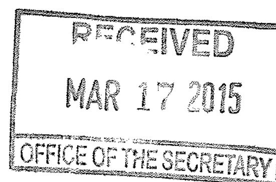
March 16, 2015

**VIA FACSIMILE**
**AND FEDERAL EXPRESS**

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




**RE: SR-OCC-2015-02, Exchange Release No. 74452**
**Petition for Review**

Dear Mr. Fields,

Enclosed please find the original and three copies of the Petition for Review regarding the above-captioned matter. BATS Global Markets, Inc. ("BATS"), on behalf of its subsidiary options exchange, BATS Exchange, Inc., submits this Petition for Review. Pursuant to Rule 154(c) of the Securities and Exchange Commission's Rules of Practice, BATS certifies that the enclosed petition for Review does not exceed 7,000 words. This Petition for review was sent via facsimile to telephone number 202-772-9324 and via Federal Express on March 16, 2015. Also enclosed, please fund a Certificate of Service and facsimile confirmation sheet.

Any questions concerning this matter can be directed to me at (913) 815-7000.

Sincerely,

Eric Swanson
General Counsel and Secretary
BATS Global Markets, Inc.
8050 Marshall Dr., Suite 120
Lenexa, KS 66214

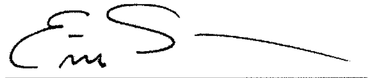
## CERTIFICATE OF SERVICE

I, Eric Swanson, General Counsel and Secretary of BATS Global Markets, Inc., hereby certify that on March 16, 2015, I served copies of the attached Petition for Review of SR-OCC-2015-02, Exchange Release No. 74452, by way of facsimile and that the original was sent that day by Federal Express to:

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

James Brown
General Counsel
The Options Clearing Corporation
1 N. Wacker Drive, Suite 500
Chicago, IL 60606

Dated: March 16, 2015



Eric Swanson
General Counsel and Secretary
BATS Global Markets, Inc.

## TABLE OF CONTENTS

**TABLE OF AUTHORITIES** ............................................................ ii

**PETITION FOR REVIEW** ............................................................ 1

**Preliminary Statement** ............................................................ 1

**Background on OCC and Description of the Rule Filing** ...................... 5

**Applicable Legal Requirements** .................................................. 7

**Significant Policy Concerns that Warrants Commission Consideration** ...... 8

**Deficiencies in Staff's Approval of the Rule Filing** ............................. 10

A. The Capital Plan Creates an Undue Burden on Competition ............ 10

B. The Capital Plan Reflects Unfair Discrimination Against The Non-Shareholder Exchanges . . ...................................... 11

C. Future Commission Review of OCC Fee Filings will not Adequately Protect the Industry against Funding Excessive Dividend Payments ........................................................ 12

D. The Capital Plan was the Result of a Flawed Governance Process in Violation of the OCC's By-Laws .............................. 13

**CONCLUSION** ............................................................................ 19

## TABLE OF AUTHORITIES

STATUTES


5 U.S.C. § 706(2)(A) .................................................... 3

15 U.S.C. § 78(C)(f) .................................................... 8

15 U.S.C. § 78w(a)(2) .................................................... 8

15 U.S.C. § 80a-2(c) .................................................... 8


CASES


*Business Roundtable v. Securities and Exchange Commission,*
647 F.3d 1144 (D.C. Cir. 2011) .......................................... 3, 8

*Chamber of Commerce v. Securities and Exchange*
*Commission,* 412 F.3d 133 (D.C. Cir. 2005) ............................. 3, 10

*American Equity Inv. Life Ins. Co. v. Securities and Exchange*
*Commission* 513 F.3d 166 (D.C. Cir. 2009) .............................. 8


RULES


17 CFR 201.430 .......................................................... 7

17 CFR 201.431 .......................................................... 7

17 CFR 201.411(b)(2) .................................................... 7


OTHER AUTHORITIES


Exchange Act Release No. 74452 (March 6, 2015),
80 FR 12058 (March 12, 2015) ............................................. 1, 4, 10, 11, 12, 24

Exchange Act Release No. 46469 (September 6, 2002),
67 FR 58093 (September 13, 2002) ........................................ 5, 13, 14

OCC By-Laws, *available at:* http://www.theocc.com/
components/docs/legal/rules_and_bylaws/occ_bylaws.pdf.................... 14

OCC Charter, *available at*: http://www.optionsclearing.com/components/
docs/about/corporate-information/board_of_directors_charter.pdf.............. 17

