

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-84521; File No. SR-OCC-2018-013)

November 1, 2018

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Extend Term Limits for Member Directors Serving on The Options Clearing Corporation's Board of Directors

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on October 26, 2018, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change by OCC would extend the term limits for Member Directors serving on the Board of Directors from two consecutive three-year terms to three consecutive three-year terms. The proposed changes to OCC's By-Laws and Board of Directors Charter and Corporate Governance Principles are included as Exhibits 5A and 5B, respectively. Material proposed to be added is underlined and material proposed to be deleted is marked in strikethrough text. The proposed rule change, including Exhibits 5A and 5B, is available on OCC's website at

<https://www.theocc.com/about/publications/bylaws.jsp>. All terms with initial

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

capitalization that are not otherwise defined herein have the same meaning as set forth in the OCC By-Laws and Rules.<sup>3</sup>

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

(A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(1) Purpose

**Background**

OCC is proposing changes to Article III, Section 2 of its By-Laws and to its Board of Directors Charter and Corporate Governance Principles ("Board Charter") that would extend the term limits for Member Directors from two consecutive three-year terms to three consecutive three-year terms. The purpose of the proposed rule change is to address issues associated with frequent Member Director turnover by providing the potential for longer consecutive service by Member Directors who, among other considerations, may have developed considerable knowledge about OCC's business and the interests of Clearing Members.

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<sup>3</sup> OCC's By-Laws and Rules can be found on OCC's public website: <http://optionsclearing.com/about/publications/bylaws.jsp>. OCC's Board of Directors Charter and Corporate Governance Principles is also available on OCC's public website: <https://www.theocc.com/about/corporate-information/board-charter.jsp>.

## Board Composition and Member Director Considerations

OCC's Certificate of Incorporation and By-Laws establish the composition of its Board of Directors ("Board") and the procedures for director selection. When at its full capacity, the Board consists of twenty directors: (i) nine directors representing OCC Clearing Members ("Member Directors"); (ii) five directors designated by and representing each of OCC's five Equity Exchanges ("Exchange Directors"); (iii) five directors who are not affiliated with any national securities exchange, national securities association or with any broker or dealer in securities ("Public Directors"); and (iv) one management director, who serves as the Executive Chairman ("Management Director").<sup>4</sup>

In connection with OCC's status as a registered clearing agency, Section 17A(b)(3)(C) of the Act<sup>5</sup> requires, among other things, that OCC's rules<sup>6</sup> must assure a fair representation of its participants in the selection of its directors and administration of its affairs.<sup>7</sup> The term "participant" when used with respect to a clearing agency under the

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<sup>4</sup> OCC By-Laws, Article III, Sections 1, 2, 6, 6A and 7 (addressing the number of directors and required qualifications of Member Directors, Exchange Directors, Public Directors and the Management Director); see also Board Charter at 4 (Size of Board; Composition).

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>6</sup> 15 U.S.C. 78c(a)(27) (defining the term "rules of a clearing agency").

<sup>7</sup> The Commission has noted that 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. 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.'" Securities Exchange Act Release No. 72564 (July 8, 2014), 79 FR 40824, 40828 (July 14, 2014) (internal citations omitted).

Act means any person, such as a Clearing Member, who directly uses the clearing agency to clear or settle securities transactions.<sup>8</sup> Accordingly, OCC's By-Laws set forth the qualifications for Member Directors, providing that a Member Director must be either a (i) Clearing Member or (ii) representative (e.g., a director, senior officer, principal or general partner) of a Clearing Member Organization or an affiliate of such organization.<sup>9</sup>

At the annual meeting of stockholders, OCC's stockholders elect Member Directors from a list of nominees prepared by the Board's Governance and Nominating Committee ("GNC") and approved by the Board.<sup>10</sup> In furtherance of the Act's fair representation requirement described above, Article III, Section 5 of OCC's By-Laws requires the GNC in selecting Member Director nominees to "endeavor to achieve balanced representation among Clearing Members on the Board of Directors to assure that (i) not all Member Directors are representatives of the largest Clearing Member Organizations based on the prior year's volume, and (ii) the mix of Member Directors includes representatives of Clearing Member Organizations that are primarily engaged in agency trading on behalf of retail customers or individual investors."<sup>11</sup> All director nominees, including Member Director nominees, must also be considered under standards for directors in OCC's Fitness Standards for Directors, Clearing Members and

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<sup>8</sup> See 15 U.S.C. 78c(a)(24) (defining the term "participant" when used with respect to a clearing agency) and 15 U.S.C. 78c(a)(9) (defining the term "person").

