



March 16, 2018

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

Re: The Options Clearing Corporation; Suspension of and Order Instituting Proceedings to Determine Whether to Approve or Disapprove the Proposed Rule Change to Revise The Options Clearing Corporation's Schedule of Fees - Rel. No. 34-82793; File No. SR-OCC-2018-004

Dear Mr. Fields:

Susquehanna International Group, LLP ("SIG") appreciates the opportunity to provide further commentary in response to the Securities and Exchange Commission's ("SEC" or the "Commission") request for comments in its temporary suspension of the above-referenced proposed rule change to allow additional analysis of the proposed rule change's consistency with the Securities Exchange Act (the "Act") and the rules thereunder. In particular, we understand that the Commission seeks to assess (1) whether the considerations currently before it in connection with its review of the Options Clearing Corporation (the "OCC") Capital Plan on remand are implicated by the issues raised by the proposed fee change; (2) whether, without access to the information provided by OCC on a confidential basis, the public cannot meaningfully comment on the propriety of the proposed fee increase; and (3) whether the proposed rule change is consistent with Section 17A(b)(3)(D) of the Act, which requires clearing agency rules to provide for the equitable allocation of reasonable dues, fees and other charges among its participants.

### ***The OCC Response To SIG's Comment Letter is Unavailing***

OCC's February 28, 2018 response (the "OCC Response") to SIG's February 14, 2018 comment letter (the "SIG Letter") offered nothing to alleviate the concerns and objections raised by SIG. OCC asserted that "No basis exists – and none has been offered by SIG – to suggest that the fee increase that is the subject of the Proposed Rule Change fails to comply with the requirements of Section 17A(b)(3)(D) of the Exchange Act." This is meritless for several reasons. First, SIG made the point that the fee increase was the fruit of a poisonous tree, the Capital Plan;<sup>1</sup> that it contravenes multiple OCC representations that lower fees would result from the Capital Plan; that the budget inflation underlying OCC's fees is consistent with our predictions as such inflation rewards OCC's shareholders with larger dividends; and that the proposed fee increase flies in the face of the material volume and revenue increases currently enjoyed by OCC. Second, it is extremely disingenuous for OCC to withhold from SIG and the public the materials necessary to assess whether the proposed fee increase complies with Section 17A(b)(3)(D) of the Act, then claim victory over our inability to make such assessment. Third, OCC's claim is a vain attempt to turn on its head the point made in the SIG Letter that it is OCC's burden to *establish* that the proposed fees are reasonable.

In support of its fee schedule, the OCC Response asserts that OCC determined that a fee increase was necessary based on an analysis, and that the resultant 2018 budget was prepared by management and approved by the OCC Board. These assertions should be discarded, as they are nothing more than an appeal to "trust the process" which, as noted in the SIG Letter, has been rejected by the D.C. Circuit.<sup>2</sup>

OCC additionally asserts that the proposed fee increase is necessary for OCC to cover its operating expenses and maintain an appropriate risk buffer, that it has substantiated those expenses by providing the SEC with its 2018 budget, that the budget confirms that OCC is projecting expenses to increase, and that the subject expenses "are normal business expenses that OCC must incur to operate a functioning clearinghouse and satisfy its obligations as a SIFMU."<sup>3</sup>

We are deprived of the opportunity to meaningfully comment on whether OCC's 2018 budget and any other confidential OCC materials substantiate the reasonability of OCC's projected expenses, which is essential to a determination of whether the proposed fee increase is reasonable. We note, however, that if the 2018 budget and any other confidential materials provided to the Commission by OCC merely state the respective expense projections, this is a mere conclusory claim and not a substantiation.<sup>4</sup> A mere statement of expense projections says nothing about whether the projections are reasonable, and does not sustain OCC's burden for its rule change. Nor does OCC's characterization that the types of expenses for which it projects increases are "normal business expenses" substantiate that the projected expense figures themselves are reasonable and not the product of self-serving budget inflation. As discussed previously and below, there are material reasons to question the reasonability of OCC's projected expenses which, again, are a predicate to the reasonability of the proposed fee increase.

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<sup>1</sup> The OCC decision-making process for which, as the D.C. Circuit noted, was not "arm's length". *Susquehanna Int'l Grp., LLP v. SEC*, 866 F.3d 442, 448 (D.C. Cir. 2017)

<sup>2</sup> OCC claimed that it is not asking anyone to "trust the process", as it "has supplied the Commission with confidential information supporting the proposed fee increase." We will address OCC's withholding from the public of the "confidential information" *infra*, but note that this assertion certainly asks the public to "trust the process" in lieu of meaningful participation.