OCC Board of Directors Corporate Governance Principles," *available at* http://www.theocc.com/components/docs/about/corporate-information/board_corporate_governance_principles.pdf .............................. 18

**Before the**
**SECURITIES AND EXCHANGE COMMISSION**

| | | |
|---|---|---|
| In the Matter of the Petition of: | ) | File No. SR-OCC-2015-02 |
| | ) | |
| BATS Global Markets, Inc. | ) | |
| | ) | |

## PETITION FOR REVIEW

BATS Global Markets, Inc. ("BATS") hereby petitions for Commission review of the March 6, 2015 Order (the "Order") made by the staff pursuant to delegated authority approving a proposed rule change by the Options Clearing Corporation ("OCC") concerning a proposed capital plan.[1]

### Preliminary Statement

The Order authorizes the OCC to raise capital from its four shareholder exchanges[2] (the "Capital Plan") and for the first time pay dividends, in perpetuity, to this select group of shareholder exchanges at a level that is significantly above market rates – estimated to be anywhere from 16% - 20% per year in the first few years and potentially significantly higher

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1 *See* Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) (SR-OCC-2015-02) (the "Order").

2 The shareholder exchanges are: Chicago Board Options Exchange, Incorporated ("CBOE"), International Securities Exchange ("ISE"), NASDAQ OMX PHLX LLC ("NASDAQ"), and NYSE MKT LLC and NYSE Arca, Inc. (collectively, "NYSE").

thereafter.[3] The Order radically changes the nature of the OCC, which has served for decades as a non-profit utility operating for the benefit of its clearing members and the investing public, by turning it into a for-profit monopoly operating for the benefit of the four shareholder exchanges. The effect of the Order is to significantly undermine competition among the various options exchanges, discriminate unfairly against non-shareholder exchanges,[4] and ultimately impose excessive costs on clearing firms and investors.

The Capital Plan devised by the OCC effectively allows its shareholder exchanges to monetize for their benefit the OCC's monopoly over options clearing. If not reversed, the Order will create a massive wealth transfer from options investors to OCC's shareholder exchanges (CBOE, NYSE, NASDAQ, and the ISE) that will stifle future competition in the options market and will result in an ongoing and unnecessary increase in the costs of trading listed options. The extraordinary subsidy to this limited group of exchanges will severely undermine competition from non-shareholder exchanges (including the exchange operated by BATS), and the costs will be borne by clearing members and options investors who will ultimately fund the excessive payments.

The Order thus implicates fundamental and systemic policy issues that warrant Commission review.

Significantly, the Order contains virtually no substantive analysis of the competitive – or anticompetitive – effects of the Capital Plan. The Order makes no reference to any market studies, reviews, statistics, or economic analysis relating to how the Capital Plan would affect

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3. The Capital Plan would permit the OCC to amend its By-Laws and certain other governing documents to effect the raising of additional capital from, and the paying of dividends to, the shareholder exchanges.

4 The non-shareholder exchanges, effectively, are: BATS, Miami International Securities Exchange, LLC ("MIAX"), and BOX Options Exchange ("BOX"). While there are an additional four non-shareholder exchanges, all four are associated with a shareholder exchange and cannot therefore be considered non-shareholder exchanges with regard to this matter.

competition among options exchanges, fee structures and what the impact would be on investors. By approving the Order's sweeping changes to the options markets without engaging in or considering such studies, the staff acted in an arbitrary and capricious manner and abused its discretion.[5]

The Order also contains numerous material errors of fact and law. For example, the staff acknowledged the likely burden on competition presented by the OCC's Capital Plan, but misanalysed both the facts and the law in concluding that such burden was not *undue*. In particular, the staff rejected arguments that the rate of return that will be realized by the shareholder exchanges is excessive and amounts to an improper subsidy. The staff relied heavily on the fact that OCC's Board of Directors (the "Board") approved the Capital Plan. In so doing, the staff failed to account for the unique nature of the OCC, including (i) the impact of its status as a monopoly, and (ii) the outsized influence the shareholder exchanges exert over the OCC's affairs. Further, the staff's analysis appears to be based on a false tradeoff between the OCC's need to raise capital and the burden on competition created by the proposal, concluding that "even if OCC's Capital Plan may result in some burden on competition, such a burden is necessary and appropriate in furtherance in the purposes of the Act given 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