<sup>9</sup> OCC By-Laws, Article I, Section 1.R.(6) and Article III, Section 2.

<sup>10</sup> OCC By-Laws, Article III, Section 5. In advance of the election, OCC shares the list of nominees with Clearing Members who are provided an opportunity to submit additional nominees. Id.

<sup>11</sup> OCC By-Laws, Article III, Section 5.

Others (“Fitness Standards”)<sup>12</sup> regarding their skills, experience, expertise, attributes and professional backgrounds.<sup>13</sup> OCC’s Fitness Standards also promote the fair representation considerations noted above under Section 17A(b)(3)(C) of the Act<sup>14</sup> and Article III, Section 5 of the By-Laws in that they require that the GNC in nominating directors seek to achieve a balanced representation of directors among all Clearing Members and among the business activities of Clearing Members.<sup>15</sup>

#### Member Director Term Limits

Member Directors are the only OCC directors currently subject to term limits.<sup>16</sup> Specifically, Member Directors are limited to serving two consecutive three-year terms for a total for a total of six consecutive years of Board service (excluding any time that may be served filling a vacancy).<sup>17</sup> These term limits are one of several mechanisms that help ensure that the composition of Member Directors serving on OCC’s Board is rotated on a periodic basis to promote fair representation of Clearing Members. Other

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<sup>12</sup> The Fitness Standards are available on OCC’s public website: <https://www.theocc.com/about/corporate-information/board-charter.jsp>.

<sup>13</sup> See OCC’s Fitness Standards at 1-2; see also OCC Governance and Nominating Committee Charter (“GNC Charter”) at 3 (providing that the GNC shall identify, screen and review individuals qualified to be elected or appointed to serve as Member Directors consistent with the Fitness Standards), available on OCC’s public website at <https://www.theocc.com/about/corporate-information/board-committee-charters.jsp>; OCC By-Laws Article III, Section 2, Interpretation and Policy .01 (providing that the GNC shall use the Fitness Standards for Directors, Clearing Members and Others in considering Member Director nominees).

<sup>14</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>15</sup> Fitness Standards at 2.

<sup>16</sup> Exchange Directors, Public Directors and the Management Director are not subject to any term limits.

<sup>17</sup> OCC By-Laws, Article III, Section 2(a). For example, a Member Director who is appointed in 2018 to fill a vacancy and then is elected to serve a three-year term beginning in 2020 would currently be eligible to serve out two consecutive three-year terms ending in 2026.

mechanisms include the GNC's administration of the fair representation considerations that are set out in Article III, Section 5 of the By-Laws,<sup>18</sup> a review by the GNC at least every three years of the composition of the Board as a whole for consistency with public interest and regulatory requirements<sup>19</sup> and evaluation of the potential nominees under the Fitness Standards.<sup>20</sup>

In a recent review by OCC of the tenure of its Member Directors from 1999 to 2018, OCC found that a majority of Member Directors during the period served for less than their full period of eligible service.<sup>21</sup> This high level of Member Director turnover indicates that factors other than Member Director term limits are already providing opportunities for OCC to rotate Board representation among the body of OCC Clearing Members. It is also the case that a high rate of early departures by Member Directors can risk impairing the Board's effectiveness due to the related disruptions in its composition as a decision-making body and the loss of institutional knowledge held by the departing Member Directors. Early departures of Member Directors also raise administrative efficiency concerns for OCC because it must devote substantial time and resources to the identification of appropriate new Member Director candidates and to their orientation upon election.

### **Proposed Changes**

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<sup>18</sup> See supra note 11 and accompanying text.

<sup>19</sup> See GNC Charter at 3-4.

<sup>20</sup> See Fitness Standards at 2 (requiring consideration of additional criteria for Member Directors such as balanced representation among all Clearing Members and the development of a mix of Member Directors).

<sup>21</sup> A Member Director may leave before the end of his or her term for a variety of reasons such as retirement, moving to a new firm, changing jobs within a firm, or because the GNC declines to nominate the individual for an additional term.

