act Release Nos. 77358 (March 14, 2016), 81 FR 14921 (March 18, 2016) (SR-OCC-2016-004) ("Proposed Rule Change"); 77628 (April 15, 2016), 81 FR 23536 (April 21, 2016) (SR-OCC-2016-801) ("Advance Notice").

[3] See Article I, Section 1 of OCC's By-Laws.

itself against the potentially very large losses that such incidents can impose and that in extreme cases could threaten the stability of the U.S. financial system.

I. BACKGROUND

As a SIFMU, OCC is subject to Title VIII of the Dodd-Frank Act ("Title VIII"). A stated purpose of Title VIII is to mitigate systemic risk in the U.S. financial system and promote financial stability by, among other things, promoting uniform risk management standards for SIFMUs.[4] Title VIII also authorizes the Commission to prescribe risk management standards for SIFMU clearing and settlement activities to (i) promote robust risk management, (ii) promote safety and soundness, (iii) reduce systemic risk, and (iv) support the stability of the broader financial system. The Commission has adopted risk management standards under Title VIII that in pertinent part require OCC to establish and enforce written policies reasonably designed to evaluate the potential sources of risks that can arise through OCC's links to clear and settle trades and to ensure that these risks are managed prudently on an ongoing basis.[5]

As demonstrated in the Proposal, recent and numerous trading firm errors have risked significant damage to OCC's clearing members, market participants, and OCC. On August 1, 2012, a trading firm erroneously sent more than 4 million orders to equity exchanges over a period of forty-five minutes, creating a loss of over $450 million.[6] On August 20, 2013, a trading firm's internal algorithm inadvertently produced options orders with inaccurate price limits that the firm sent to options exchanges and might have caused approximately $500 million in losses if many of the trades had not later been cancelled.[7] Shortly after a significant interruption of trading in NASDAQ-listed securities on August 22, 2013, Chair White called a meeting with the leaders of the equities and options exchanges, the Financial Industry Regulatory Authority, The Depository Trust & Clearing Corporation, and OCC to discuss ways to "work collaboratively – together and with the Commission – to strengthen critical market infrastructure[.]"[8] Chair White specifically requested in short order "a series of concrete measures designed to address specific areas where the robustness and resilience of market systems can be improved" and noted that "[t]he investing public deserves no less."[9]

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[4] See 12 U.S.C. 5461(b).

[5] See 17 CFR 17Ad-22(d)(7).

[6] See U.S. SEC examining risk controls at Knight Capital (August 3, 2012), http://www.reuters.com/article/us-sec-knight-idUSBRE8721NE20120803.

[7] See Exchange Act Release No. 75331 (June 30, 2015) (In the Matter of Goldman, Sachs & Co., Order Instituting Administrative and Cease-and-Desist Proceedings, Pursuant to Sections 15(b) and 21C of the Exchange Act, Making Findings, and Imposing Remedial Sanctions and a Cease-and-Desist Order).

[8] See Chair White Statement on Meeting with Leaders of Exchanges (September 12, 2013); see also Chair White Statement on NASDAQ Trading Interruption (August 22, 2013).

[9] Id.

In response, OCC and all of the options exchanges announced publicly in May of 2014 that they had agreed upon risk control principles that are the foundation for the Proposal.[10] Thereafter, options exchanges began submitting related rule changes to the Commission to implement controls consistent with the principles. OCC and the options exchanges also continued to collaborate to develop the related Proposal and significant care was taken to ensure that the Risk Control Standards retain maximum flexibility so that each options exchange can adopt Risk Controls, consistent with the principles, that are best suited to its particular market.

Today there are 14 options exchanges and all of them have already adopted at least some pre-trade risk controls that appear to be in furtherance of the Proposal.[11] The Proposal represents the only coordinated and industry-led solution that responds to Chair White's plea for such a response to mitigate risks to critical market infrastructure. If approved, it will give investors important market infrastructure improvements that they deserve and protect OCC and the U.S. financial system from serious risk that will not otherwise be properly managed. If disapproved, Chair White's pleas will go unheeded and the options industry will continue to be unnecessarily exposed to potentially catastrophic risks. Moreover, a disapproval by the Commission would also be an unfortunate deterrent to the further development of an industry-led solution to this serious problem. That outcome cannot be consistent with the Chair's request.