[5] *See* Adminstrative Procedure Act, 5 U.S.C. §706(2)(A) (authorizing courts to set aside agency action that is "arbitrary, capricious, an abuse of discretion or otherwise not in accordance with law"); *Business Roundtable v. Securities and Exchange Commission*, 647 F.3d 1144, 1148 (D.C. Cir. 2011) (holding that "the Commission acted arbitrarily and capriciously for having failed . . . adequately to assess the economic effects of a new rule"); *Chamber of Commerce v. Securities and Exchange Commission*, 412 F.3d 133, 144 (D.C. Cir. 2005) (finding Commission violated its obligations under the APA because it failed in its "statutory obligation to do what it can to apprise itself – and hence the public and the Congress—of the economic consequences of a proposed regulation before it decides whether to adopt the measure.").

market conditions."[6] This logic erroneously assumes that the only issue at stake is the OCC's need to raise capital. In fact, BATS does not dispute the OCC's need to raise capital; rather, BATS takes issue with the means by which the OCC is raising that capital and fundamentally altering the nature of the OCC in the process. Moreover, when taken to its logical conclusion, the staff appears to be stating that no amount of subsidy to the shareholder exchanges could be so high as to create an *undue* competitive burden on the non-shareholder exchanges.

The Order also erroneously dismissed concerns regarding the impact on future clearing fees, reasoning that any OCC fee increases will need to be filed with the Commission, despite the fact that such filings will be too attenuated, both temporally and substantively, from the dividend to allow for adequate review of their excessiveness by either the Commission or the public.

Finally, the Order also failed to adequately address the evidence in the record demonstrating that, in approving the Capital Plan, the OCC failed to comply with the provisions of its By-Laws and Charter designed to prevent conflicts of interest and to give non-shareholder exchanges, like BATS, fair representation in the affairs of the OCC through express notice of the type of action taken here and an opportunity to be heard. In particular, the Order acknowledges that "[s]everal commenters raised concerns that OCC's Capital Plan was not approved in accordance with OCC's By-Laws due to vacancies on the Board, that certain Board directors (*i.e.*, Stockholder Exchanges) were 'interested parties' and therefore should have recused themselves from any decision to approve or disapprove OCC's proposal, and OCC failed to promptly inform non-Stockholder Exchanges of the proposed change."[7] In rejecting these arguments, the Order merely cited to representations from the OCC that it complied with its By-Laws, stating that the staff has no basis to dispute the OCC's representations. In so doing, the

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6 Order, *supra* note 1, at 13068.

7 *Id.*

staff failed to articulate how the OCC complied with its By-Laws and, critically, the staff ignored the specific representations from commenters, including BATS, that the OCC failed to promptly notify it of this matter of competitive significance as expressly required by the OCC's By-Laws, in order to enable BATS to exercise its rights to address the Board on the topic as further required by the OCC's By-Laws. The net result of OCC's conduct was to deny non-shareholder exchanges, including BATS, their rights to fair representation in the OCC's affairs.

For these reasons, and as discussed in more detail below, the Order is arbitrary and capricious, and amounts to an abuse of discretion, reflecting a dramatic shift in policy regarding the nature of the OCC that is premised on erroneous factual findings and legal conclusions and that, therefore, warrants Commission review.

**Background on OCC and Description of the Rule Filing**

Founded in 1973, the OCC is the sole clearing house for exchange-listed options in the U.S. Transactions in listed options are required to occur through an OCC clearing member broker-dealer. In addition, all options transactions are required to occur on a registered national securities exchange; unlike in equities, there is no off-exchange trading, or internalization, permitted in exchange-listed options. While the OCC serves as the sole centralized clearing house for listed options transactions, pursuant to the market structure established by the Commission, the various options exchanges directly compete with one another for order flow through pricing and execution services.

All options exchanges are required to be OCC "participants," which had historically been achieved by options exchanges becoming equity shareholders of the OCC. In 2002, the OCC amended its By-Laws to foreclose additional equity ownership by new options exchanges.[8]

[8] *See* Securities Exchange Act Release No. 46469 (September 6, 2002), 67 FR 58093 (September 13, 2002) (SR-OCC-2002-02) ("2002 By-Laws Amendment Order").

Options exchanges launched since this rule change became participants of the OCC by becoming noteholders. Thus, this rule change had the effect of permanently limiting equity ownership of the OCC to the CBOE, NYSE, NASDAQ, and ISE. Consequently, BATS, BOX, and MIAX, formed after the 2002 rule change, are only noteholders.

