

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>18</sup>

**Robert W. Errett,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77112; File No. SR-OCC-2015-02]

### Self-Regulatory Organizations; The Options Clearing Corporation; Order Setting Aside Action by Delegated Authority, Approving Proposed Rule Change Concerning the Options Clearing Corporation's Capital Plan and Denying Motions

February 11, 2016.

#### I. Introduction

The Options Clearing Corporation ("OCC") is a clearing agency registered with the Securities and Exchange Commission ("Commission") and is the only clearing agency for standardized U.S. options listed on U.S. national securities exchanges. Today, listed options are traded on twelve national securities exchanges: five national securities exchanges that are equal owners of OCC ("Stockholder Exchanges")<sup>1</sup> and seven national securities exchanges that have no ownership stake in OCC ("Non-Stockholder Exchanges").<sup>2</sup> OCC also serves other markets, including those trading commodity futures, commodity options, and security futures,<sup>3</sup> the securities lending market and the OTC options market. In each of these markets, OCC provides clearing members<sup>4</sup> with central counterparty

("CCP") clearing services and performs critical functions in the clearance and settlement process.<sup>5</sup> OCC's services increase the efficiency and speed of options trading and settlement as well as reduce members' operational expenses and counterparty credit risk.

OCC's role as the CCP for all listed options contracts in the U.S. makes it an integral part of the national system for clearance and settlement, and its failure or service disruption could have cumulative negative effects on the U.S. options and futures markets, financial institutions, and the broader financial system. As such, OCC was designated by the Financial Stability Oversight Council as a systemically important financial market utility ("SIFMU") in 2012.<sup>6</sup>

In the context of a number of developments in the financial markets, OCC's Board of Directors ("Board") decided that OCC was significantly undercapitalized, and, in response, proposed and implemented an expedited plan to substantially increase OCC's capitalization (the "Capital Plan"), and, given OCC's critical clearing functions and its systemic importance, the Commission agrees that having OCC increase its capitalization is appropriate and in the public interest.<sup>7</sup>

#### Procedural Background

OCC filed the Capital Plan as an advance notice, SR-OCC-2014-813,

under Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act")<sup>8</sup> on December 29, 2014. OCC filed the proposed rule change implementing the Capital Plan, SR-OCC-2015-02, with the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>9</sup> and Rule 19b-4 thereunder<sup>10</sup> on January 14, 2015. The proposed rule change was published for comment in the **Federal Register** on January 30, 2015.<sup>11</sup> The Commission received seventeen comment letters on OCC's proposal from twelve commenters, including OCC.<sup>12</sup>

<sup>8</sup> 12 U.S.C. 5465(e)(1). On February 26, 2015, the Commission issued a notice of no objection to the advance notice filing. See Exchange Act Release No. 74387 (February 26, 2015), 80 FR 12215 (March 6, 2015) (SR-OCC-2014-813).

<sup>9</sup> 15 U.S.C. 78s(b)(1).

<sup>10</sup> 17 CFR 240.19b-4.

<sup>11</sup> See Notice.

<sup>12</sup> See Letter from Eric Swanson, General Counsel & Secretary, BATS Global Markets, Inc. ("BATS") (February 19, 2015) ("BATS Letter I"); Letter from Tony McCormick, Chief Executive Officer, BOX Options Exchange, ("BOX") (February 19, 2015) ("BOX Letter I"); Letter from Howard L. Kramer on behalf of Belvedere Trading, CTC Trading Group, IMC Financial Markets, Integral Derivatives, Susquehanna Investment Group, and Wolverine Trading (February 20, 2015) ("MM Letter"); Letter from Ellen Greene, Managing Director, Financial Services Operations, SIFMA (February 20, 2015) ("SIFMA Letter"); Letter from James E. Brown, General Counsel, OCC (February 23, 2015) (responding to BATS Letter and BOX Letter) ("OCC Letter I"); Letter from James E. Brown, General Counsel, OCC (February 23, 2015) (responding to MM Letter) ("OCC Letter II"); Letter from Barbara J. Comly, Executive Vice President, General Counsel & Corporate Secretary, Miami International Securities Exchange, LLC, ("MIAX") (February 24, 2015) ("MIAX Letter I"); Letter from James E. Brown, General Counsel, OCC (February 24, 2015) (responding to SIFMA Letter) ("OCC Letter III"); Letter from John A. McCarthy, General Counsel, KCG Holdings, Inc., ("KCG") (February 26, 2015) ("KCG Letter I"); Letter from Eric Swanson, General Counsel and Secretary, BATS (February 27, 2015) ("BATS Letter II"); Letter from John A. McCarthy, General Counsel, KCG (February 27, 2015) ("KCG Letter II"); Letter from Richard J. McDonald, Chief Regulatory Counsel, Susquehanna International Group, LLP, ("SIG") (February 27, 2015) ("SIG Letter I"); Letter from Barbara J. Comly, Executive Vice President, General Counsel & Corporate Secretary, MIAX (March 1, 2015) ("MIAX Letter II"); Letter from James E. Brown, General Counsel, OCC (March 2, 2015) ("OCC Letter IV"); Letter from Eric Swanson, General Counsel and Secretary, BATS (March 3, 2015) ("BATS Letter III"); and Letter from Tony McCormick, Chief Executive Officer, BOX (March 3, 2015) ("BOX Letter II"); Letter from Brian Sopinsky, General Counsel, SIG (March 4, 2015) ("SIG Letter II"). Since the proposal was filed as both an advance notice and proposed rule change, the Commission considered all comments received on the proposal, regardless of whether the comments were submitted to the proposed rule change or advance notice file. See comments on the advance notice (File No. SR-OCC-2014-813), <http://www.sec.gov/comments/sr-occ-2014-813/occ2014813.shtml> and comments on the proposed rule change (File No. SR-OCC-2015-02), <http://www.sec.gov/comments/sr-occ-2015-02/occ201502.shtml>. In its evaluation of the proposed

<sup>18</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> The Stockholder Exchanges are: Chicago Board Options Exchange, Incorporated; International Securities Exchange, LLC; NASDAQ OMX PHLX, LLC; NYSE MKT LLC; and NYSE Arca, Inc. See Exchange Act Release No. 74136 (January 26, 2015), 80 FR 5171 (January 30, 2015) (SR-OCC-2015-02) ("Notice").

<sup>2</sup> Under OCC's By-Laws, exchanges other than Stockholder Exchanges may participate in OCC's services subject to meeting certain qualifications. See OCC By-Laws, Article VIII (Non-Equity Exchanges).

<sup>3</sup> OCC also is registered with the Commodity Futures Trading Commission as a derivatives clearing organization regulated to provide clearing services for four futures exchanges.