As an available tool to help address the concerns described above regarding Member Director turnover, OCC proposes to amend its By-Laws and its Board Charter to provide that a Member Director may serve for a limit of three consecutive three-year terms rather than two consecutive three-year terms.<sup>22</sup> OCC believes that this change would enhance the tools at its disposal to promote administrative efficiency of the Board without compromising fair representation among Clearing Members. In OCC's experience, Member Directors who reach the current two-term limit often have developed considerable knowledge of OCC's business and provide valuable judgment about the intersection of OCC's interests and the interests of Clearing Members. If the continued service of such a Member Director would be appropriate but for the current term limit as decided through the Board's approval of the nominee, OCC believes that it should not have to forgo the benefits of that Member Director's service for an additional consecutive three-year term for reasons unrelated to the quality of the Member Director's service. Currently, a high performing Member Director in this situation would be denied the ability to serve a third consecutive three-year term, to the detriment of OCC and its stakeholders. By contrast, a similarly situated Public Director or Exchange Director would not be limited in this way since they are not subject to term limits.

In connection with the proposed rule change, Member Directors would still be required to be nominated by the Board and elected by OCC's stockholders to each three-year term. Therefore, the proposed rule change would not guarantee that any Member Director would serve for the proposed limit of three consecutive three-year terms.

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<sup>22</sup> Specifically, OCC would replace the reference to "two" consecutive term limits with "three" consecutive term limits in Article III, Section 2 of the By-Laws and in Item 8 of the Membership subsection under the Board Issues section of the Board Charter.

Rather, a Member Director would merely be eligible to serve a third consecutive term if such continued service was also appropriate under all other relevant considerations (e.g., the GNC's administration of the fair representation considerations in Article III, Section 5 of the By-Laws, a review by the GNC at least every three years of the composition of the Board as a whole for consistency with public interest and regulatory requirements, and the evaluation of the potential nominees under the Fitness Standards). In the case of any Member Director who has served two consecutive terms, the GNC would be free to determine that such Member Director would not be appropriate as a nominee for a third consecutive term, including in light of the fair representation considerations described above. However, where a high performing Member Director is not otherwise disqualified, OCC would not be forced to lose the benefits of his or her continued service for a third consecutive three-year term.

(2) Statutory Basis

Section 17A(b)(3)(F) of the Act<sup>23</sup> requires, among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions, and, in general, protect investors and the public interest. OCC believes that the proposed rule change is consistent with these requirements because OCC would be afforded flexibility to continue to benefit from the institutional knowledge and experience of a Member Director for a third consecutive three-year term where appropriate. The benefits that flow from informed and experienced Member Directors in turn help OCC carry out its clearing agency functions to promote the prompt and accurate clearance and settlement of securities transactions, consistent with the protection of

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<sup>23</sup> 15 U.S.C. 78q-1(b)(3)(F).

investors and the public interest. Allowing for this flexibility would increase the tools available to OCC to mitigate the effects of high Member Director turnover on Board performance, which in turn promotes OCC's ability to carry out its clearing agency functions consistent with Section 17A(b)(3)(F) of the Act.<sup>24</sup>

As described above, Section 17A(b)(3)(C) of the Act<sup>25</sup> requires, among other things, that the rules of a clearing agency assure a fair representation of its participants in the selection of its directors and administration of its affairs.<sup>26</sup> OCC believes that the proposed rule change is consistent with the fair representation requirements of Section 17A(b)(3)(C) of the Act<sup>27</sup> because it would provide OCC with greater flexibility to select Member Directors who optimize Board performance while keeping in place the mechanisms described above that would continue to promote fair representation among Clearing Members on the Board, including: the GNC's administration of the fair representation considerations in Article III, Section 5 of the By-Laws, a review by the GNC at least every three years of the composition of the Board as a whole for consistency with public interest and regulatory requirements, and evaluation of the potential nominees under the Fitness Standards.<sup>28</sup> The proposed rule change would cause Member Directors to be eligible to serve a third consecutive three-year term but would not guarantee that any Member Director would be nominated or elected to a third consecutive term. Moreover, in certain circumstances the disqualification of Member

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<sup>24</sup> Id.

<sup>25</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>26</sup> See supra note 7.

<sup>27</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>28</sup> See supra notes 18-20 and accompanying text.

Directors who have reached the current term limit could actually inhibit OCC's ability to assure fair representation where the disqualified Member Director is a superior candidate to others in terms of assuring fair representation among Clearing Members. In this regard, the greater flexibility OCC would enjoy under the proposed rule change offers greater opportunity to assure consistency with Section 17A(b)(3)(C) of the Act<sup>29</sup> by not precluding Member Director nominees who could further fair representation objectives through continued service.