Since its founding, the OCC has operated as a non-profit industry utility monopoly for the benefit of its clearing members and the options industry as a whole. As such, the OCC set fees to its clearing members at a level that was designed to cover its operating expenses and maintain capital reserves as the OCC deemed necessary to meet its obligations. To the extent the OCC collected fees each year in excess of its operating expenses and capital needs, the OCC historically refunded that excess to its clearing members.

Under the rule filing approved by the Order, the OCC would amend its By-Laws and other governing documents to allow the OCC to raise significant new capital and pay dividends for the first time to its shareholder exchanges. The existing OCC shareholder exchanges would contribute additional capital, and commit to contributing additional replenishment capital under certain dire circumstances. In exchange for the contribution, those shareholder exchanges would receive an annual dividend (subject to the OCC's compliance with its capital requirements) for so long as those exchanges continued to be equity shareholders. As a result of the dividend proposed to be paid to the shareholder exchanges, the amount of any refunds of excess capital to clearing members will be reduced, and could be permanently eliminated under certain circumstances if the shareholder exchanges are required to contribute replenishment capital.

The exact amount of the dividend to be paid to the shareholder exchanges is not known because it is redacted from the rule filing. However, based on the information disclosed in the

rule filing, estimates of the rate of return to the shareholder exchanges range from 16%-20% per year in the first few years, and possibly significantly higher than that in later years.

## **Applicable Legal Requirements**

Rules 430 and 431 of the Rules of Practice,[9] provide for Commission review of staff action taken by delegated authority upon request by a person aggrieved by the staff's action. BATS operates a national securities exchange registered with the Commission that trades exchange-listed options and is directly affected by the Order because, as discussed in detail below, it fundamentally alters the competitive dynamic between shareholder and non-shareholder options exchanges to the detriment of the non-shareholder exchange participants of the OCC (such as BATS) and the industry at-large. BATS has complied with the procedural requirements contained in Rule 430.[10]

Rule 431 contains the requirements relating to the Commission's review of the petition. Rule 431 provides that the Commission, in determining whether to grant review in response to a petition such as this one, must look to the standards set forth in Rule 411 (b)(2) of the Rules of Practice.[11] This provision instructs the Commission to consider whether the petition for review makes a reasonable showing that (i) a prejudicial error was committed in the conduct of the proceeding; or (ii) the decision embodies: (A) a finding or conclusion of material fact that is clearly erroneous; (B) a conclusion of law that is erroneous; or (C) an exercise of discretion or decision of law or policy that is important and that the Commission should review.

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9 17 CFR 201.430 and 17 CFR 201.431.

10 BATS had actual notice of the Order on March 6, 2015, and BATS filed an Intent Notice on March 13, 2015. *See* Letter from Eric Swanson, General Counsel and Secretary, BATS Global Markets, Inc., to Brent Fields, Secretary, SEC, dated March 13, 2015.

11 17 CFR 201.411 (b)(2)

Additionally, under the Exchange Act, "the Comission has a unique obligation to consider the effect of a new rule upon efficiency, competition and capital formation."[12]

**Significant Policy Concerns that Warrants Commission Consideration**

The Commission should set aside the Order and grant this petition because of the significant policy concerns at issue. The proposed rule approved by the Order fundamentally changes the nature of the OCC from a non-profit industry utility operated for the benefit of its clearing members and options investors, into a for-profit monopoly operating for the benefit of its exclusive group of shareholder exchanges. While there is nothing unique today about a self-regulatory organization ("SRO") operating as a for profit business, with respect to the OCC, this transition raises significant policy concerns in light of the unique role of the OCC, its ownership, and its governance. The confluence of the following unique attributes of the OCC and the options markets in general implicate significant policy concerns warranting Commission review:

- The OCC is a monopoly – unlike other SROs (*i.e.* registered national securities exchanges), there is no competition for the OCC's services and, hence, no competitive pressures on fees.
- There is no over-the-counter market for listed options transactions. As such, every execution of a listed options contract *must* be cleared through the OCC subject to the OCC's fees; broker-dealers cannot engage in internal compression or netting to reduce their exposure to OCC's fees.

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12 *Business Roundtable*, 647 F.3d at 1148 (quoting 15 U.S.C. §§ 78(C)(f), 78w(a)(2), 80a-2(c)). *See American Equity Inv. Life Ins. Co. v. Securities and Exchange Commision*, 513 F. 3d 166, 177 (D.C. Cir. 2009) (finding Commission's consideration of the effect of a rule on efficiency, competition and capital formation was arbitrary and capricious because the SEC did not disclose a reasoned basis for its conclusion that the rule would increase competition).