<sup>4</sup> OCC has over 100 members which include large domestic and international broker-dealers and futures commission merchants. See OCC's 2014 Annual Report (available at: [http://www.optionsclearing.com/components/docs/about/annual-reports/occ\\_2014\\_annual\\_report.pdf](http://www.optionsclearing.com/components/docs/about/annual-reports/occ_2014_annual_report.pdf)), and OCC's Web site, "What is OCC?" (available at: <https://www.optionsclearing.com/about/corporate-information/what-is-occ.jsp>).

<sup>5</sup> For instance, OCC provides CCP services for OTC options, and for two securities lending market structures, OCC's OTC Stock Loan Program and AQS, an automated marketplace for securities lending and borrowing operated by Automated Equity Finance Markets, Inc. OCC currently participates in cross-margin programs with the CME and ICE and offers an internal cross-margin program for products regulated by the SEC and CFTC. See OCC's Web site, OCC Fact Sheet (available at: <http://www.optionsclearing.com/components/docs/about/occ-factsheet.pdf>), "What is OCC?" (available at: <http://www.optionsclearing.com/about/corporate-information/what-is-occ.jsp>) and OCC's Web site, "Cross Margin Programs" (available at: <http://www.optionsclearing.com/clearing/clearing-services/cross-margin.jsp>).

<sup>6</sup> See Financial Stability Oversight Council ("FSOC") 2012 Annual Report, Appendix A, (available at <http://www.treasury.gov/initiatives/fsoc/Documents/2012%20Appendix%20A%20Designation%20of%20Systemically%20Important%20Market%20Utilities.pdf>).

<sup>7</sup> According to OCC, as of December 31, 2013, at the time it developed the Capital Plan, OCC had total shareholders' equity of about \$25 million, which represents approximately 6 weeks of operating expenses. Based on internal operational risk scenarios and loss modeling, OCC quantified its operational risk at \$226 million and pension risk at \$21 million. According to OCC, as of August 31, 2015, in the absence of the \$150 million capital contribution made pursuant to the Capital Plan, OCC's adjusted shareholder equity would be about \$149 million and OCC's total capital resources would be less than \$150 million. See Notice at 15172-73; OCC's Written Statement in Support of Affirming March 6, 2015 Order Approving Capital Plan (October 7, 2015) ("OCC Support Statement").

The Commission issued an order on March 6, 2015, through delegated authority, approving the proposal (“Delegated Order”).<sup>13</sup>

The Delegated Order describes the elements of the proposed Capital Plan, OCC’s financial condition, and the basis for OCC’s projected capital requirement. The Delegated Order also discusses and responds to the comments received on the proposed Capital Plan. The Delegated Order makes findings that the Capital Plan is consistent with Exchange Act Sections 17A(b)(3)(A), 17A(b)(3)(F), 17A(b)(3)(D) and 17A(b)(3)(I).<sup>14</sup>

In response to the Delegated Order, BATS, BOX, KCG, MIAX, and SIG (collectively “Petitioners”) filed notices of intention to petition for review of the Delegated Order, the first of which was filed on March 12, 2015.<sup>15</sup> The Commission received five petitions for review of the Delegated Order (collectively “Petitions for Review” or “Petitions”) from the Petitioners between March 16 and March 20, 2015.<sup>16</sup> The filing of the first notice of intention to petition for review on March 12, 2015 automatically stayed the Delegated Order pursuant to Rule 431(e) of the Commission’s Rules of Practice.<sup>17</sup> OCC filed a motion to lift the automatic stay on April 2, 2015.<sup>18</sup> The Petitioners filed responses opposing lifting the stay, and OCC filed a reply brief supporting its motion to lift the stay.<sup>19</sup>

The Commission issued two orders on September 10, 2015. The first order

rule change, the Commission assessed whether the proposal was consistent with the requirements of the Exchange Act and the applicable rules and regulations thereunder.

<sup>13</sup> Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) (SR–OCC–2015–02).

<sup>14</sup> See 15 U.S.C. 78q–1(b)(3)(A); 15 U.S.C. 78q–1(b)(3)(F); 15 U.S.C. 78q–1(b)(3)(D); 15 U.S.C. 78q–1(b)(3)(I).

<sup>15</sup> See Letter from Barbara J. Comly, Executive Vice President, General Counsel & Corporate Secretary, MIAX (March 12, 2015); Letter from Lisa J. Fall, President, BOX (March 13, 2015); Letter from Eric Swanson, General Counsel and Secretary, BATS (March 13, 2015); Letter from Brian Sopinsky, General Counsel, SIG (March 13, 2015); Letter from John A. McCarthy, General Counsel, KCG (March 13, 2015).

<sup>16</sup> See BATS Petition for Review (March 16, 2015) (“BATS Petition”); BOX Petition for Review (March 20, 2015) (“BOX Petition”); KCG Petition for Review (March 20, 2015) (“KCG Petition”); MIAX Petition for Review (March 20, 2015) (“MIAX Petition”); SIG Petition for Review (March 20, 2015) (“SIG Petition”).

<sup>17</sup> 17 CFR 201.431(e).

<sup>18</sup> OCC Motion to Lift Stay (April 2, 2015) (“OCC Stay Motion”).

<sup>19</sup> BATS, BOX, MIAX Response to OCC’s Motion to Lift the Stay (April 8, 2015) (“BATS Response”); KCG Response to OCC’s Motion to Lift the Stay (April 9, 2015) (“KCG Response”); SIG Opposition to OCC’s Motion to Lift the Stay (April 9, 2015) (“SIG Response”); OCC’s Reply Brief in Support of its Motion to Lift the Stay (April 13, 2015) (“OCC Stay Brief”).

granted the Petitions for Review and scheduled the filing of statements either in support of or against the Delegated Order (“Review Order”).<sup>20</sup> The second order lifted the automatic stay (“Stay Order”).<sup>21</sup> Shortly thereafter, on September 15, 2015, Petitioners filed a motion to reinstitute the automatic stay.<sup>22</sup> OCC filed an opposition to the Reinstitution Motion on September 22, 2015,<sup>23</sup> and Petitioners filed a memorandum in further support of the Reinstitution Motion on September 25, 2015.<sup>24</sup> On December 22, 2015, in response to OCC’s announcement of the declaration of refunds, dividends, and fee reduction pursuant to the Capital Plan, a commenter filed a letter further advocating for reinstatement of the automatic stay.<sup>25</sup> On February 5, 2016, Petitioners filed a motion to expedite the Commission’s ruling on the pending Reinstitution Motion.<sup>26</sup> The Reinstitution Motion, Expedition Motion, various other motions, and the comments thereto are discussed in Section IV below.