<sup>3</sup> OCC Response.

<sup>4</sup> We also caution against high-level conclusory statements in the confidential materials, including any report or discussion of OCC's claimed analysis, that OCC may purport to be more than that.

As noted in the SIG Letter, the protection afforded by the “opportunity for public comment” to the OCC rule filing is utterly hollow if the public is not provided the basis of the fee increase proposal. The extent of OCC’s response to this dilemma is that the budget is confidential and OCC does not have to make such information available. This response, of course, does nothing to refute the point that there is no basis upon which the public may meaningfully comment on the propriety of the OCC rule filing; nor does OCC even attempt to argue otherwise. Indeed, OCC’s response is all the more egregious in view of its prior comments regarding fee increases under the Capital Plan:

Clearing Members have additional protections against changes in expenses that would result in fee increases because any future change in the Fee Policy would also require SEC approval. This need for approval would provide an opportunity for Clearing Members and other market participants to object to any proposed changes. In addition, any change in OCC’s fee schedule also requires an SEC rule filing, and the Commission has the authority to disapprove a fee filing as inconsistent with the requirement of Section 17A of the Exchange Act that fees of a clearing agency be “reasonable.”<sup>5</sup>

It is disingenuous for OCC to argue in support of SEC approval of the Capital Plan that the rule filing process – with its “opportunity for Clearing Members and other market participants to object to any proposed changes” – protects the investing public from changes in OCC expenses and resultant fee increases, then subvert that process by depriving those paying the fees of a meaningful “opportunity to object” by withholding the allegedly supporting materials. This wholly undercuts the “protection” OCC alleged to the SEC in order to have its Capital Plan approved.

OCC seeks to justify its anemic response by arguing (1) that “the proper regulator to evaluate OCC’s confidential information as [a self-regulatory organization (“SRO”)] is the Commission, not SIG”; and (2) that OCC’s approach is consistent with other SRO proposed fee schedule changes. Its first argument is an utter disregard for the public comment opportunity that is essential to the rule filing process. Its second argument is inapposite, as the fee increases of the other SROs do not result from a conflicted Capital Plan that incentivizes budget bloat to increase shareholder dividends.

### ***There Are Material Reasons to Question the OCC Fee Increase Proposal and Underlying Budget***

#### *OCC’s Year-Over-Year Expenses Have Increased Significantly Since Its SIFMU Designation*

As with its Capital Plan, OCC seeks to justify its proposed fee increase and underlying budget under cover of its designation as a systemically important financial market utility (“SIFMU”). This designation was made in July 2012 and, to the extent it entailed additional responsibilities and associated costs beyond those that OCC was already incurring, one would expect that most such additional costs would be incurred in the year or two following said designation; and not continuously increasing year-over-year thereafter, as OCC has done.

In fact, OCC’s expense increase rate since its SIFMU designation and under its conflicted Capital Plan has far outpaced its fellow SIFMUs that were designated at the same time as OCC. The below chart of SIFMU expense increase rates demonstrates this point.

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<sup>5</sup> February 23, 2015 letter from James E. Brown, Executive Vice President, General Counsel and Secretary, Options Clearing Corporation, to Brent J. Fields, regarding File No. SR-OCC-2015-02, p. 11.

| <b>SIFMU<sup>6</sup></b>      | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>2017</b> | <b>Cumulative</b> |
|-------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------------|
| OCC <sup>7</sup>              | 4.22%       | 8.8%        | 18.87%      | 10.65%      | 12.91%      | 21.34%      | 104.33%           |
| DTC <sup>8</sup>              | 10.11%      | -10.36%     | 3.7%        | 7.64%       | -2.24%      | -4.11%      | 3.28%             |
| NSCC <sup>9</sup>             | 14.35%      | 6.51%       | 16.67%      | 13.01%      | -2.96%      | -3.53%      | 50.33%            |
| FICC <sup>10</sup>            | 13.64%      | 6.78%       | 1.21%       | 7.95%       | 8.98%       | 5.75%       | 52.79%            |
| CME Group <sup>11</sup>       | -2.93%      | 6.27%       | 3.45%       | -0.45%      | 4.07%       | -4.29%      | 5.82%             |
| CLS Bank Int'l. <sup>12</sup> | 28.53%      | No data     | 6.08%       | 0.59%       | 4.77%       | No data     | 43.69%            |
| ICE Clearing <sup>13</sup>    | No data     | No data     | No data     | -8.28%      | -14.47%     | 7.9%        | -15.35%           |