- The OCC is owned by four exchange operators (*i.e.* CBOE, NYSE, NASDAQ, and ISE) and, by rule, the OCC has prohibited any other options exchange from becoming a shareholder.
- Each of the existing shareholder exchanges possesses a veto right over certain aspects related to the OCC's affairs, including the issuance of equity that could dilute its ownership.[13]

The Capital Plan is unfairly discriminatory in favor of the shareholder exchanges by paying them an outsized dividend, or more aptly, subsidy, in perpetuity. The shareholder exchanges would receive this windfall just through the fortuity of historical timing because they were formed prior to 2002, the year the OCC changed its By-Laws to prevent newly formed exchanges from having an equity stake in OCC. The Capital Plan fundamentally alters the competitive landscape between shareholder and non-shareholder exchanges, and will impose excessive and unreasonable costs on the options industry in perpetuity. Market participants will have no recourse to avoid the OCC's fees that will fund the subsidy to shareholder exchanges. Moreover, the anti-competitive, inequitable Capital Plan was approved as a result of the unique ownership and governance of the OCC, which made it possible for any of the shareholder exchanges to veto an alternative capital raising plan, such as one subject to a competitive, open, market-based process that would have delivered a lower rate of return.[14] Yet, in the Order, the staff ignored these unique factors and their impact on the competitive burden on non-shareholder exchanges, the discrimination between exchanges, and the interests of the investing public.

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13 BATS understands that the private shareholder agreements between each of the four OCC shareholder exchanges and the OCC include a provision requiring unanimity of the shareholder exchanges in order for the OCC to take certain actions, including, at a minimum, actions that would have the effect of diluting each of those shareholder's equity stake in the OCC.

14 In fact, BATS believes there may have been alternate capital raising plans proposed to the board on more favorable terms that were rejected.

Given the significant policy issues at stake in this rule filing, Commission review is warranted to ensure full and careful consideration of those issues.

**Deficiencies in Staff's Approval of the Rule Filing**

The Commission also should set aside the Order and grant this petition because many of the staff's findings are either erroneous or unsupported by relevant facts or analysis.

A. The Capital Plan Creates an Undue Burden on Competition

The staff recognized that a dividend to the shareholder exchanges that does not accurately reflect the true risk of the investment may result in a burden on competition. However, the staff erred in concluding that because the OCC is a unique entity that is not publicly traded, determining the cost of capital is subjective and, hence, the "OCC's Board of Directors *must* use its judgment to determine the appropriate or competitive rate of return and the dividend policy that appropriately reflects the risk of the Stockholder Exchanges' equity investment."[15] To the contrary, private companies routinely raise capital through competitive processes that are not left solely to the judgment of a board of directors and that result in a competitive rate of return. Here especially, where the governance process was so heavily biased in favor of the shareholder exchanges that stand to accrue excess monopoly rents from the Capital Plan, a competitive process would have informed the Board's judgment to ensure it was, in fact, fulfilling its fiduciary obligations to the OCC. Thus, the staff erred in finding that the only means to determine the appropriate rate of return was a subjective one appropriately left solely to the Board's judgment.[16]

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15 Order, *supra* note 1, at 13068 (*emphasis added*).

16 *See Chamber of Commerce*, 412 F.3d at 362 (Commision had an obligation to consider reasonable suggested alternatives to conditions imposed by rule).

Moreover, while the staff recognized that the Capital Plan may result in some burden on competition, the staff rejected the idea that that burden was undue, finding that "such a burden is necessary and appropriate in furtherance of the purposes of the Act given 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."[17] This finding is not supported by the record in this matter. The question of whether the competitive burden is "undue" is necessarily determined by reference to the extent of the anticompetitive subsidy that will be paid solely to the shareholder exchanges (the precise amounts of which have been redacted in the record). Taken to its logical conclusion, the staff's finding suggests that regardless of the amount of the subsidy, the resulting competitive burden would never be considered undue but would always be considered necessary and appropriate in furtherance of the Act. Again, where, as here, the Capital Plan was the result of a confluence of unique factors associated with the OCC's monopoly status and governance structure that inured to the benefit of the shareholder exchanges, the staff's findings that any dividend paid is appropriate and necessary, regardless of its amount and its impact on competition, constitutes an erroneous conclusion of law.