#### Summary of Findings

The Commission’s Rules of Practice set forth procedures for reviewing actions made pursuant to delegated authority. Pursuant to Rule 431(a) of the Rules of Practice, the Commission may affirm, reverse, modify, set aside or remand for further proceedings, in whole or in part, the action made pursuant to delegated authority.<sup>27</sup> Here, the Commission is setting aside the Delegated Order and conducting a *de novo* review of, and giving careful consideration to, the entire record, which includes: OCC’s proposal, all comments received in response to the Notice, the Petitions for Review,

<sup>20</sup> Exchange Act Release No. 75885 (September 10, 2015), 80 FR 55700 (September 16, 2015).

<sup>21</sup> Exchange Act Release No. 75886 (September 10, 2015), 80 FR 55668 (September 16, 2015).

<sup>22</sup> BATS, BOX, KCG, MIAX, SIG Motion to Reinstitute Automatic Stay (September 15, 2015) (“Reinstitution Motion”).

<sup>23</sup> OCC Brief in Opposition to Motion to Reinstitute Automatic Stay (September 22, 2015) (“OCC Reinstitution Response”).

<sup>24</sup> Memorandum in Further Support of Motion to Reinstitute Automatic Stay (on behalf of BATS, BOX, MIAX, and SIG) (September 25, 2015) (“Memo in Further Support of Reinstitution”).

<sup>25</sup> Letter from Joseph C. Lombard, Murphy & McGonigle, on behalf of SIG (and together with the Petitioners) (December 22, 2015) (“SIG Letter III”). On February 2, 2016, SIG requested a telephone call to inquire about the status of the Reinstitution Motion. See Email from Stephen J. Crimmins, on behalf of SIG, to Brent J. Fields on February 2, 2016 (“SIG Email”).

<sup>26</sup> See BATS, BOX, KCG, MIAX, SIG Motion to Expedite the Commission’s Ruling on the Pending Motion to Reinstitute the Automatic Stay (February 5, 2016) (“Expedition Motion”).

<sup>27</sup> 17 CFR 201.431(a).

comments received in response to the Review Order, all motions filed, and OCC’s responses thereto.

In conducting its *de novo* review, the Commission looks to Section 19(b)(2)(C) of the Exchange Act,<sup>28</sup> which directs the Commission to approve a proposed rule change of a self-regulatory organization if the Commission finds that the proposed rule change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such self-regulatory organization. After carefully considering the entire record, for the reasons discussed throughout this order, the Commission finds that OCC’s proposed rule change is consistent with the Exchange Act requirements, including Exchange Act Sections 17A(b)(3)(A), 17A(b)(3)(D), 17A(b)(3)(F), and 17A(b)(3)(I),<sup>29</sup> and the rules and regulations thereunder, that are applicable to OCC.<sup>30</sup> Accordingly, the Commission is approving the proposed rule change implementing the Capital Plan. In approving this proposed rule change, the Commission also has considered the impact of the Capital Plan on efficiency, competition, and capital formation under Section 3(f) of the Exchange Act.<sup>31</sup>

#### II. Description of the Proposal<sup>32</sup>

OCC proposes to amend its rules to implement the Capital Plan.<sup>33</sup> According to OCC, the Capital Plan is designed to support OCC’s functions and continuity of its operations as a SIFMU. As proposed by OCC, the Capital Plan is designed to address business, operational, and pension risks. It is not designed to address counterparty risk, on-balance sheet credit risk, or market risk, all of which

<sup>28</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>29</sup> 15 U.S.C. 78q–1(b)(3)(A); 15 U.S.C. 78q–1(b)(3)(F); 15 U.S.C. 78q–1(b)(3)(D); 15 U.S.C. 78q–1(b)(3)(I).

<sup>30</sup> As the Commission notes in the Notice, OCC states this proposal’s purpose is (in part) to facilitate compliance with proposed Commission rules on standards for covered clearing agencies (Exchange Act Release No. 71699 (March 12, 2014), 79 FR 29508 (May 22, 2014) (S7–03–14)) and address Principle 15 of the Principles for Financial Market Infrastructures (“PFMIs”) (international standards for financial market intermediaries). Because the proposed Commission rules are pending, the Commission has evaluated this proposed rule change under the Exchange Act and the rules currently in force thereunder.

<sup>31</sup> See 15 U.S.C. 78c(f).

<sup>32</sup> See Notice at 5171–78, unless otherwise noted.

<sup>33</sup> To implement the Capital Plan, OCC’s proposed rule change included: (i) Establishing policies on fees, refunds, and dividends (described further below); (ii) amending its By-Laws; (iii) amending its Restated Certificate of Incorporation; and (iv) amending its Stockholders Agreement.

are addressed through margin, clearing fund deposits, and other means.

OCC represents that it reviewed a range of risk scenarios and modeled potential losses arising from business, operational, and pension risks, and based on those results, it was appropriate to significantly increase its capital. After evaluating alternate sources of capital funding, including increasing fees or suspending refunds to clearing members, the Board approved the proposed Capital Plan.<sup>34</sup>

Under the Capital Plan, OCC annually will determine a target capital requirement (“Target Capital Requirement”). To meet the initial Target Capital Requirement, the Stockholder Exchanges provided capital to OCC (“Capital Contribution”) and entered into an agreement (“Replenishment Capital Agreement”) to provide additional replenishment capital (“Replenishment Capital”) under certain circumstances. In return, the Stockholder Exchanges are eligible to receive dividends from OCC (“Dividend Policy”). Additionally, OCC will set its fees annually to cover its estimated operating expenses plus a “Business Risk Buffer” (“Fee Policy”). Finally, clearing members will be eligible to receive refunds annually, under certain circumstances (“Refund Policy”).

#### A. Target Capital Requirement

The Target Capital Requirement consists of: (i) A “Baseline Capital Requirement” plus (ii) a “Target Capital Buffer.” The Baseline Capital Requirement is equal to the greatest of: (i) Six months budgeted operating expenses for the following year; (ii) the maximum cost of the recovery scenario from OCC’s recovery and wind-down plan; or (iii) the cost to OCC of winding down operations as set forth in its recovery and wind-down plan. The Target Capital Buffer is linked to plausible loss scenarios from business, operational, and pension risks and is designed to provide a significant capital cushion to offset potential business losses.<sup>35</sup>

#### B. Capital Contribution and Replenishment Capital Agreement

Under the Capital Plan, OCC requires the Stockholder Exchanges to provide a Capital Contribution pursuant to their Class B Common Stock on a *pro rata* basis. At the time of the January 14,

2015 filing, OCC proposed the Capital Contribution to be \$150 million, and the Stockholder Exchanges have since contributed that amount to OCC pursuant to the Capital Plan.<sup>36</sup>

The Capital Contribution is supported by a Replenishment Capital Agreement, under which the Stockholder Exchanges have committed to provide Replenishment Capital if OCC’s total shareholders’ equity falls below a certain threshold. Specifically, if OCC’s shareholders’ equity falls below a “Hard Trigger” as described below, the Stockholder Exchanges are obligated to provide a committed amount of Replenishment Capital on a *pro rata* basis. The provision of Replenishment Capital is capped at the excess of: (i) The lesser of either the Baseline Capital Requirement at the time of relevant funding or \$200 million,<sup>37</sup> minus (ii) outstanding Replenishment Capital (collectively, the “Cap”).<sup>38</sup> In exchange for any Replenishment Capital made under the Replenishment Capital Agreement, the OCC will issue the Stockholder Exchanges a new class of OCC common stock (“Class C Common Stock”). The Capital Plan also has a “Soft Trigger,” which would alert OCC that it should re-evaluate the sufficiency of its capitalization.