II. COMMENTS ON THE PROPOSAL

A. Five Supporting Comment Letters

Six comment letters have been submitted on the Proposal.[12] All six commenters acknowledge the importance of the options exchanges having risk controls that mitigate market

[10] OCC and the U.S. Options Exchanges Adopt New Pre- and Post-Trade Risk Control Principles (May 21, 2014), http://www.optionsclearing.com/about/newsroom/releases/2014/05_21.jsp.

[11] See, e.g., (1) Bats BZX Exchange, Inc., Rule 21.14 (Mass Cancellation of Trading Interest); (2) Bats EDGX Exchange, Inc., Rule 21.14 (Message Traffic Mitigation); (3) BOX Options Exchange LLC, Rule 7280 (Bulk Cancellation of Trading Interest); (4) Chicago Board Options Exchange, Incorporated, Rule 6.23C (Technical Disconnect); (5) C2 Options Exchange, Incorporated, Rule 6.17(a) (Market Width and Drill Through Parameters); (6) International Securities Exchange, LLC, Rule 722.07 (Price limits for complex orders and quotes); (7) ISE Gemini, LLC, Rule 714(d) (Market Wide Risk Protection); (8) ISE Mercury, LLC, Rule 804(g)(Automated Quotation Adjustments); (9) Miami International Securities Exchange LLC, Rule 519A (Risk Protection Monitor); (10) NASDAQ BX, Inc., Chapter IX, Sec. 6 (Risk Analysis of Market Maker Accounts); (11) The NASDAQ Stock Market LLC, Chapter VI, Sec. 18 (Order Price Protection); (12) NASDAQ PHLX LLC, Rule 1080(p)(1) (Acceptable Trade Range); (13) NYSE Arca, Inc., Rule 6.61 (Price Protection – Quotes); (14) NYSE MKT LLC, Rule 967NY (Price Protection – Orders).

[12] Letters from: (1) Lisa J. Fall, President, BOX Options Exchange ("BOX"); (2) Mark Dehnert, Managing Director, Goldman Sachs & Co. and Kyle Czepiel, Co-CEO, Goldman Sachs Execution and Clearing, L.P. ("Goldman Sachs"); (3) James G. Lundy, Associate General Counsel, ABN AMRO Clearing Chicago LLC ("ABN AMRO"); (4) Ellen Greene, Managing Director, Securities Industry and Financial Markets Association ("SIFMA"); (5) Michael J. Simon, Secretary and General Counsel, International Securities Exchange ("ISE"); (6) Edward T. Tilly, CEO, Chicago Board Options Exchange ("CBOE").

disruptions and other risks associated with their activities. Five of the commenters urged the Commission to approve the Proposal and expressly support it as a reasonable measure that will strengthen the critical infrastructure of the listed options markets.[13]

B. BOX Options Exchange's Concerns

BOX submitted a letter that supports options exchange risk controls generally but also expressed concern regarding OCC's authority to implement the Proposal.[14] These concerns are at best surprising and at worst disingenuous; BOX was a party to and supported the development of the principles that are the foundation for the Proposal, and BOX acknowledges it has already submitted several rule changes to the Commission that are in furtherance of the Risk Controls.[15] Despite these facts, BOX questions the validity of the Proposal for three chief reasons. It contends that (i) OCC does not have authority to prescribe what Risk Controls the options exchanges must make available, (ii) OCC lacks authority to charge the Fee and does not have a reasonable basis for it, and (iii) the Proposal imposes a burden on competition that OCC has not adequately justified. All of these arguments lack merit and mischaracterize the Proposal in a variety of ways for BOX's convenience so that BOX can attack OCC under the false premise that it is dangerously trying to usurp authority from the Commission to regulate options exchanges. These arguments are patently false. For the reasons that are described in more detail below, the actual attributes of the Proposal promote the protection of investors and critical market infrastructures and are entirely consistent with the Exchange Act, Title VIII, and Commission rules thereunder applicable to OCC.