B. <u>The Capital Plan Reflects Unfair Discrimination Against the Non-Shareholder Exchanges</u>

The staff's failure to find that the Capital Plan results in unfair discrimination against the non-shareholder exchanges is erroneous. As previously stated, the OCC holds a unique position in the options market – it is a utility monopoly that clears all transactions in listed options executions. All options exchanges are required to be participants of the OCC, but the OCC amended its By-Laws in 2002 such that no subsequent options exchange is allowed to own

[17] Order, *supra* note 1, at 13068.

equity in the OCC. As such, although similarly situated in terms of their status, function in, and contribution to, the options industry, not all options exchanges are treated similarly vis-à-vis their relationship with this industry utility monopoly. While this has been historically acceptable because the OCC acted in the best interests of its clearing members and the industry at-large, it will be unacceptable if the OCC is allowed to use the fees charged on options transactions – fees to which all exchanges contribute equally – to fund excessive subsidies solely to the select group of shareholder exchanges. The net result of this Capital Plan is unfair discrimination against the non-shareholder exchanges, and the staff's failure to find as much constitutes an erroneous conclusion of law.

C. Future Commission Review of OCC Fee Filings will not Adequately Protect the Industry against Funding Excessive Dividend Payments

In the Order, the staff dismissed concerns about inappropriate fee increases being used to fund excessive future dividend payments, stating that "[f]uture changes to OCC's fee schedule as well as future changes to the Fee Policy, Refund Policy, and Dividend Policy, are subject to Section 19(b)(1) of the Act and Section 806(e) of the Payment, Clearing, and Settlement Supervision Act, as applicable, both of which require OCC to (i) submit appropriate regulatory filings with the Commission, (ii) provide an opportunity for public comment, and (iii) require the Commission to review and ultimately disapprove, object to, or require modification or rescission, as applicable, if these future proposed changes do not meet regulatory requirements."[18] The flaw with the staff's finding is that the OCC sets fees each year and throughout the year based on its forecasts of operating costs, capital needs, and options volumes, while the dividends are only paid after year-end when the OCC can determine the extent that it collected fees in excess of

[18] *See* Order, *supra* note 1, at 13067 (citations omitted).

these forecasts. Hence, at the moment in time when fee increases are filed with the Commission, the impact on the dividend will be too attenuated, both temporally and substantively, from the payment of the dividend itself.

BATS submits neither the Commission staff nor the public will be adequately equipped to peer through the forecasts to determine the extent to which fees were set in anticipation of funding an excessive dividend at year-end, and by the time the dividend can be determined with precision it will be too late for the Commission to act to suspend or abrogate a fee increase from months earlier that in retrospect was excessive. As such, the rule filing process regarding future OCC fee increases is not an adequate protection against a massive transfer of wealth from clearing members and the investing public to the shareholder exchanges, and the staff's finding to the contrary was erroneous and arbitrary and capricious.

D. The Capital Plan was the Result of a Flawed Governance Process in Violation of the OCC's By-Laws

The staff also erred in its findings related to the governance process that led to the filing of this rule proposal. In particular, in 2002, the OCC amended its By-Laws so that it could provide clearing services to new options exchanges without having those exchanges become shareholders of the OCC.[19] In so doing, the OCC created a new category of non-shareholder exchange participants. To ensure fair representation in the OCC's affairs by the non-shareholder exchanges and to address concerns that the non-shareholder exchange participants could be disadvantaged vis-à-vis the exchange shareholder participants, the OCC ensured that non-shareholder exchange participants "will be entitled under that [By-Law] provision to 'fair

[19] *See* 2002 By-Laws Amendment Order, *supra* note 5.

representation . . . in the selection of [OCC's] directors and administration of its affairs.'"[20] In connection with the adoption of these changes, the OCC made the following additional representations to the SEC:

> OCC has represented to the Commission that OCC management will (1) provide non-equity exchanges with the opportunity to make presentations to the OCC board or the appropriate board committee upon request and (2) will promptly pass on to non-equity exchanges any information that management considers to be of competitive significance to such exchanges disclosed to exchange directors at or in connection with any meeting or action of the OCC board or any board committee. Letter from William H. Navin, Executive Vice President, General Counsel, and Secretary, OCC (July 8, 2002).[21]

Ultimately, the OCC adopted the following language as Interpretation and Policy .01 to Article VIIB of its By-Laws[22]:

> .01 Non-Equity Exchanges will be promptly provided with information that the Executive Chairman considers to be of competitive significance to such Non-Equity Exchanges that was disclosed to Exchange Directors at or in connection with any meeting or action of the Board of Directors or any Committee of the Board of Directors.