As mentioned above, OCC has identified two triggers concerning the shareholders’ equity that would require action by OCC: (i) A “Soft Trigger,” a warning sign that OCC’s capitalization has fallen to a level that requires action to prevent it from falling to unacceptable levels, and (ii) a “Hard Trigger,” a sign that corrective action must be taken in the form of a mandatory Replenishment Capital call.

The Hard Trigger is reached when OCC’s shareholders’ equity falls below 125% of the Baseline Capital Requirement.<sup>39</sup> Upon such occurrence, the Board will determine whether to attempt a recovery or a wind-down of

OCC’s operations,<sup>40</sup> or a sale or similar transaction, subject in each case to any necessary stockholder consent.<sup>41</sup> OCC believes that the Hard Trigger would occur only as the result of a significant, unexpected event.

The Soft Trigger is reached when OCC’s shareholders’ equity falls below the sum of: (i) The Baseline Capital Requirement and (ii) 75% of the Target Capital Buffer.<sup>42</sup> Upon such occurrence, OCC’s senior management and the Board will evaluate options to restore the shareholders’ equity to the Target Capital Requirement, including, but not limited to, through increasing fees and/or decreasing expenses.

In addition, the Board will review the Replenishment Capital Agreement on an annual basis. While the Replenishment Capital amount will increase as the Baseline Capital Requirement increases, if the Baseline Capital Requirement approaches or exceeds \$200 million, the Board will review and revise the Capital Plan, as needed, to address potential future needs for Replenishment Capital higher than the \$200 million cap. OCC also represents that its management will monitor OCC’s shareholders’ equity to identify additional triggers or reduced capital levels that may require action.

#### C. Fee Policy, Refund Policy, and Dividend Policy

Under the Capital Plan, OCC will also implement a Fee Policy, Refund Policy, and Dividend Policy designed to maintain OCC’s shareholders’ equity above the Baseline Capital Requirement. Changes to the Fee Policy, Refund Policy, and Dividend Policy will require the affirmative vote of two-thirds of the directors then in office and unanimous approval by the holders of OCC’s outstanding Class B Common Stock.<sup>43</sup> Any such changes also will be subject

<sup>34</sup> See OCC Support Statement.

<sup>35</sup> According to OCC, the \$200 million takes into account projected growth in the Baseline Capital Requirement for the foreseeable future and OCC estimated that the Baseline Capital Requirement would not exceed \$200 million before 2022.

<sup>36</sup> For example, if the Baseline Capital Requirement is greater than \$200 million, then the Replenishment Capital that could be accessed by OCC would be capped at \$200 million minus any outstanding Replenishment Capital. Therefore, if there is no outstanding Replenishment Capital, OCC could access up to \$200 million. If on the other hand, the Baseline Capital Requirement is \$100 million, then OCC could access Replenishment Capital up to \$100 million minus any Replenishment Capital outstanding.

<sup>37</sup> For 2015, the Hard Trigger would be reached if OCC’s shareholders’ equity fell below \$146.25 million.

<sup>38</sup> See OCC Support Statement.

<sup>39</sup> For 2015, the Soft Trigger would be reached if OCC’s shareholders’ equity fell below \$227.5 million.

<sup>40</sup> If the Board decides to wind-down OCC’s operations, then OCC will access Replenishment Capital in the amount the Board determines is sufficient to fund the wind-down, subject to the Cap. If the Board decides to attempt a recovery of OCC’s capital and business, then OCC will access Replenishment Capital in the amount sufficient to return shareholders’ equity to \$20 million above the Hard Trigger, subject to the Cap.

<sup>41</sup> Article IV of OCC’s Certificate of Amendment of Certificate of Incorporation requires the approval of a majority of the issued and outstanding shares of each series of Class B Common Stock, voting separately as a series, to authorize or consent to the sale, lease, or exchange of all or substantially all of the property and assets of the Corporation, or to authorize or consent to the dissolution of the corporation.

<sup>42</sup> For 2015, the Soft Trigger would be reached if OCC’s shareholders’ equity fell below \$227.5 million.

<sup>43</sup> The Stockholder Exchanges are the sole holders of the Class B common stock and have each made Capital Contributions to OCC in respect of their equal ownership of Class B common stock, which entitles them to receive dividends, if declared.

<sup>34</sup> See OCC Support Statement.

<sup>35</sup> OCC has determined that its current appropriate “Target Capital Requirement” is \$247 million, reflecting a “Baseline Capital Requirement” of \$117 million, which is equal to six-month projected operating expenses, plus a “Target Capital Buffer” of \$130 million.

to the filing requirements of Section 19(b) of the Exchange Act and the rules and regulations thereunder.

### 1. Fee Policy

Under the Fee Policy, OCC will set fees at a level that will cover OCC's estimated operating expenses plus a "Business Risk Buffer." According to OCC, the purpose of the Business Risk Buffer is to ensure that OCC accumulates sufficient funds to cover unexpected fluctuations in operating expenses, business capital needs, and regulatory capital requirements. Specifically, in setting fees each year, OCC will calculate an annual revenue target based on a forward twelve months expense forecast divided by the difference between one and the Business Risk Buffer of 25% (*i.e.*, OCC will divide the expense forecast by 0.75). OCC believes that establishing the Business Risk Buffer at 25% will allow OCC to manage unexpected fluctuations in expenses or revenue.<sup>44</sup>

OCC notes that the 25% Business Risk Buffer will be lower than OCC's historical 10-year average buffer of 31%. OCC represents that the lower buffer will permit it to charge lower fees to market participants, and thus become less reliant on refunds to clearing members to return any excess fees paid.<sup>45</sup> In addition, by capitalizing OCC through shareholders' equity (*i.e.*, the Capital Contribution), OCC represents that it is positioned to charge lower fees that are more closely tied to its projected operating expenses, rather than annually generating a larger surplus to address business, operational, and pension risks.<sup>46</sup> OCC states that the Business Risk Buffer will remain at 25% as long as OCC's shareholders' equity remains above the Target Capital Requirement. OCC represents that it will

<sup>44</sup> For example, fees could generate less revenue than expected if trading volume decreases. According to OCC, because OCC's clearing fee schedules typically reflect different rates for different categories of transactions, fee projections will include projections of relative volume in each category. Therefore, the clearing fee schedule will be set to achieve the annual revenue target through a blended or average rate per contract, multiplied by total projected contract volume.

