

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72564; File No. SR-OCC-2014-09)

July 8, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change Concerning the Consolidation of the Governance Committee and Nominating Committee into a Single Committee, Changes to the Nominating Process for Directors, and Increasing the Number of Public Directors on The Options Clearing Corporation's Board of Directors

I. Introduction

On May 13, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change SR-OCC-2014-09 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on May 30, 2014.³ The Commission received no comment letters. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

OCC is proposing to: (i) amend its By-Laws and Governance Committee Charter to combine the Nominating Committee ("NC") and the Governance Committee ("GC") to establish a single Governance and Nominating Committee ("GNC"), (ii) make changes concerning OCC's nomination process for Directors, and (iii) increase the number of

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 72242 (May 23, 2014), 79 FR 31166 (May 30, 2014).

Public Directors on OCC's Board of Directors ("Board") from three to five. The proposed modifications are based on recommendations from the GC in the course of carrying out its mandate of reviewing the overall corporate governance of OCC and recommending improvements to the structure of OCC's Board. In part, the GC's recommendations stem from suggestions of an outside consultant that was retained to review and report on OCC's governance structure in relationship to industry governance practices. To conform to these proposed changes, OCC is also proposing to make certain edits to its Stockholders Agreement, Board of Directors Charter, and Fitness Standards for Directors.

Currently, the GC operates pursuant to its own Charter.⁴ The NC is not a Board level Committee and does not operate pursuant to a charter; however, provisions in Article III of OCC's By-Laws prescribe certain aspects of the NC's structure and operation. OCC is proposing to apply to the GNC many of the existing provisions of the relevant By-Laws that apply to the NC and GC Charter. Amendments to the existing By-Laws and GC Charter are discussed below.

Certain provisions of Article III of OCC's By-Laws govern the role the NC plays in nominating persons as Member Directors⁵ on OCC's Board as well as the composition and structure of the NC itself. The NC is required to endeavor to achieve balanced

⁴ Securities Exchange Act Release Nos. 71030 (Dec. 11, 2013), 78 FR 7612 (Dec. 16, 2013) (SR-OCC-2013-18); 71083 (Dec. 16, 2013), 78 FR 77182 (Dec. 20, 2013) (SR-OCC-2013-807).

⁵ Under Article III, Section 2 every Member Director must be either a Clearing Member or a representative of a Clearing Member Organization.

representation in its Member Director and Non-Director Member nominees, giving due consideration to business activities and geographic distribution.

The NC is composed of seven total members: one Public Director and six Non-Director Members.⁶ The Public Director member, who is nominated by the Executive Chairman with the approval of a majority of the Board, generally serves a three year term, unless she ceases to qualify as a Public Director.⁷ The six Non-Director Members nominated by the NC and selected by OCC's stockholders are divided into two equal classes of three members, and the classes serve staggered two year terms.⁸ By comparison, the GC Charter requires the current GC to have no fewer than five directors and to include at least one Public Director, at least one Exchange Director, and at least one Member Director. It also provides that no Management Directors may serve on the GC.

OCC's Board currently has 19 members consisting of nine Member Directors,

⁶ Under Sections 4 and 5 of Article III, a Non-Director Member of the NC must be a representative of a Clearing Member and no person associated with the same Clearing Member Organization as a member of the NC may be nominated by the NC for a position as a Member Director on the Board of Directors or a Non-Director Member of the NC for the ensuing year.

⁷ Public Directors may not be affiliated with any national securities exchange or national securities association or any broker or dealer in securities, and OCC's Executive Chairman and President, who are Management Directors. See OCC By-Laws Article III, Section 6A.

⁸ This tiered structure eliminated the complete turnover of the members of the NC each year and fostered greater continuity among its elected members. Securities Exchange Act Release No. 29437 (July 12, 1991), 56 FR 33319 (July 19, 1991) (SR-OCC-91-11).

five Exchange Directors, three Public Directors, and two Management Directors. Based on recommendations from the GC in the course of review of OCC's overall corporate governance, OCC is proposing certain amendments detailed below to merge OCC's NC and GC into a single GNC, change the nominating process for directors, and increase the number of Public Directors from three to five.