Rules 17Ad-22(e)(2)(i) – (iv) under the Act<sup>30</sup> require that a covered clearing agency, such as OCC, establish, implement, maintain and enforce written policies and procedures reasonably designed to “provide for governance arrangements that, among other things: (i) are clear and transparent; (ii) clearly prioritize the safety and efficiency of the covered clearing agency; (iii) support the public interest requirements in Section 17A of the Act (15 U.S.C. 78q-1) applicable to clearing agencies, and the objectives of owners and participants; and (iv) establish that the board of directors and senior management have appropriate experience and skills to discharge their duties and responsibilities[.]” OCC believes that the proposed rule change would be consistent with these requirements for the reasons described below.

The revised term limits for Member Directors would be set forth explicitly in OCC's By-Laws and its Board Charter that are available on its website, consistent with clear and transparent governance arrangements.<sup>31</sup> The proposed rule change would also promote a governance structure that prioritizes the safety and efficiency of OCC by

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<sup>29</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>30</sup> 17 CFR 240.17Ad-22(e)(2)(i) – (iv).

<sup>31</sup> 17 CFR 240.17Ad-22(e)(2)(i).

providing it with greater flexibility, where appropriate, to retain the institutional knowledge and skills of high performing Member Directors for a third consecutive three-year term.<sup>32</sup> For the same reasons described above regarding how the proposed rule change is consistent with the fair representation requirements under Section 17A(b)(3)(C) of the Act, the proposed rule change would also be consistent with the requirement in Rule 17Ad-22(e)(2)(iii)<sup>33</sup> to support the public interest requirements in Section 17A of the Act (which includes the fair representation requirement) applicable to clearing agencies and the objectives of owners and participants. Finally, consistent with Rule 17Ad-22(e)(2)(iv)<sup>34</sup> the proposed rule change would promote a Board structure in which OCC's directors have appropriate experience and skills to discharge their duties and responsibilities by making available an additional pool of qualified Member Director candidates who have already served two consecutive three-year terms and therefore may possess institutional knowledge and judgment that is valuable to the Board and difficult to replace.

The proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

(B) Clearing Agency's Statement on Burden on Competition

Section 17A(b)(3)(I) of the Act<sup>35</sup> requires that the rules of a clearing agency not impose any burden on competition not necessary or appropriate in furtherance of the

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<sup>32</sup> 17 CFR 240.17Ad-22(e)(2)(ii).

<sup>33</sup> 17 CFR 240.17Ad-22(e)(2)(iii).

<sup>34</sup> 17 CFR 240.17Ad-22(e)(2)(iv).

<sup>35</sup> 15 U.S.C. 78q-1(b)(3)(I).

purposes of the Act. OCC does not believe that the proposed rule change would impact or impose any burden on competition.

Clearing Members would not be placed at a competitive disadvantage to other Clearing Members as a result of Member Directors becoming eligible to serve for a third consecutive three-year term. Member Directors would still be required to be nominated by the GNC and elected by OCC's stockholders, and in the case of any Member Director who has served two consecutive terms the GNC would remain free to determine that such Member Director is not appropriate as a nominee for a third consecutive term, including in light of fair representation considerations. In this way, the proposed rule change applies equally to all Clearing Members. The proposed term limit increase is intended to provide OCC with greater flexibility to select Member Directors who optimize Board performance while keeping in place existing requirements that promote fair representation among Clearing Members on the Board, such as the GNC's administration of the fair representation considerations in Article III, Section 5 of the By-Laws, a review by the GNC at least every three years of the composition of the Board as a whole for consistency with public interest and regulatory requirements, and evaluation of the potential nominees under the Fitness Standards.<sup>36</sup>

For the foregoing reasons, OCC believes that the proposed rule change is in the public interest, would be consistent with the requirements of the Act applicable to clearing agencies, and would not impact or impose a burden on competition.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments on the proposed rule change were not and are not intended to be

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<sup>36</sup> See supra notes 18-20 and accompanying text.

solicited with respect to the proposed rule change and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove the proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2018-013 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2018-013. This file number should be included on the subject line if e-mail is used. To help the Commission process

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's website at <https://www.theocc.com/about/publications/bylaws.jsp>.

All comments received will be posted without change. Persons submitting comments are cautioned that we do not redact or edit personal identifying information from comment submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-OCC-2018-013 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>37</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>37</sup> 17 CFR 200.30-3(a)(12).