<sup>45</sup> OCC stated that the Capital Plan would allow OCC to refund approximately \$40 million from 2014 fees to clearing members and to reduce fees in an amount to be determined by the Board. See Notice at 5174. OCC issued a press release announcing the declaration of a refund, dividend, and fee reduction, pursuant to the Capital Plan on December 17, 2015. See OCC Press Release, "OCC Declares Clearing Member Refund and Dividend for 2015 and Reduction of Fees under Approved Capital Plan." (available at: [http://www.optionsclearing.com/about/newsroom/releases/2015/12\\_17.jsp](http://www.optionsclearing.com/about/newsroom/releases/2015/12_17.jsp) ("OCC Press Release").

<sup>46</sup> OCC has announced it intended to lower fees by about 19% pursuant to the Capital Plan. See OCC Press Release.

review its fee schedule on a quarterly basis to manage revenues as close to the 25% Business Risk Buffer as possible, and, if the fee schedule needs to be changed to achieve the 25% Business Risk Buffer, OCC would file a proposed rule change with the Commission.

### 2. Refund Policy

Under the Refund Policy, except at a time when Replenishment Capital is outstanding, OCC will declare a refund to clearing members in December of each year using the formula set out in the Refund Policy. Specifically, the refund will equal 50% of the excess of: (i) Pre-tax income for the year in which the refund is declared over (ii) the sum of the following: (x) The amount of pre-tax income after the refund necessary to produce after-tax income for such year sufficient to maintain shareholders' equity at the Target Capital Requirement for the following year, and (y) the amount of pre-tax income after the refund necessary to fund any additional reserves or additional surplus not already included in the Target Capital Requirement.

The Refund Policy states that OCC will declare refunds, if any, in December of each year, and such refunds would be paid in the following year after OCC issues its audited financial statements, provided that: (i) The payment does not result in a total shareholders' equity falling below the Target Capital Requirement and (ii) the payment is otherwise permitted by Delaware law, federal laws, and regulations.<sup>47</sup>

OCC will not make refund payments while Replenishment Capital is outstanding and will resume refunds after the Replenishment Capital is repaid in full and the Target Capital Requirement is restored. However, OCC will not resume paying refunds and will recalculate how refunds are made if, for more than 24 months: (i) Replenishment Capital remains outstanding or (ii) the Target Capital Requirement is not restored.

### 3. Dividend Policy

Under the Dividend Policy, OCC will pay dividends to Stockholder Exchanges as consideration for their Capital Contribution and commitment to provide Replenishment Capital under the Replenishment Capital Agreement. OCC will declare dividends, if any, in December of each year, and such dividends would be paid in the following year after OCC issues its

<sup>47</sup> OCC announced for 2016, that it will pay a previously declared 2014 refund of \$33.3 million, a 2015 refund of \$39 million, and special refund of \$72 million. See OCC Press Release.

audited financial statements, provided that: (i) The payment does not result in total shareholders' equity falling below the Target Capital Requirement and (ii) the payment is otherwise permitted by Delaware law, federal laws, and regulations.

Pursuant to the Dividend Policy, except at a time when Replenishment Capital is outstanding, OCC will declare a dividend on its Class B Common Stock in December of each year in aggregate equal to the excess of: (i) After-tax income for the year, after application of the Refund Policy<sup>48</sup> over (ii) the sum of: (A) The amount required to be retained in order to maintain total shareholders' equity at the Target Capital Requirement for the following year, plus (B) the amount of any additional reserves or additional surplus not already included in the Target Capital Requirement.<sup>49</sup>

Similar to the Refund Policy, if Replenishment Capital is outstanding, OCC will not pay dividends. OCC will resume dividends after the Replenishment Capital is repaid in full and the Target Capital Requirement is restored through the accumulation of retained earnings. However, OCC will not resume paying dividends and will recalculate how dividends are made if, for more than 24 months: (i) Replenishment Capital remains outstanding or (ii) the Target Capital Requirement is not restored. Moreover, the formulas for determining the refunds and dividends treat refunds as tax-deductible, and dividends are not tax-deductible. In the event that refunds are not tax-deductible, OCC represents that it will amend the Refund Policy and Dividend Policy to restore the relative economic benefits between the recipients of the refunds and the Stockholder Exchanges to what the Capital Plan currently provides.

## III. Summary of the Comments and Discussion

### A. Statutory Standards

Exchange Act Section 19(b)(2)(C) directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds the change is consistent with the requirements of the Exchange Act and the rules and regulations thereunder applicable to such organization.<sup>50</sup> In particular, the Commission addresses the following provisions of the

<sup>48</sup> If the Refund Policy has been eliminated, the refunds shall be deemed to be \$0.

<sup>49</sup> OCC issued a press release announcing the declaration of an approximate \$17 million dividend for 2015 pursuant to the Capital Plan. See OCC Press Release.

<sup>50</sup> 15 U.S.C. 78s(b)(2)(C).

Exchange Act in its review of this proposed rule change:

- Section 17A(b)(3)(F) of the Exchange Act requires, in part, that the rules of a registered clearing agency be designed to protect investors and the public interest.<sup>51</sup>

- Section 17A(b)(3)(I) of the Exchange Act requires, in part, that the rules of a registered clearing agency do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>52</sup>

- Section 17A(b)(3)(D) of the Exchange Act requires, in part, that the rules of a registered clearing agency provide for the equitable allocation of reasonable dues, fees, and other charges among its participants.<sup>53</sup>

- Section 17A(b)(3)(A) of the Exchange Act requires, in part, that a registered clearing agency be so organized and have the capacity to be able to facilitate the prompt and accurate clearance and settlement of securities transactions and to safeguard securities and funds in its custody or control or for which it is responsible.<sup>54</sup>

- Section 3(f) of the Exchange Act requires, in part, that whenever pursuant to the Exchange Act the Commission is engaged in the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission must also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.<sup>55</sup>

#### *B. Comments Received and Commission Response*

The discussion below summarizes the comments received regarding OCC's proposed Capital Plan and provides OCC's responses and the Commission's evaluation of the proposal in accordance with the applicable Exchange Act requirements.