A. Proposed Amendments Common to the By-Laws and Other OCC Governance Documents

Certain of the proposed changes would amend the existing By-Laws as well as other governance documents of OCC. For example, conforming edits would be made throughout the By-Laws and GC Charter to delete NC and GC references and replace them with references to the GNC.

1. GNC Composition

The new GNC would be composed of a minimum of three total members: at least one Public Director, at least one Exchange Director, and at least one Member Director. To reflect this change, OCC would: (i) eliminate in Section 4 of Article III of the By-Laws the requirement for six Non-Director Members, (ii) add requirements for at least one Member Director and one Exchange Director, and (iii) modify the current requirement for one Public Director to instead require that there must be at least one Public Director. The proposed composition for the GNC mirrors the existing composition specified in the GC Charter. Therefore, no changes are proposed to the current GC Charter other than the elimination of the requirements that the GNC have no fewer than five directors. In its filing with the Commission, OCC stated that that

limitation would be eliminated with the goal of providing the Board with greater flexibility to determine the optimal size and composition of the GNC, so long as the composition also facilitates diverse representation by satisfying the proposed requirement for at least one GNC representative from each of the Member Director, Exchange Director, and Public Director categories. The prohibition on Management Directors serving on the GC would continue to apply to the GNC.

2. GNC Member Appointment Process and Term Limits

The members of the GNC would be appointed annually by the Board from among certain Board members recommended by the GNC after consultation with OCC's Executive Chairman. GNC Members would serve at the pleasure of the Board. The GNC's Chairman ("GNC Chair") would be designated from among the GNC's Public Directors. Provisions implementing these changes would be added to Section 4 of Article III of the By-Laws to entirely supplant the class and term limit structure and nominations process that currently applies to the NC and its Non-Director Members and Public Director, and references to Non-Director Members would be removed from the By-Laws. The GC Charter would also be amended to reflect this structure for GNC nominations and appointments.

3. Number of Public Directors and Member Directors

OCC is proposing to amend its By-Laws to increase the minimum number of Public Directors on its Board from three to five. It is also making certain other changes related to the overall composition of the Board and the classification and term of office of Public Directors. The proposed change in the number of Public Directors from three to

five would reconstitute OCC's Board with a total of 21 directors. OCC believes that, as indicated in its initial proposal to add Public Directors to its Board,⁹ Public Directors broaden the mix of viewpoints and business expertise that is represented on the Board. Accordingly, OCC believes that the input and expertise of two more Public Directors will further benefit OCC in the administration of its affairs in respect of the markets that it serves, and in the performance of its duties as a systemically important financial market utility.

The proposed changes would remove a provision that, under certain conditions, automatically adjusts the number of Member Directors serving on the Board. OCC's By-Laws currently require that if the aggregate number of Exchange Directors and Public Directors equals at least nine, the total number of Member Directors must be automatically adjusted to exceed that number by one.¹⁰ OCC believes that the removal of this provision would provide the Board with greater flexibility to determine its optimal composition. The proposed changes also remove a provision that reduces the number of Member Directors if the number is above nine and exceeds the sum of the number of Exchange Directors and the number of Public Directors by more than one, because the number of Member Directors would be fixed at nine.

OCC is also proposing certain amendments to its Stockholders Agreement, Board of Directors Charter, and Fitness Standards for Directors, Clearing Members, and Others.

⁹ Securities Exchange Act Release No. 30328 (January 31, 1992), 57 FR 4784 (February 7, 1992) (SR-OCC-1992-02).

¹⁰ OCC By-Laws Article III, Section 1.