III. RESPONSES TO CONCERNS AND QUESTIONS

OCC appreciates the opportunity to respond to the concerns and questions that were primarily raised by BOX and to address the reasons why the Proposal (i) is consistent with the Exchange Act and (ii) promotes the protection of investors and critical market infrastructures. We wish to emphasize that all of the options exchanges, including BOX, participated extensively in the development of the Proposal and have supported it in a variety of ways. Specifically, each of the options exchanges was involved in one or more of the following three ways: (i) voting for the Proposal as a representative of OCC's Board of Directors, (ii) publicly supporting the principles underpinning the Proposal in May of 2014, and (iii) helping in the development of the Proposal through coordinated efforts with OCC.

Because BOX has changed course and now objects to the Proposal, we also wish to emphasize that any weight given to its concerns should be in fair proportion to the extent of BOX's position in the market. In 2015, OCC estimates that BOX represented less than 3% of

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[13] Letters from Goldman Sachs, ABN AMRO, SIFMA, ISE, and CBOE at 1.

[14] BOX letter at 1.

[15] See, e.g., Exchange Act Release Nos. 71344 (January 17, 2014), 79 FR 4186 (January 24, 2014)(SR-BOX-2014-02) (Automatic Quote Cancellation); 71343 (January 17, 2014) 79 FR 4224 (January 24, 2014)(SR-BOX-2014-03)(Bulk Cancellation of Trading Interest); 71346 (January 17, 2014) (SR-BOX-2014-04)(Price Protection for Limit Orders); 77692 (April 22, 2016), 81 FR 25473 (April 28, 2016) (SR-BOX-2016-16) (Kill Switch and Cancellation of Session Orders).

the volume in the U.S. listed options market. By contrast, the support from the other options exchanges for the Proposal cumulatively represents support from an overwhelming 97% of the market share. It would be a serious mistake to allow the objections of one options exchange that represents less than 3% of U.S. listed options market volume to stop critical investor protections advanced by the Proposal based on the spurious argument, as noted below, that it cannot readily afford appropriate Risk Controls and therefore would suffer a competitive burden in relation to larger exchanges.

A. There is Clear Authority Under the Exchange Act for OCC to Implement the Proposal

In its letter, BOX "questions whether OCC has authority to prescribe what risk controls the options exchange must make available to market participants."[16] For the reasons described below, we agree with the statement that ISE makes in its comment letter that there is clear authority under Section 17A of the Exchange Act for OCC to implement the Proposal.[17] However, we must also note that BOX's comment misconstrues the Proposal from the outset. By design, the Proposal does not prescribe specific risk controls that must be made available to market participants; rather, the Proposal establishes principles-based standards and allows each options exchange to adopt Risk Controls best suited to its own market. As a result of the principles-based nature of the Risk Control Standards, there also must be a review process to determine whether the mechanism in which the options exchanges decided to implement the Risk Controls in fact achieves the intended result. The review process proposed by OCC – in which OCC would evaluate each options exchange's certification to OCC that it implemented Risk Controls consistent with the Risk Control Standards and for which each options exchange could appeal the initial determination and request OCC Risk Committee[18] review – is *necessary* given the flexibility required by the options exchanges to adopt Risk Controls best suited to their own markets, and is appropriate within the context of the commercial relationships between OCC and options exchanges. OCC does not seek to regulate the Exchanges. It seeks only to require them to have adequate mechanisms in place to prevent them from sending erroneous trades to OCC that can impose potentially disastrous losses on OCC, its clearing members, their customers, and ultimately the broader U.S. financial system.

Regarding OCC's authority to adopt rules that serve these interests, Section 17A(b)(3)(F) requires that the rules of a registered clearing agency such as OCC must be "designed to promote the prompt and accurate clearance and settlement of securities transactions and . . . assure the safeguarding of securities and funds which are in the custody or control of [OCC] or for which [OCC] is responsible[.]"[19] The Proposal serves these interests because without Risk Controls

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[16] BOX letter at 2.

[17] ISE letter at 2.

[18] OCC's Risk Committee is chaired by a public director and does not currently have an options exchange representative. In the event OCC's Risk Committee has an options exchange representative at some time in the future, such representative would be recused from a decision on the appeal of a determination of an options exchange's compliance with the Risk Control Standards.