#### 1. Investor Protection and Public Interest in Exchange Act Section 17A(b)(3)(F) and Burden on Competition in Exchange Act Section 17A(b)(3)(I)

Commenters argue that the Capital Plan is inconsistent with Exchange Act Sections 17A(b)(3)(F) and 17A(b)(3)(I),<sup>56</sup> which require that the rules of a registered clearing agency, *i.e.*, OCC, are

designed to protect investors and the public interest and do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Broadly, commenters argue that the Capital Plan is contrary to the protection of investors and the public interest, and imposes unnecessary and inappropriate burdens on competition, because: (i) The Dividend Policy would unfairly subsidize Stockholder Exchanges at the expense of the Non-Stockholder Exchanges, (ii) the Capital Plan would raise transaction costs by increasing fees and reducing refunds to pay dividends to the Stockholder Exchanges, and (iii) the Dividend Policy would pay Stockholder Exchanges an excessive rate of return. Commenters also assert that the Capital Plan imposes an inappropriate burden on competition, inconsistent with Exchange Act Section 17A(b)(3)(I),<sup>57</sup> because OCC's Target Capital Requirement is inflated, or in the alternative, OCC is already sufficiently capitalized, thus rendering the Capital Plan unnecessary. Finally, commenters argue that the Capital Plan imposes an inappropriate burden on competition because OCC did not consider less costly alternative capital raising initiatives.

The Commission discusses each of these comments and OCC's responses below. After considering the entire record, and for reasons discussed below, the Commission finds that the Capital Plan is consistent with Exchange Act Sections 17A(b)(3)(F) and 17A(b)(3)(I).<sup>58</sup>

(i) Commenters Argue That the Dividend Policy Fails To Protect Investors and the Public Interest and Imposes a Burden on Competition Not Necessary or Appropriate in Furtherance of the Act

Commenters argue that the Dividend Policy is inconsistent with Sections 17A(b)(3)(F) and 17A(b)(3)(I) of the Exchange Act,<sup>59</sup> because it enables the Stockholder Exchanges to monetize OCC's clearing monopoly and changes OCC from a low-cost public utility to a for-profit enterprise by paying dividends to the Stockholder Exchanges.<sup>60</sup> Commenters also assert

that because only Stockholder Exchanges are eligible to receive dividend payments, and any such dividend payments are tantamount to a subsidy from OCC, the Dividend Policy harms the competitive balance between Stockholder Exchanges and Non-Stockholder Exchanges.<sup>61</sup> In the commenters' view, Stockholder Exchanges will be able to use the dividend "subsidy" to lower their options exchange operating costs and thus compete more effectively to provide trading and execution services than the Non-Stockholder Exchanges, which would not receive any such subsidy.<sup>62</sup>

OCC responds that the Dividend Policy is an integral part of the Capital Plan and is necessary to protect OCC against business, operational, and pension risks. OCC refutes the statement that the Capital Plan would turn OCC into a for-profit enterprise for the sole benefit of the Stockholder Exchanges.<sup>63</sup> OCC states the purpose of the Capital Plan is to ensure sufficient capital to cover business, operational, and pension risks, and further argues that the plan as a whole works to limit returns to the Stockholder Exchanges to an appropriate level and lower clearing fees for all market participants.<sup>64</sup> OCC also counters that the Capital Plan does not unfairly advantage Stockholder Exchanges as the obligations of the Stockholder and Non-Stockholder Exchanges are not identical. OCC maintains that commenters do not appropriately consider that the Stockholder Exchanges incur financial obligations under the Capital Plan by providing Capital Contributions and committing to provide Replenishment Capital, and therefore face the substantial risk of losing both contributions.<sup>65</sup> OCC further states that the competitive balance between and among the options exchanges, including between the Stockholder Exchanges and the Non-Stockholder Exchanges, is far more complex than portrayed by the commenters, and that any dividend payments received by Stockholder Exchanges under the Dividend Policy would not have a meaningful impact on competition.<sup>66</sup> Moreover, OCC argues

<sup>51</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>52</sup> 15 U.S.C. 78q-1(b)(3)(F) and (I).

<sup>53</sup> *Id.*

<sup>54</sup> SIG Statement in Opposition to the Order Approving OCC's Capital Plan (October 7, 2015) ("SIG Opposition Statement"). This commenter also argues that the Dividend Policy fosters rewards, *i.e.*, larger dividends paid to Stockholder Exchanges, thereby incenting the Board to approve inflated operating costs and larger budgets, which increases transaction costs. The Commission discusses this aspect of the comment regarding cost increases below in Section B(1)(ii).

<sup>61</sup> See, e.g., BATS Letter I and Letter II; BOX Letter I; MIAA Letter II; BATS, BOX, and MIAA Statement in Opposition to the Action Made by Delegated Authority (October 7, 2015) ("BATS Opposition Statement"); KCG Statement in Opposition to the Order (October 7, 2015) ("KCG Opposition Statement").

<sup>62</sup> *Id.*

<sup>63</sup> OCC Support Statement; OCC Letter II; OCC Stay Brief.

<sup>64</sup> OCC Letter I; OCC Support Statement.

<sup>65</sup> See OCC Support Statement.

<sup>66</sup> *Id.*

<sup>51</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>52</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>53</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>54</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>55</sup> 15 U.S.C. 78c(f).

<sup>56</sup> 15 U.S.C. 78q-1(b)(3)(F) and (I).

the commenters artificially inflate the so-called “subsidy” effect by making erroneous assumptions that any dividend received would be devoted exclusively to subsidizing a segment of the products listed by the Stockholder Exchanges (and offsetting the cost of those listings).<sup>67</sup> OCC also states that the commenters’ analysis does not appropriately address the other ways the Stockholder Exchanges and Non-Stockholder Exchanges compete.<sup>68</sup>

(ii) Commenters Argue That the Capital Plan Raises Transaction Costs and Imposes a Burden on Competition Not Necessary or Appropriate in Furtherance of the Act

Commenters also argue that the Capital Plan is inconsistent with Sections 17A(b)(3)(F) and 17A(b)(3)(I) of the Exchange Act<sup>69</sup>, because it raises transaction costs.<sup>70</sup> Commenters allege that the Dividend Policy creates incentives for OCC to increase its operating expenses, and in turn, charge higher clearing fees because higher clearing fees will lead to higher dividend payments.<sup>71</sup> Commenters state that these higher fees harm the Non-Stockholder Exchanges and are particularly detrimental to the public interest and investor protection because clearing members and customers collectively pay 95% of OCC operating expenses through clearing fees.<sup>72</sup> Commenters argue that the Refund Policy does not protect investors or promote the public interest, because it reduces the percentage of excess net income refunded to clearing members from 100% to 50%. Commenters state that this reduction in refunds will lead to increased transaction costs through wider quoted spreads.<sup>73</sup> Finally, commenters argue that the increased transaction costs impose a burden on competition not necessary or appropriate.