In each case, conforming changes would be made to recognize the merger of the NC and GC into the GNC as a standing Committee of the Board and reflect the role it would play in OCC's director nomination process. The proposed modifications to the Board Charter and Fitness Standards would reflect the increase in the number of Public Directors serving on the Board from three to five and the removal of the provision that automatically adjusts the number of Member Directors serving on the Board when certain conditions are met. The criteria specified in the Fitness Standards for Directors, Clearing Members, and Others for use in considering individuals nominated to be Member Directors would also be revised for consistency with the criteria proposed to be added to Article III, Section 5 of the By-Laws, discussed below, designed to achieve balanced Board representation.

The Stockholders Agreement also contains proposed amendments to replace the term Chairman with Executive Chairman. This parallels a separate proposed amendment by OCC to implement this change in its By-Laws and Rules, but a consolidated amendment to the Stockholders Agreement is proposed for ease of administration.

B. Proposed Amendments to By-Laws

As explained in more detail below, certain of the proposed changes would require amendments only to OCC's existing By-Laws. One such example is that Sections 2 and 5 of Article III of the By-Laws would be amended to remove prohibitions against representation of the same Clearing Member Organization on the Board and the NC.¹¹

¹¹ A Clearing Member Organization is a Clearing Member that is a legal entity

This prohibition would be eliminated since GNC members will be selected from among the members of the Board under the new approach.

1. Balanced Representation

The NC's responsibility to endeavor to achieve balanced representation among Clearing Members on the Board would be carried over to the GNC. Specifically, the GNC would be required to ensure that (1) not all of the Member Directors are from the members having the largest volume of business with OCC during the prior year and (2) the mix of Member Directors includes members primarily engaged in agency trading on behalf of retail investors.

2. Nomination and Election Process

The Board would appoint members to the GNC from among the Board's members who are recommended by the GNC. This change requires certain proposed modifications to the nomination and election process currently reflected in Article III, Section 5 of the By-Laws. Changes are also proposed that would change the deadlines for nominations of Member Directors by both the GNC and Clearing Members, and OCC would preserve the petition process by which Clearing Members may nominate additional candidates to be Member Directors on the Board. In recognition of the elimination of the concept of Non-Director Members, several provisions in Section 5 of Article III of the By-Laws addressing the ability of stockholders to elect or nominate Non-Director Members of the NC would be deleted. In relevant part, however, these provisions would be retained to

rather than a natural person.

the extent they apply to the ability of stockholders under certain conditions to nominate and elect Member Directors of the Board.

3. Public Directors

Proposed changes to Section 6A of Article III of the By-Laws would require the GNC to nominate Public Directors for election by OCC's stockholders and to use OCC's fitness standards in making such nominations. Currently, OCC's Executive Chairman nominates Public Directors with Board approval. Changes are also proposed to help clarify the class structure and term limits of Public Directors that are independent of changes proposed to facilitate the formation of the GNC.¹²

The proposed changes to Article III, Section 6A of the By-Laws would also provide for the classification of the two new Public Directors. One of the new Public Directors will be designated as a Class I Public Director, and the other will be designated as a Class III Public Director. The proposed changes also establish the times at which the successors of the two new Public Directors will be elected. The successor of the new Public Director that is a Class III Public Director will be elected at the 2015 annual meeting of stockholders, and the successor of the new Public Director that is a Class I Public Director will be elected at the 2016 annual meeting.

¹² These changes would specify that, aside from the Class II Public Director who was elected to the Board at the 2011 annual meeting, two other Public Directors were appointed to the Board prior to its 2013 annual meeting, one designated as a Class I Public Director and the other designated as a Class III Public Director. Generally, the three year terms for Public Directors with staggered expiration for each class would be preserved; however, an exception would be added for the initial Class I and III Public Directors.