[19] See 15 U.S.C. 78q-1(b)(3)(F).

that are consistent with the Risk Control Standards OCC has no assurance that reasonable pre-trade controls are in place to mitigate risk of trading errors that OCC has no ability to predict or measure. Since the options exchanges do not guarantee settlement of trades, they do not bear these risks; OCC does. Because (i) OCC has agreed to clear all matched trades reported to it pursuant to the Restated Participant Exchange Agreement to which all options exchanges are a party[20] and (ii) amendments to the Restated Participant Exchange Agreement require unanimous consent of all parties thereto,[21] which consent OCC could not have received given the objections on the record here, trades carrying these uncovered risks increase the likelihood that an OCC clearing member would default on its obligations and cause OCC to use the clearing fund deposits of other clearing members to meet its obligations. To address this, the Fee charged and collected from clearing members would be held by OCC as retained earnings and would provide an additional measure of protection for OCC to manage a clearing member default.[22] ISE points out that these aspects of the Proposal are also consistent with the provision in Section 17A(b)(3)(F) of the Exchange Act that requires OCC's rules to be designed "to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest." We agree. All of these Exchange Act provisions are clear authority in support of OCC's ability to implement the Proposal.

We further believe, as noted above, that Title VIII and risk management standards prescribed by the Commission in Rule 17Ad-22(d)(7) *require* OCC to create policies to ensure that it is prudently and appropriately identifying and managing the risks posed to OCC associated with links to clear and settle options trades, including regarding links with the options exchanges that transmit trades to OCC.[23] BOX states that it "fails to see" how the requirement in Rule 17Ad-22(d)(7) for OCC to have policies and procedures to prudently manage risks associated with links "relates to the link between the options exchanges and OCC."[24] We stress again, as we did in the Proposal, that the Commission stated when adopting the rule that "a registered clearing agency is confronted with a variety of risks that must be identified and understood if they are to be effectively controlled" and that Rule 17Ad-22(d)(7) helps ensure clearing agencies have policies and procedures designed to address those risks "[t]o the extent that [they] arise as a result of a registered clearing agency's links with another entity involved with the clearance and

[20] See Restated Participant Exchange Agreement (July 26, 1983) (at Section 7 as amended to date among OCC and the options exchanges).

[21] See Id. (at Section 26, noting that "[n]either this Agreement nor any term hereof may be changed, waived, discharged or terminated orally, but only by an instrument in writing signed by the party against which enforcement of such change, waiver, discharge or termination is sought"). As noted above, BOX's objection to the Risk Control Standards here is indicative that an amendment to the Restated Participant Exchange Agreement to compel compliance with the Risk Controls Standards by all options exchanges was impossible.

[22] See Article VIII, Section 5(d) of OCC's By-Laws.

[23] See supra note 5.

[24] BOX letter at 3.

settlement process."[25] The Commission also states that it adopted the rule to expressly promote the complementary statutory requirement for clearing agencies to cooperate and coordinate with other persons involved in the clearance and settlement process.[26] Accordingly, we believe the combination of these requirements provide OCC with ample authority to manage risks from participant exchanges like BOX that transmit trades to OCC.

B. The Fee is Reasonably Designed to Mitigate Risks from Trades Not Subjected to Appropriate Pre-Trade Risk Controls

1. Authority for the Fee

BOX also questions OCC's authority to "charge different fees for clearing transactions based on the executing exchange" and states that this "proposed departure from treating all options exchange [sic] the same is extremely concerning" because it will "establish that OCC has the authority to discriminate between exchanges through the fees OCC charges."[27] Here again, BOX's comment from the outset misconstrues the Proposal and is patently false. Further, as described below, OCC's ability to implement the Fee is supported by clear authority. Contrary to BOX's comments, the Proposal does not represent an effort by OCC to regulate options exchanges, and the Commission's supervision of OCC under the Exchange Act serves as a real and effective control against this misleading concern of overreach by OCC. In fact, the Proposal is a very narrowly focused measure that was developed in cooperation with all of OCC's participant exchanges, including BOX, to reduce the likelihood that exchanges will transmit erroneous trades to OCC, and in the absence of Risk Control Standards OCC will be protected from the increased risk from erroneous trades and clearing member defaults by collecting and holding a related amount of funds.