OCC refutes commenters’ assertion that the Dividend Policy creates incentives for OCC to increase its

operating expenses or its fees as a means to pay higher dividends to Stockholder Exchanges.<sup>74</sup> OCC explains that the operation of the Capital Plan, in its totality, places limits on these purported incentives. OCC notes that commenters ignore the fact that higher operating expenses lead to a higher Target Capital Requirement, which would require additional capital contributions to be withheld from funds that would otherwise be used to pay dividends and refunds and therefore, would have the effect of reducing the rate of return to the Stockholder Exchanges.<sup>75</sup> OCC further explains that the Capital Plan incorporates a lower Business Risk Buffer, *i.e.*, 25%, than the historical average buffer of 31%. Because this buffer is used to set the clearing fee schedules, it will provide members with a lower fee structure.<sup>76</sup> In addition, because the Capital Plan uses shareholders’ equity as capital to offset potential business, operational, and pension risks, OCC states that it would become less dependent on clearing fees to manage these risks.<sup>77</sup> OCC also states that commenters’ concerns regarding future fee increases are speculative.<sup>78</sup>

(iii) Commenters Argue That the Dividend Rate Under the Capital Plan is Excessive and Inconsistent With the Protection of Investors and the Public Interest and Imposes a Burden on Competition Not Necessary or Appropriate in Furtherance of the Act

Commenters assert that the rate of return the Stockholder Exchanges will receive for providing the Capital Contribution and committing to provide Replenishment Capital under the Dividend Policy is excessive, and is therefore inconsistent with Sections 17A(b)(3)(F) and 17A(b)(3)(I) of the Exchange Act.<sup>79</sup> Specifically, the commenters argue that OCC is a monopoly, and as such, its risk of capital impairment is low, such that the imputed rate of return to the Stockholder Exchanges is excessive.<sup>80</sup>

OCC responds that its status as the sole registered clearing agency in the options market does not mean that the Capital Contribution by the Stockholder Exchanges is a risk-free investment.<sup>81</sup> As noted above, the Capital Plan is designed to support OCC’s operations in the event of substantial losses from potential business, operational, and pension risks—these risks are not mitigated by OCC’s status as the sole clearing agency in the listed options space.<sup>82</sup> OCC also responds that the potential rate of return is not excessive and notes that the Capital Plan, including the Dividend Policy, was developed after an extensive and detailed deliberative process.<sup>83</sup> OCC adds that the Board relied on advice received from external advisers to help ascertain whether the potential rate of return to Stockholder Exchanges was reasonable in light of the nature of the capital commitments and the additional risks inherent in their contributions.<sup>84</sup> OCC further argues that the elements of the Capital Plan (the Fee Policy, Refund Policy, and Dividend Policy) are designed to provide appropriate limits on any dividend paid pursuant to the Dividend Policy.<sup>85</sup>

(iv) Commenters Argue That OCC Was Sufficiently Capitalized Without the Capital Plan

Commenters argue that the Capital Plan is inconsistent with 17A(b)(3)(I) of the Exchange Act<sup>86</sup> because OCC’s Target Capital Requirement is inflated, and as a result, the Capital Plan imposes an unnecessary and inappropriate burden on competition.<sup>87</sup> Commenters argue in the alternative that, even if the Target Capital Requirement is not inflated, there is no need for the Capital Plan<sup>88</sup> because OCC is sufficiently capitalized through the accumulation of fees since the publication of the Notice.<sup>89</sup> In the commenters’ view, the accumulation of retained earnings has placed OCC within reach of its proposed capital levels and may even leave OCC

<sup>67</sup> See *id.*

<sup>68</sup> *Id.* OCC notes that both Stockholder and Non-Stockholder Exchanges have pricing power from many sources, and all of these sources have more impact than the dividend on these exchanges’ ability to compete. See *id.* at 19–20 (arguing that pricing power derives from many factors, and stating that “the revenue per contract variation among exchanges and among products, which [commenters] themselves note, suggests that the Stockholder Exchanges are not competing on the basis of price alone”).

<sup>69</sup> 15 U.S.C. 78q–1(b)(3)(F) and (I).

<sup>70</sup> See MM Letter; KCG Petition; SIG Petition; SIG Opposition Statement.

<sup>71</sup> *Id.*

<sup>72</sup> See, e.g., KCG Opposition Statement; SIG Opposition Statement.

<sup>73</sup> See SIG Petition; SIG Opposition Statement.

<sup>74</sup> OCC Letter II; OCC Stay Brief.

<sup>75</sup> *Id.*

<sup>76</sup> OCC Support Statement.

<sup>77</sup> *Id.*

<sup>78</sup> *Id.*

<sup>79</sup> 15 U.S.C. 78q–1(b)(3)(F) and (I). Commenters separately describe the dividend rate as unconscionable, exorbitant, and above market rate. Commenters estimate that the dividend payments will result in a rate of return for the Stockholder Exchanges’ investment of additional capital of upwards of 20% to 30% but state that the true amount is not known to them. See BATS Letter I; BATS Letter II; MIAIX Letter I; KCG Opposition Statement; SIG Opposition Statement.

<sup>80</sup> See BATS Letter II; Peak6 Capital Management Statement in Opposition to the Order (October 7, 2015) (“Peak6 Opposition Statement”); SIG Opposition Statement.

<sup>81</sup> See OCC Support Statement.

<sup>82</sup> See Notice. See also OCC Support Statement.

<sup>83</sup> See OCC Support Statement.

<sup>84</sup> OCC engaged an outside consulting firm to develop capital needs and targets and a financial advisor to provide analysis on dividend returns. Outside counsel also provided advice on governance matters. See OCC Letter I; OCC Letter IV; OCC Support Statement.

<sup>85</sup> See OCC Letter I.

<sup>86</sup> 15 U.S.C. 78q–1(b)(3)(I).

<sup>87</sup> See SIG Opposition; Reinstitution Motion.

<sup>88</sup> See KCG Opposition Statement; PEAK6 Opposition Statement; SIG Opposition Statement.