4. Disqualifications and Filling Vacancies and Newly Created Directorships

The disqualification provisions in Article III, Section 11 of the By-Laws would be revised to reflect that any determination to disqualify a director would be effective and result in a vacancy only if the GNC makes a recommendation for disqualification in addition to an affirmative vote for disqualification by a majority of the whole Board. The By-Laws currently provide that if a Member Director vacancy is filled by the Board, the person filling the vacancy will serve until the next scheduled election for the relevant class of Member Director and a successor is elected. However, if the term for that class of Member Director extends beyond the Board's next annual meeting the vacancy must be filled by a person who is recommended by the Nominating Committee. Proposed changes to these terms in respect of the GNC would require the Board in all cases to appoint a person who is recommended by the GNC. Similarly, Public Director vacancies would be required to be filled by the Board as generally provided for in Section 6A of Article III of the By-Laws, including with regard to candidates being nominated by the GNC using OCC's fitness standards for directors. Provisions concerning filling vacancies with respect to the NC would be deleted, consistent with its elimination in favor of the GNC.

5. Ministerial Changes

The proposed changes to Article III of the By-Laws also include certain ministerial changes. A reference to stockholder exchanges in the interpretation and policy to Section 6 would be replaced by the defined term Equity Exchanges, and a

reference in Section 14 to notice by telegram would be changed to facsimile to reflect current means of communication.

C. Proposed Amendments to the GC Charter

Certain of the proposed amendments relating to the creation of the GNC would apply only to OCC's existing GC Charter. These amendments are discussed below.

1. GNC Purpose

The statement of purpose in the GC Charter would be revised to reflect the GNC's larger scope of responsibilities. The existing GC purpose of reviewing the overall corporate governance of OCC would be maintained, along with language clarifying that this review would be performed on a regular basis and that recommendations concerning Board improvements should be made when necessary. The GNC Charter would also provide that the GNC assists the Board in identifying, screening, and reviewing individuals qualified to serve as directors and by recommending candidates to the Board for nomination for election at the annual meeting of stockholders or to fill vacancies. The GNC Charter would also specify that the GNC would develop and recommend to the Board, and oversee the implementation of, a Board Code of Conduct.

2. GNC Membership and Organization

The requirement in the GC Charter that the GC hold four meetings annually would be modified to also permit the GNC to call additional meetings as it deems appropriate.¹³ The GC Charter requirement for regular reporting to the Board on

¹³ This would bring the Governance and Nominating Committee Charter in line with

Committee activities by the GC chair or a designee would be revised in favor of placing the reporting responsibility solely on the GNC Chair and requiring the GNC Chair to make timely reports to the Board on important issues discussed at GNC meetings. Taking into consideration certain pre-established guidelines in the GNC Charter, the GNC Chair would also be given responsibility for determining whether minutes should be recorded at any executive session. Aside from this exception for executive sessions, GNC meeting minutes would be required to be recorded. The GNC Charter would also create a position to be filled by an OCC officer who would assist the GNC and liaise between it and OCC's staff.

3. GNC Authority

As in the case of the existing GC, the GNC would have authority to inquire into any matter relevant to its purpose and responsibilities in the course of carrying out its duties. The GNC Charter would further specify that in connection with any such inquiry the GNC would have access to all books, records, facilities, and personnel of OCC. Unlike the existing GC Charter, the GNC Charter would not provide express authority for the GNC to rely on members of OCC's management for assistance. Instead, this relationship between the GNC and OCC's management would be more specifically addressed through the role of the newly created staff liaison position. Additional revisions to the GC Charter would also establish that the GNC Chair would not have discretion to take unilateral action on behalf of the Committee, even in special

the Charters of OCC's other Board Committees.

circumstances.