What is more alarming, OCC's actual expense growth rate is exponentially greater than the rate it relied upon in developing its Capital Plan. In seeking to debunk SIG's projections of OCC shareholder rates of return in opposition to the Capital Plan, OCC stated, "SIG assumes an 8.0% compound annual growth rate for expenses from 2015 to 2022, which is far in excess of the 2.3% annual expense growth rate that OCC projected internally when developing the Capital Plan."<sup>14</sup> (emphasis added) Shockingly, OCC's actual expense growth rates for the years 2015 (when the Capital Plan was approved) to 2017 of 10.65%, 12.91%, and 21.34%, respectively, reflect a compound annual growth rate of 14.86%; which is not only 85.7% greater than SIG's "excessive" projected rate, but is 6.5 times greater than the rate upon which the OCC Board relied in approving the Capital Plan. This massive disparity calls into question the OCC approval process for the Capital Plan beyond previously raised concerns about that process; and supports the concerns SIG and others have raised about self-interested budget bloat under a conflicted Capital Plan. Now it seems that an emboldened OCC seeks to aggressively continue this stratagem via its current budget and fee increase proposal.

The composition of OCC's expenses should also be considered. "Employee costs" and "professional fees and outside services" are expense items well within OCC's control and ripe areas for self-interested budget inflation. Under the Capital Plan, OCC's "employee costs" increased from 2014 through 2017 by 25.3% from \$95.8 million to \$120 million; and "professional fees and outside services" increased by 89.5% from \$43.8 million to \$83 million. Together, these two items comprised 68% of OCC's 2017 expenses; and, we suspect that these trends continue in OCC's confidential 2018 budget. Like OCC's general expense rate increases under the Capital Plan, the ballooning of these controllable expense items is consistent with public concerns about the Capital Plan. These self-same concerns undercut the instant proposed fee increase.

#### *OCC's Budget Increases Have Inflated Shareholder Dividends Beyond SIG's Projections*

The record shows that the concerns about budget bloat as a tool to increase dividends under the Capital Plan have been realized even more than anticipated. The below table compares SIG's aforementioned

<sup>6</sup> SIG was unable to identify expense data for The Clearing House Payments Company.

<sup>7</sup> Source: Annual Reports. Note the substantial and growing discrepancy between the OCC expense rate increases and that of the other SIFMUs after implementation of the conflicted OCC Capital Plan. Indeed, OCC posted rising double digit increases while some other SIFMUs reduced expenses.

<sup>8</sup> Source: Annual Financial Statements.

<sup>9</sup> Source: Annual Financial Statements.

<sup>10</sup> Source: Annual Financial Statements.

<sup>11</sup> Source: Form 10-K.

<sup>12</sup> Source: Annual Reports/Financial Statements.

<sup>13</sup> ICE Clear Credit LLC. Source: Form 10-K.

<sup>14</sup> OCC Brief in Support of Motion to Lift Stay (April 2, 2015), File No. SR-OCC-2015-02, p. 11.

2015 to 2022 projected OCC shareholder dividends and associated return rate under the Capital Plan to the actual amounts paid during the first three years of the Capital Plan.

|      | <u>Projected Div.</u> | <u>Projected Rate</u> <sup>15</sup> | <u>Actual Div.</u> | <u>Actual Rate</u> |
|------|-----------------------|-------------------------------------|--------------------|--------------------|
| 2015 | \$21.3M               | 14.2%                               | \$19.7M            | 13.1%              |
| 2016 | \$22.9M               | 15.3%                               | \$25.6M            | 17%                |
| 2017 | \$24.8M               | 16.5%                               | \$32.5M            | 21.7%              |
| 2018 | \$26.7M               | 17.8%                               |                    |                    |
| 2019 | \$28.9M               | 19.2%                               |                    |                    |
| 2020 | \$31.2M               | 20.8%                               |                    |                    |
| 2021 | \$33.6M               | 22.4%                               |                    |                    |
| 2022 | \$36.3M               | 24.2%                               |                    |                    |