Regarding OCC's authority to charge the Fee to clearing members for this purpose, BOX correctly points out that the Exchange Act requires OCC's rules to provide for the "equitable allocation of reasonable dues, fees, and other charges among its participants"[28] and that Article IX, Section 9 of OCC's By-Laws governs OCC's fee structure.[29] In sum, Article IX, Section 9 requires that OCC's fee structure must cover OCC's operating expenses plus an additional business risk buffer, and in certain circumstances the fee structure can also be used to accumulate additional surplus amounts that OCC's Board of Directors deems advisable for OCC to meet its obligations to clearing members and the general public.[30] This is authorized in extraordinary circumstances when the Board determines that the amount of additional surplus that is needed is expected to exceed the full amount that it expects to be accumulated through the business risk buffer for the calendar year. BOX asks OCC to explain how the Fee is not inconsistent with

[25] See Proposal at 14926; see also Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 22, 2012).

[26] See 15 U.S.C. 78a-1(b)(3)(F).

[27] BOX letter at 4.

[28] See 15 U.S.C. 78q-1(b)(3)(D).

[29] BOX letter at 4 - 5.

[30] See Article IX, Section 9 of OCC's By-Laws.

these requirements.[31] In view of these considerations and the potentially extraordinary risks that are posed to OCC from erroneous trades, OCC's Board of Directors approved the Fee so that OCC would have additional financial resources to continue to meet its obligations to clearing members and the general public in a related default scenario. As noted below, OCC also has authority to adjust the Fee in either direction if that is warranted.

2. Reasonable Basis of the Fee

BOX further criticizes the Proposal because it says that OCC "has provided no specific data or study that supports the need for a two-cent fee increase for transactions occurring on exchanges that do not have the proposed risk controls."[32] In fact, there is no "specific data or study" that could be gathered or conducted for this purpose. While Chair White[33] and the Commission[34] have recognized and focused attention on the serious risks posed by market disruptions and erroneous trades, the economic consequences or frequency of these events are not susceptible to any precise measurement. Similarly, it is not possible to predict with a high degree of certainty how multiple market participants would choose to react to the Fee. This does not mean, however, that the Fee or its size was determined arbitrarily or without reason.

Significant consideration was given to the Fee based on the knowledge and business judgment of many individuals with experience in the options markets, including members of OCC's Board of Directors that at the time included five exchange directors and nine member directors, representing a broad cross-section of OCC's clearing membership.[35] We believe the Board's business judgment in this area deserves significant weight. As noted in the relevant legislative history to the Exchange Act regarding "Self-Regulatory Rule-Making," Congress stated that it intended to preserve discretion for SROs in their internal deliberative process because "one of the advantages of self-regulation is the flexibility and informality of its decision-

[31] BOX letter at 4 - 5.

[32] BOX letter at 4.

[33] See supra note 8.

[34] See, e.g., Exchange Act Release Nos. 67091 (May 31, 2012), 77 FR 33498, 33499-500 (June 6, 2012) (Order Approving, on a Pilot Basis, the National Market System Plan to Address Extraordinary Market Volatility) (noting that Commission staff worked with SROs to fashion policy responses to the significant market disruption of May 6, 2010, including by setting forth clearer standards and reduced discretion of SROs with respect to breaking erroneous trades); 74556 (March 20, 2015), 80 FR 16031 (March 26, 2015) (SR-BATS-2014-067) (Commission order approving a rule change relating to the adjustment and nullification of erroneous transactions that occur on the exchange's equity options platform); 71343 (January 17, 2014), 79 FR 4224 (January 24, 2014) (SR-BOX-2014-03) (codifying a bulk cancellation mechanism to help exchange members quickly mitigate the risk of erroneous trades when faced with technology issues); 70038 (July 25, 2013), 78 FR 46392 (July 31, 2013) (SR-NYSEArca-2013-72) (codifying price protection mechanisms and trade collars); 77692 (April 22, 2016), 81 FR 25473 (April 28, 2016) (SR-BOX-2016-16) (adopting, among other things, a "Kill Switch" mechanism to allow exchange members to remove or cancel all of their quotations or orders).