4. Board Composition

Without limiting the GNC to particular activities, the GNC Charter would specify certain responsibilities meant to guide the GNC in achieving its purposes, including with respect to its role in the development of the Board's composition. The GNC's Charter would require it to pursue development of a Board comprised of individuals who have a reputation for integrity and represent diverse professional backgrounds as well as a broad spectrum of experience and expertise. The GNC Charter would also prescribe more detailed responsibilities designed to further this goal. For example, the GNC would be required to conduct periodic reviews of the composition of the Board against the goal, including whether the Board reflects the appropriate balance of types of directors, business specialization, technical skills, diversity, and other qualities.¹⁴

The GNC would be required to recommend policies and procedures to the Board for identifying and reviewing Board nominee candidates, and it would implement and oversee the effectiveness of those policies, including with regard to criteria for Board nominees. Using criteria approved by the Board, the GNC would identify, screen, and review persons it determines are qualified to serve as directors. This process would also extend to incumbent directors concerning any potential re-nomination. In all cases, the GNC would only recommend candidates to the Board for nomination for election after consulting with OCC's Executive Chairman.

¹⁴ The GNC would also review director conflicts of interest and the manner in which any such conflicts are to be monitored and resolved.

In the event that a sitting director offers to resign because of a change in occupation or business association, the GNC would be responsible for reviewing whether continued service is appropriate and making a recommendation of any action, consistent with OCC's By-Laws and Rules, that should be taken by the Board. The GNC would also undertake periodic reviews of term limits for certain directors and recommend changes to these limits where appropriate.

5. Governance Practices

The GNC would have responsibility for reviewing the Board's Charter for consistency with regulatory requirements, transparency of the governance process, and other sound governance practices. Currently, this is a GC function, and certain GC Charter amendments are proposed to help further detail the GNC's review responsibilities. These include a general responsibility to recommend changes, as the GNC deems appropriate, to the Board concerning Committee Charters. This would include the GNC Charter, which the GNC would be required to review annually.¹⁵ In connection with a periodic review of Board Committee structure, the GNC would advise the Board regarding related matters of structure, operations, and charters. Furthermore, and in each case after consultation with OCC's Executive Chairman, the GNC would recommend to the Board for its approval certain directors for Committee service as well as for assignment as Committee chair persons.

The GNC would develop and recommend to the Board the annual process used by

¹⁵ As part of the annual review, the GNC would also submit the GNC Charter to the Board for re-approval, including any changes the GNC deems advisable.

the Board and Board Committees for self-evaluation of their role and performance in the governance of OCC. The GNC would also be responsible for coordinating and providing oversight of that process. Corporate governance principles applicable to OCC would be developed by the GNC for recommendation to the Board, and the GNC would review them at least once a year.

6. Other Proposed GC Charter Amendments

The GNC Charter would require the GNC to regularly evaluate its performance and the performance of its individual members and provide results of such assessments to the Board. It would also require an annual report to be prepared by the GNC and delivered to the Board regarding the GNC's activities for the preceding year, and the GNC would be required to include a statement that it carried out all of its GNC Charter responsibilities. In addition to such responsibilities, the GNC would generally be empowered to perform any other duties that it deems necessary or appropriate and consistent with the GNC Charter or as may otherwise be further delegated to it by the Board.

III. Discussion

Section 19(b)(2)(C) of the Act¹⁶ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder

¹⁶ 15 U.S.C. 78s(b)(2)(C).

applicable to such organization. Section 17A(b)(3)(C) of the Act requires the rules of a clearing agency to assure fair representation of its shareholders (or members) and participants¹⁷ in the selection of its directors and administration of its affairs.¹⁸

The Act does not define fair representation or set up particular standards of representation. Instead, it provides that the Commission must determine whether the rules of the clearing agency regarding the manner in which decisions are made give fair voice to participants as well as to shareholders in the selection of directors and the administration of its affairs.¹⁹ The Commission has stated that “at a minimum, fair representation requires that the entity responsible for nominating individuals for membership on the board of directors should be obligated by by-law or rule to make nominations with a view toward assuring fair representation of the interests of shareholders and a cross-section of the community of participants.”²⁰

The Commission finds that the proposed rule change is consistent with the requirements of the Act, and specifically the requirements in Section 17A(b)(3)(C) that

¹⁷ In relevant part, a clearing agency participant is defined in Section 3(a)(24) of the Act as “any person who uses a clearing agency to clear or settle securities transactions or to transfer, pledge, lend, or hypothecate securities...”