As noted above, OCC sought to discredit SIG’s projections in 2015 as uninformed overestimations, but OCC’s actual dividends have grown beyond, and at a faster rate, than our projections.<sup>16</sup> In view of these outsized returns beyond even our disconcerting predictions, it is not surprising that OCC has changed its defense of the shareholder return rates from protesting that they are reasonable to “[n]othing in the Exchange Act regulates what shareholders can, and cannot, earn on investments in SROs.”<sup>17</sup> The realization of these exorbitant shareholder returns resulting from OCC’s vast and unabashed budget increases under the Capital Plan further underscores the concerns about the Capital Plan and OCC’s consequent actions, including the instant 2018 confidential budget underlying the proposed fee increase, which is rendered all the more dubious.

*OCC’s 2018 Budget Increase Does Not Reconcile With OCC’s 2017 Excess Refund*

As noted above, OCC’s 2017 expenses increased by 21.34% over 2016 expenses, yet OCC still announced a special refund of 2017 clearing fees of approximately \$25.7 million in addition to its regular refund of approximately \$53 million. The special refund represented fees collected in excess of OCC’s 33% Budget Buffer. In view of the \$25.7 million excess fees collected by OCC in 2017, together with the over 40% increase in cleared option contract volume levels OCC has enjoyed so far this year, it is astonishing to think that OCC intends to increase its expenses so much that they would outstrip its obviously abundant revenue levels; and that the expense increases would be so great that they would call for a fee increase.

The fact that OCC spending has increased by over \$130 million over the past five years requires more explanation to the public than has so far been provided, especially because larger budgets lead to greater dividends. Remaining mindful of this conflict is especially important at this time

<sup>15</sup> SIG Petition for Review of Order Made Pursuant to Delegated Authority Approving Proposed Rule Change by Options Clearing Corporation (March 20, 2015), File No. SR-OCC-2015-02, p. 11.

<sup>16</sup> As noted in our opposition to the Capital Plan, SIG itself offered to contribute \$150 million to OCC at LIBOR + 3%. (See, Petitioners’ Submission on Remand (November 30, 2017), File No. SR-OCC-2015-02, p. 15.) The vast difference between that reasonable capital cost and the staggering, open-ended cost of shareholder exchange capital under the Capital Plan is an unconscionable burden on market participants.

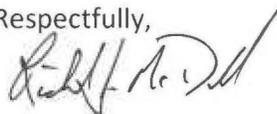
<sup>17</sup> OCC Reply to Petitioners’ Submission on Remand and in Further Support of the Re-Approval of the Capital Plan (Dec. 20, 2017), File No. SR-OCC-2015-02, p. 6.

while OCC is experiencing historically high volume. When the 70% increase in OCC fees was imposed in 2014, it came with the explanation that it would be temporary. And, as noted above, when the Capital Plan was adopted in 2015 it came with the explanation that it would produce lower fees in the future. Neither assertion turned out to be true. As it stands today, the new fee (if adopted) coupled with a continuation for 2018 of listed options volume trending at approximately 40% over last year would likely produce OCC gross revenues of over \$500 million for 2018. Thus, while the approximately 22% rate of return on the dividends for 2017 is astonishing, 2018 has the potential to be considerably higher. This is highly disconcerting for an entity that was created as a monopoly to operate as a low-cost utility for the benefit of all market participants. That paradigm worked when OCC was owned by exchanges that were themselves owned by the self-same members that paid OCC fees; but fails under the OCC Capital Plan which pays outsized returns to de-mutualized, for-profit exchanges that are unconstrained by OCC fee obligations.

### ***Conclusion***

For the reasons noted above, SIG believes that OCC's fee increase proposal should be disapproved; and that any fee increase proposal under the Capital Plan should be open to public scrutiny, including review of all supporting materials proffered by OCC, to afford a meaningful opportunity to comment thereon. Even without access to OCC's confidential materials supporting the instant fee increase proposal, the circumstances discussed above provide ample bases to refute the prospect that the OCC budget is reasonable, and that the consequent fee increase proposal is consistent with the requirements of Section 17A(b)(3)(D) of the Act that clearing agency rules must provide for the equitable allocation of reasonable dues, fees and other charges among its participants. Thank you for your consideration.

Respectfully,

A handwritten signature in black ink, appearing to read "Richard J. McDonald", written in a cursive style.

Richard J. McDonald