[35] Clearing member representatives on the OCC Board of Directors at the time the Fee was approved were: (1) ABN AMRO; (2) Bank of America Merrill Lynch; (3) Bank of New York – Mellon; (4) Charles Schwab; (5) Citigroup; (6) Goldman Sachs; (7) Newedge; (8) TD Ameritrade; and (9) Wolverine Trading.

making procedures" and also because "it would be difficult to prescribe a single 'proper' decision making procedure appropriate to the circumstances of every [SRO], and it is doubtful that any such formal procedure would better serve the goal of effective securities regulation than the present practice of encouraging each organization to develop procedures which best serve its needs and those of public investors."[36] In addition to the business judgment of the Board, OCC also collaborated with representatives from all of its participant exchanges and considered a number of factors, including, but not limited to, the seriousness of the risks presented by erroneous trades, the relationship of the Fee to the risks that it targets, and how the Fee affects execution and clearing costs. In consideration of these factors the design of the Fee is reasonable because it (i) is equitable in its potential application to all options exchanges, (ii) applies at the level of the trade to target real risks presented to OCC and the clearing system, and (iii) creates a rational relationship between the funds that would be collected and the measure of transaction volume on any relevant exchange. OCC expects the Fee would also cause market participants to direct at least some trading activity away from an options exchange that does not have the appropriate Risk Controls and that it therefore provides reasonable incentives for such an exchange to implement Risk Controls that respond to the Policy and reduce the likelihood that erroneous trades will be transmitted to OCC at all.

C. The Proposal Imposes No Burden on Competition That is Not Necessary or Appropriate

BOX identifies two main areas in which it believes the Proposal imposes a burden on competition that OCC has not adequately justified: (i) costs associated with implementing and maintaining Risk Controls Consistent with the Risk Control Standards and (ii) costs that the Fee would impose on the overall cost of effecting trades on an affected exchange. BOX argues that these costs would improperly frustrate its ability in particular to compete with other options exchanges because BOX is a "smaller exchange" that, as a relative matter of its position to larger exchanges, is less readily able to afford these costs.[37] This argument must be rejected insofar as erroneous trades executed on BOX, irrespective of its size, have the same ability to destabilize OCC and the entire U.S. listed options market as erroneous trades on other options exchanges. Additionally, as described below, we believe these characterizations are not accurate as to the recognized relationship between costs and burdens under the Exchange Act. First, compliance costs that apply uniformly and are equitable do not inherently impose a burden on competition. Second, if the Fee does impose a burden it is obviously necessary and appropriate to further the purposes of the Exchange Act.

1. Costs Regarding the Risk Control Standards Are Not a Burden on Competition

OCC stated in its rule filing that the proposed rule change "may" impose a burden on competition among options exchanges that do not implement sufficient risk controls. BOX asserts that "[t]here is no question the [Proposal] will impose a burden on competition, regardless

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[36] See S. Rep. No. 94-75, at 28 (1975).

[37] BOX letter at 3.

of any fee increase."[38] BOX's justification for this statement is that even if an options exchange is found to have Risk Controls consistent with the Risk Control Standards "there is still a substantial burden placed on the individual exchanges" and that "[t]his includes, but is not limited to the resources needed to guarantee the exchange has required risk controls and the resources expended yearly to remain compliant."[39] We disagree. While implementing and maintaining Risk Controls that are consistent with the Risk Control Standards may impose varying costs on the exchanges, the same is true of many standards that OCC requires an exchange to meet to become and remain a participant exchange. For example, participant exchanges are required to be registered national securities exchanges or associations, have effective rules for trading options, purchase either common stock or a promissory note of OCC, and have infrastructure and communication systems sufficient to interact with OCC.[40]

These costs are not a burden on competition so long as they are equitable and apply equally to all options exchanges, which they do under the Proposal. Accordingly, BOX's complaint that the burden of these costs "is especially high for smaller exchanges, such as BOX"[41] is irrelevant. The fact that some options exchanges may be larger or smaller than others or have greater or lesser financial resources does not give rise to a burden on competition under the Exchange Act so long as there is no discrimination. Otherwise, every risk-based requirement of an SRO that entails any significant cost would be a burden on competition. This cannot be true. Moreover, BOX's complaint that it cannot afford the pre-trade controls seems contrary to the record given the competing statements BOX makes in its letter that it "has already made numerous rule changes in response to Chair White's Statement,"[42] that it "does not object to increased risk controls,"[43] and given BOX's participation in the development of the risk control principles that were announced in May of 2014.