¹⁸ 15 U.S.C. 78q-1(b)(3)(C). The statute further provides that one way of establishing that the representation of participants is fair is by affording them a reasonable opportunity to acquire voting stock of the clearing agency in reasonable proportion to their use.

¹⁹ Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167, 45172 (October 3, 1983) (Depository Trust Co., et. al.; Order).

²⁰ Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167, 45172 (October 3, 1983) (Depository Trust Co., et. al.; Order).

the rules of a clearing agency assure fair representation of its shareholders (or members) and participants²¹ in the selection of its directors and administration of its affairs.²² The GNC would be composed of and selected by OCC's participants and shareholders or their representatives because, along with at least one Public Director, the GNC would be composed of Board members who represent OCC's Clearing Members and equity exchanges.

Furthermore, the GNC would be obligated by OCC's By-Laws and the GNC Charter to make nominations that serve the interests of shareholders and a cross-section of participants because it would be required to nominate candidates with a view toward ensuring: (1) that the Board consists of, among other things, individuals who have a reputation for integrity and represent diverse professional backgrounds and a broad spectrum of experience and expertise; (2) that not all Member Directors of the Board will represent the largest Clearing Member Organizations; and (3) that the mix of Member Directors on the Board will include representatives of Clearing Member Organizations primarily engaged in agency trading on behalf of retail customers or individual investors.

The Commission also finds that the proposed rule change is consistent with Rule 17Ad-22(d)(8), which requires that each "registered clearing agency establish,

²¹ In relevant part, a clearing agency participant is defined in Section 3(a)(24) of the Act as "any person who uses a clearing agency to clear or settle securities transactions or to transfer, pledge, lend, or hypothecate securities..."

²² 15 U.S.C. 78q-1(b)(3)(C). The statute further provides that one way of establishing that the representation of participants is fair is by affording them a reasonable opportunity to acquire voting stock of the clearing agency in reasonable proportion to their use.

implement, maintain and enforce written policies and procedures reasonably designed to have governance arrangements that are clear and transparent to fulfill the public interest requirements of Section 17A of the Act . . . to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency’s risk management procedures.”²³ The proposed rule change requires the GNC to be composed of representatives of at least one Member Director, Exchange Director, and Public Director. We believe this composition of the committee nominating directors is consistent with the requirement to have policies and procedures reasonably designed to support the objectives of both owners and participants.

The proposed rule change requires the GNC to endeavor to develop a Board that represents a broad range of skills and experience. We believe this is consistent with the requirement to have policies and procedures reasonably designed to promote the effectiveness of the clearing agency’s risk management procedures. A Board with a broad range of skill and expertise, including in risk management, will be better able to oversee the development, implementation, effectiveness, and potential areas in need of improvement or change of a clearing agency’s risk management framework, policies, and procedures.

The Commission also believes that increasing the number of Public Directors from three to five is consistent with both the Act and Rule 17Ad-22(d)(8). The Commission agrees with OCC that the input and expertise of two more Public Directors

²³ 17 CFR 240.17Ad-22(d)(8).

will further benefit OCC in the administration of its affairs in respect of the markets that it serves, and in the discharge of its obligations as a systemically important financial market utility.

V. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act²⁴ and the rules and regulations thereunder.

²⁴ 15 U.S.C. 78q-1.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁵ that the proposed rule change (File No. SR-OCC-2014-09) be and hereby is APPROVED.²⁶ For the Commission by the Division of Trading and Markets, pursuant to delegated authority.²⁷

Kevin M. O'Neill
Deputy Secretary

²⁵ 15 U.S.C. 78s(b)(2).

²⁶ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁷ 17 CFR 200.30-3(a)(12).