As previously stated, the rule filing at issue raises significant competitive concerns between the non-shareholder exchanges and shareholder exchanges because the rule filing allows the shareholder exchanges to extract an excessive subsidy from the OCC at the expense of both the non-shareholder exchanges and the industry at-large, which will be used to subsidize the shareholder exchanges' provision of execution services, and which in turn provides the shareholder exchanges with a significant and unfair competitive advantage over the non-

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20 *See* 2002 By-Laws Amendment Order, *supra* note 5, at 58094.

21 *Id.*

22 OCC By-Laws, *available at* http://www.theocc.com/components/docs/legal/rules_and_bylaws/occ_bylaws.pdf

shareholder exchanges. It was precisely these types of potential competitive concerns that led to the adoption of the above-referenced By-Law provisions and the explicit representations the OCC made to the Commission regarding disclosure of information to non-equity exchanges and their opportunity to be heard.

However, in developing the rule filing, and as BATS noted in its comment letter of March 3, 2015,[23] the OCC failed to comply with either the By-Law provisions or the explicit representations it made to the Commission in July 2002. In particular, although the rule filing was indisputably a matter of competitive significance to the non-shareholder exchanges, the OCC failed to inform BATS, a non-shareholder exchange, – "promptly" or otherwise – that the rule filing was under consideration by the OCC. BATS was thus not given an opportunity to exercise its right to request to make presentations regarding the matter to the Board or to the appropriate committee of the Board. By virtue of being denied the information to which it was entitled, BATS was unable to exercise its right at all, let alone in a timely fashion, before the Board voted on the rule filing.

Nonetheless, in the Order the staff summarily rejected this argument, noting nothing more than that the "OCC represents that OCC and its Board of Directors have conducted its business in conformity with applicable state laws and its own By-Laws" and that "[t]he Commission has no basis to dispute OCC's position on this matter."[24]

The staff's finding in this regard is alarming. In particular, it is not possible to reconcile the staff's finding that it has no basis to dispute the OCC's position against the fact that two of the non-shareholder exchanges, BATS and BOX, both submitted comment letters explicitly

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23 *See* Letter from Eric Swanson, General Counsel and Secretary, BATS Global Markets, Inc., to Brent Fields, Secretary, SEC, dated March 3, 2015 ("BATS Comment Letter").

24 *See* Order, *supra* note 1, at 13068.

stating that the OCC did not follow the above-referenced By-Law provisions and such failure resulted in such non-shareholder exchanges' respective inabilities to assert their rights to fair representation under the By-Laws.[25]

The staff declined to articulate in the Order why it had no basis to dispute the OCC's position on the matter, but only two possible reasons for the staff's position exist, neither of which is sustainable. First, it may be that the staff is of the view that the Capital Plan is not a matter of "competitive significance" that would trigger the OCC's obligations to promptly provide notice to the non-shareholder exchanges. However, such a view is unsustainable because, as described above the Capital Plan raises very significant competitive concerns and, moreover, the Order itself acknowledges the potential anticompetitive impact of the Capital Plan.

Second, it may be that the staff is of the view that the public notice of the rule filing amounted to prompt notice of a matter of competitive significance that came before the Board. Again, however, such a view would be unsustainable as it is neither consistent with the language nor spirit of the By-Laws. It would be inconsistent with the language of the By-Laws because the By-Laws require "prompt" notice, and no doubt the proposal for the Capital Plan first came before the Board many months before it was ever drafted into a rule filing, vetted with Commission staff, and ultimately approved by the Board.[26] Moreover, provisions related to prompt notice and an opportunity for the non-shareholder exchanges to present to the Board clearly contemplate the ability to do so at a point in time prior to the Board taking formal action on the matter of competitive significance, not after when there would be no conceivable benefit to exercising the right. Hence, the public notice of the filing could not be considered "prompt"

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[25] *See* BATS Comment Letter, *supra* note 15; *see also* Letter from Tony McCormick, Chief Executive Officer, BOX Options Exchange, to Brent Fields, Secretary, SEC, dated March 3, 2015.