2. The Extent of Any Competitive Burden From the Fee is Not Clear

BOX's comment letter states that "BOX strongly believes that an increased clearing fee applicable to a single exchange could have devastating effects on that exchange's ability to successfully compete, and that OCC fails to adequately justify the need for the proposed fee."[44] While the Fee imposes clearing costs that provide a reasonable incentive for exchanges to adopt adequate Risk Controls consistent with the Risk Control Standards, BOX provides no evidence that the alternative application of the Fee would have "devastating" effects on an options

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[38] Id.

[39] Id. BOX does not identify what other costs might be incurred by implementing Risk Controls consistent with the Risk Control Standards.

[40] See Articles VIIA and VIIB, Sections 1 and 2 of OCC's By-Laws; see also Restated Participant Exchange Agreement (July 26, 1983) (at Section 1 as amended to date among OCC and the options exchanges).

[41] BOX letter at 3.

[42] BOX letter at 2. See also supra note 15 and accompanying text regarding proposed rule changes by BOX to implement risk controls.

[43] BOX letter at 1.

[44] BOX letter at 4.

exchange's ability to compete. As noted by ISE, an exchange that chooses not to adopt adequate Risk Controls would make an economic decision that non-compliance is economically preferable,[45] and any resulting competitive disparity could be resolved simply by that exchange adopting the appropriate Risk Controls. Also, options exchanges that do not adopt the Risk Controls may realize cost savings that the other exchanges would not. Such an exchange might choose to deploy its savings to attract additional order flow from members by, for example, offering rebates to incentivize members to post tight quotations that are at or improve the national best bid or national best offer ("NBBO") and promote executions against the exchange's superior quotations.[46] The exchange might also use the savings to attract order flow through the development of new products or other features. The exchange may also reconsider and determine that it is preferable to adopt adequate Risk Controls to avoid the Fee or as a way to attract exchange members that desire better protection of their orders from erroneous executions.

3. Any Burden Would be Necessary or Appropriate in Furtherance of the Purposes of the Exchange Act

Even if the Proposal and the Fee impose some burden on competition, it would be clearly outweighed and justified under the Exchange Act by the significant risk of financial harm from erroneous trading activity and the fact that the Proposal mitigates that risk to further the crucial policy purposes in Section 17A of the Exchange Act. The Proposal also responds to Chair White's call to action for OCC, the exchanges, and others to work collaboratively and use concrete measures to protect critical U.S. market infrastructures. Chair White again emphasized the continued importance of this agenda just recently.[47]

The Exchange Act requires that the rules of a clearing agency must not "impose any burden on competition not necessary or appropriate in furtherance of the purposes of this title."[48] As established in Bradford Nat'l Clearing Corp. v. SEC, courts have held in reviewing the Commission's application of this authority that "our task is not to decide whether the Commission made the 'right' (or least anticompetitive) decision or the one that this court might have made were it charged with doing so but rather whether the Commission's decision falls within the boundaries of its broad authority."[49] That court also noted that the relevant legislative history in the Exchange Act makes clear that the Commission is only required to "balance"

[45] ISE Letter at 4.

[46] The options markets are subject to an Order Protection Rule that generally prevents market participants from trading through better priced quotations on other options exchanges. Consequently, market participants may have to execute transactions on exchanges that do not have Risk Controls consistent with the Risk Control Standards. See Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (Options Order Protection and Locked/Crossed Market Plan ("Options Linkage Plan")).

[47] Chair White Remarks Before the SEC Historical Society – "The Continuous Process of Optimizing the Equity Markets" (June 2, 2016) (noting the priority of ensuring the integrity of critical market infrastructures).

[48] See 15 U.S.C. 78q-1(b)(3)(I).

[49] See Bradford Nat 'l Clearing Corp. v. SEC, 590 F.2d 1085, 1107 (D.C. Cir. 1978).

competitive concerns against all others that are statutorily relevant.[50] Against this standard of review, any burden that would arise through the Commission's approval of the Proposal is unquestionably in furtherance of the most basic purposes of Section 17A, which are to "facilitate the prompt and accurate clearance and settlement of securities transactions . . . assure the safeguarding of securities and funds in [the clearing agency's] custody or control or for which it is responsible" and to "remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest."[51]

It would not be consistent with these purposes to allow options exchanges to compete with one another through less effective risk controls while passing the increased risk of erroneous trading on to others and not reserving resources to manage the corresponding risk. The risk of harm from erroneous trades is serious, as evidenced by the scale of the trading firm errors noted above and by the response of the Commission and Chair White to make it such a high priority. By ensuring that exchanges will either have Risk Controls consistent with the Risk Control Standards or that the Fee will apply, the Proposal advances the goals of the Exchange Act by protecting OCC, the markets it serves, clearing members, and the U.S. financial system—all while allowing options exchanges discretion to operate their business. As persuasively noted in the comment letter submitted by ISE, "[t]he proposed fee levels the playing field and avoids economically rewarding exchanges that choose to avoid the costs of complying with the Policy."

IV. THE INDUSTRY NEEDS EXCHANGE RISK CONTROL STANDARDS THAT COMPLEMENT SEC REGULATIONS

Furthermore, and as noted in the Proposal and agreed to expressly by three of the commenters,[52] we believe that the initiative complements Commission regulations in place today that share the aim of supporting the resiliency of critical market infrastructures, such as Commission Rule 15c3-5,[53] regarding market access, and Regulation Systems Compliance and Integrity ("Reg. SCI").[54] We continue to emphasize that even while Rule 15c3-5 has been in place it has not prevented the occurrence of the significant trading errors noted above and that OCC believes the proposed Risk Controls would have limited substantially. Accordingly, the

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[50] Id. at 1105. See also S. Rep. No. 94-75, at 13 (1975) (the Senate Committee on Banking Housing and Urban Affairs stating that the "explicit obligation to balance against other regulatory criteria and considerations the competitive implications of self-regulatory and Commission action should not be viewed as requiring the Commission to justify that such actions be the least anti-competitive manner of achieving a regulatory objective. Rather, the Commission's obligation is to weigh competitive impact in reaching regulatory conclusions. The manner in which it does so is to be subjected to judicial scrutiny upon review in the same fashion as are other Commission determinations, with no less deference to the Commission's expertise than is the case in other matters subject to its jurisdiction.").

[51] See 15 U.S.C. 78q-1(b)(3)(F).

[52] ABN AMRO letter at 1; SIFMA letter at 2; CBOE letter at 2.

[53] See 17 CFR 240.15c3-5.

[54] See Exchange Act Release No. 73639 (November 19, 2014), 79 FR 72252 (December 4, 2014) (Reg. SCI Adopting Release).

principles at the foundation of the Proposal are a necessary complement to ensure continued resilience of critical market infrastructures.

Moreover, the protections in the Proposal and their complementary relationship to Rule 15c3-5 and Reg. SCI reflects coordinated protections that are in line with how Commission rules and SRO rules already work together in other areas. For example, while no statute or Commission rule codifies the duty of best execution for broker-dealers, SROs have adopted rules that explicitly impose a duty of best execution on their members.[55] In adopting Regulation NMS, the Commission noted that the Order Protection Rule (Rule 611),[56] which generally requires broker-dealers to obtain the best possible price in the market for a customer's order at a given time, in no way lessened a broker-dealer's duty of best execution but rather helped serve the common interest of customer protection.[57] In this way, SRO rules and Commission rules can combine to create a regulatory framework that promotes safe and efficient markets. Our Proposal is similarly designed to promote policy objectives stated by Chair White[58] while buttressing the existing regulatory framework under Rule 15c3-5 and Reg. SCI to protect critical market infrastructures.

V. CONCLUSION

The vast majority of commenters support OCC's Proposal and have urged the Commission to approve it.[59] Because the Proposal is consistent with the Exchange Act, enables OCC to comply with risk management standards applicable to it under Title VIII, and responds to the important policy goals outlined by Chair White, we urge the Commission to end any further delay in approving the Proposal.

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[55] See, e.g., FINRA Rule 5310 (Best Execution and Interpositioning). The duty of best execution originally derives from common law agency principles and fiduciary obligations.

[56] See 12 CFR 242.611.

[57] See Exchange Act Release No. 51808 (June 29, 2005), 70 FR 37496, 37537 - 8 (June 29, 2005) (discussing the Commission's adoption of Rule 611 and its relationship to a broker-dealer's duty of best execution). The listed options markets are subject to an Order Protection Rule similar to Commission Rule 611 through the Options Linkage Plan.

[58] See supra note 8.

[59] See supra note 13 and accompanying text.