[26] By the OCC's own admission, it "engaged in a nearly year-long process" of analyzing the Capital Plan. See Letter of James E. Brown, General Counsel, OCC, (February 23, 2015) at p. 4. However, at no point during such process was BATS notified of such process, analysis or plan.

notice of this matter of competitive significance, and the staff's finding that it had no basis to dispute the OCC's representations in this regard was erroneous, arbitrary and capricious, and resulted in an abuse of discretion that serves to deny BATS fair representation in the OCC's affairs – namely, the opportunity to participate in and influence the deliberative process over the Capital Plan.

Moreover, the Board process was tainted by conflicts of interest in violation of the OCC's Charter and Code of Conduct. In particular, none of the five directors representing the shareholder exchanges recused themselves from either the deliberations or the vote, despite the obvious conflict of interest associated with their financial interest in the outcome. Pursuant to Article V of the OCC's Charter, "[e]ach Director is required to act in good faith in the best interests of OCC and with due regard to the fiduciary responsibilities owed to OCC as a business and systemically important financial market utility. In addition, each Director is required to comply with the provisions of the Code of Conduct for OCC Directors, including, without limitation, the provisions relating to conflicts of interest and confidentiality."[27] While the actual Code of Conduct is not publicly available, the OCC does publish its Corporate Governance Principles, which summarize the relevant portions of the Code of Conduct as follows:

> The Board has adopted a Code of Conduct for OCC Directors that includes a Conflict of Interest Policy. The Conflict of Interest Policy incorporates various provisions of applicable corporate law and other standards adopted by OCC to ensure that Board and committee decisions are not impacted by conflicts of interest. Directors are expected to avoid any action, position or interest that conflicts with an interest of OCC, or gives the appearance of a conflict, in accordance with the Conflict of Interest Policy. OCC annually solicits information from directors in order to monitor potential conflicts of interest and directors are

[27] OCC Charter, *available at*: http://www.optionsclearing.com/components/docs/about/corporate-information/board_of_directors_charter.pdf.

expected to be mindful of their fiduciary obligations to OCC as set forth in the Code of Conduct.[28]

In the present case, each of the five shareholder exchange directors acting on behalf of exchanges had a direct and significant interest in the outcome of the Board's consideration of the Capital Plan that was in conflict with the OCC. That is, each shareholder exchange had an interest in extracting the highest rate of return from the OCC in exchange for their capital investment. Yet, none of these directors recused themselves from the deliberations or the vote, which unalterably tainted the governance process.

In addition, the Board failed to maintain the requisite number of public directors on its Board as required by the OCC's By-Laws, which could have impacted both the quality of the deliberations on the matter as well as the outcome of the Board vote. By failing to maintain the requisite number of public directors on the Board while this matter was deliberated and voted on, the process was deprived of key input from disinterested directors who would be most likely to argue for an outcome that is objectively in the best interest of the OCC and the options industry. In addition, with respect to the three public directors who did participate in the deliberations and vote, the record is unclear with respect to what they did to ensure that the Capital Plan was fair and appropriately in the interests of the OCC.

BATS is not arguing that every board action that precedes an SRO rule filing must be scrutinized by the Commission prior to Commission action. However, given the unique role and structure of the OCC as discussed above, as well as the specific comments received identifying significant flaws in the governance process, BATS believes it is incumbent on the Commission to conduct a reasonable level of inquiry to satisfy itself on the question of the appropriateness of

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[28] OCC Board of Directors Corporate Governance Principles, *available at* http://www.theocc.com/components/docs/about/corporate-information/board_corporate_governance_principles.pdf.

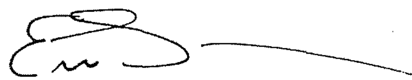
the Board governance in this matter. Based on the available record, it does not appear the staff conducted such inquiry. For these reasons, the governance process surrounding the submission of the rule filing was flawed and the staff's failure to find as much in the Order was an arbitrary and capricious abuse of discretion resulting in erroneous findings of fact and law.

**Conclusion**

The Capital Plan reflects an unprecedented attempt by four shareholder exchanges to monetize an industry utility monopoly to their benefit. Because of the unique nature of the OCC, including its monopoly status, and discriminatory governance that favors the shareholder exchanges, the resulting impact of this effort is to significantly undermine competition among the various options exchanges, discriminate unfairly against non-shareholder exchanges, and ultimately impose excessive costs on clearing firms and investors. The detrimental impact of the Capital Plan on the U.S. options markets cannot be overstated, and the staff made numerous errors of fact and law in approving it. For these reasons, BATS respectfully requests that the Commission exercise its discretion to review this petition and set aside the Order.

DATED: March 16, 2015

Respectfully Submitted,



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