<sup>89</sup> See KCG Opposition; SIG Opposition.

with a surplus, which renders the Capital Plan wholly unnecessary.<sup>90</sup>

OCC counters that the Target Capital Requirement is the product of extensive analysis and takes into account a broad set of factors to cover plausible loss scenarios from business, operational, and pension risks.<sup>91</sup> OCC notes that commenters, in deeming OCC adequately capitalized, do not provide a methodology for ascertaining a Target Capital Requirement, nor do they provide with sufficient granularity or specificity the risks that would be covered (and those that would be excluded) with their proposed lower Target Capital Requirement.<sup>92</sup> OCC notes its financial resources, such as margin and the clearing fund deposits, and not its capital, protect it against counterparty risk and on-balance sheet credit and market risk. In addition, OCC states that the commenters incorrectly included in their estimate of its current capital reserve capital refunds owed by OCC to clearing members and excess over expenses that would be subject to taxes if they were retained by OCC.<sup>93</sup>

OCC also disagrees that it has accumulated sufficient funds from clearing fees since the Capital Plan was proposed to render the Capital Plan unnecessary. OCC takes issue with commenters' calculations because, despite claiming the Capital Plan as being unnecessary, commenters included the contributions already made pursuant to the Plan in their calculations.<sup>94</sup> In absence of the Capital Plan, OCC notes that its capital resources would be less than \$150 million, which is less than both: (i) Half of the \$364 million in capital resources available to it under the Capital Plan; and (ii) the \$247 million Target Capital Requirement.<sup>95</sup>

#### (v) Commenters Argue That OCC Failed To Properly Consider Alternative Sources of Raising Capital

Finally, commenters argue that the Capital Plan is inconsistent with Section 17A(b)(3)(I) of the Exchange Act<sup>96</sup> because OCC's Board failed to consider alternative and less costly ways to raise capital, including having OCC raise capital by accumulating retained earnings through some combination of fees and reduced rebates,<sup>97</sup> raise capital

from existing Stockholder Exchanges at a lower rate of return,<sup>98</sup> raise capital from Non-Stockholder Exchanges, clearing members or third party investors at a lower rate of return,<sup>99</sup> and raise capital through other instruments, such as perpetual preferred stock.<sup>100</sup> Commenters suggested that the failure of the Board to pursue these alternative sources of capital renders the Capital Plan inconsistent with Section 17A(b)(3)(I) of the Exchange Act<sup>101</sup> because it imposes unnecessary and inappropriate burdens on competition.<sup>102</sup>

OCC counters that the Board evaluated all viable and potential alternatives.<sup>103</sup> Specifically, OCC notes that the Board considered potential alternatives and, after a thorough deliberation, voted in favor of the Capital Plan because it allowed OCC to increase its capital almost instantaneously (*i.e.*, the Capital Contribution was paid immediately) and provided the benefit of Replenishment Capital.<sup>104</sup> In addition to immediately

earnings, commenters proposed an alternative of an escrow, or Payer Asset Approach, where OCC could accumulate retained earnings and place them in escrow. *See* MM Letter; SIG Petition. These commenters argue that by placing the fee revenue (which would be retained earnings if held by OCC) in escrow to cover business, operational, and pension risks, those monies would not be considered an asset of the Stockholder Exchanges and subject to tax and OCC could return excess from the escrow to investors through refunds or lower fees.

<sup>98</sup> *See* MM Letter. Another commenter states that the Chicago Board Options Exchange offered to provide OCC with a capital infusion at a lower annual rate over a certain period of time that is more favorable than the Capital Plan, which contemplates paying the Stockholder Exchanges dividends in perpetuity. *See* SIG Opposition Statement.

<sup>99</sup> *See, e.g.*, BATS Letter I; BATS Letter II.

<sup>100</sup> *See* BOX Letter I.

<sup>101</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>102</sup> *See, e.g.*, SIG Petition; BATS Letter I.

<sup>103</sup> *See* OCC Letter II (noting that it was not clear how an escrow fund that is not an asset of OCC would satisfy the Commission's proposed rule requirement concerning liquid net assets funded by equity); OCC Support Statement (noting that accumulating fees would require "\$593 million in pre-tax clearing fees" from members). In addition, OCC states that its Board considered CBOE's proposal, but did not find it viable in meeting its capital needs because CBOE's proposed contribution would have been in the form of a loan, and thus would be debt, and was not fully developed. *See* October 15, 2015 Declaration of Craig S. Donohue ("Donohue Declaration"). OCC also states that it considered issuing capital stock to clearing members and Non-Stockholder Exchanges and issuing perpetual preferred shares to outside institutional investors. *See* OCC Letter I; OCC Letter II.

<sup>104</sup> *See* OCC Letter II (noting the importance of OCC's continuity and need for capital to withstand an event arising from business, operational and pension risks and the Board's concern with timeliness; based on these considerations, the Board considered alternate plans as taking too long to accumulate sufficient capital); *also see* OCC

increasing OCC's Capital, OCC's Board determined that the Capital Plan was superior to other alternatives when it took into account factors such as liquidity, the timeliness and certainty of obtaining capital, and applicable taxes.<sup>105</sup>

#### (vi) Commission Findings

##### a. Capital Plan Is Consistent With Exchange Act Section 17A(b)(3)(F)

The Commission has considered the comments described above and finds that the Capital Plan is consistent with Exchange Act Section 17A(b)(3)(F).

After reviewing the Dividend Policy in conjunction with the other elements of the Capital Plan, the Commission does not believe that the Dividend Policy, or the Capital Plan as a whole, changes OCC's essential role as a market utility. Instead, the Capital Plan is designed to enhance OCC's capitalization rather than to enable the Stockholder Exchanges to monetize OCC's clearing monopoly. This enhanced capitalization is designed to allow OCC to continue its essential role by raising sufficient capital to cover business, operational, and pension risks. The Board determined that the historical practice of solely using fees, with annual refunds, to cover operating expenses and manage risks did not allow OCC to reach adequate capitalization.<sup>106</sup> Under the Refund Policy, OCC will continue its practice of refunding a significant percentage of excess clearing fees to clearing members, thus preserving that aspect of OCC's industry "utility" function. And the components of the Capital Plan—the Fee Policy, Refund Policy, and Dividend Policy—are designed to set the dividends to be paid to the Stockholder Exchanges at a level that the Board, with the assistance of independent outside financial experts, has determined to be reasonable for the cost and risks associated with the Stockholder Exchanges' contributed and committed capital. As pointed out by OCC, the plan as a whole works to avoid unnecessarily and unreasonably high operating expenses, maintain the Target Capital

Support Statement (noting that raising capital through fee increases does not provide the immediate access to additional capital that the Replenishment Capital commitment provides under the Capital Plan).

<sup>105</sup> *Id.*

<sup>106</sup> Historically, the Stockholder Exchanges have contributed only minimal capital to OCC. The Board determined that to obtain substantial Capital Contributions and Replenishment Capital from the Stockholder Exchanges is the best alternative, which cannot be accomplished without modification of the past practice of not providing dividends to Stockholder Exchanges owners of OCC. *See* Notice at 5173–75.

<sup>90</sup> *See* SIG Letter III.

<sup>91</sup> *See* Notice; OCC Support Statement.

<sup>92</sup> *See* OCC Support Statement.

<sup>93</sup> *Id.*

<sup>94</sup> *See* OCC Support Statement.

<sup>95</sup> *See* OCC Support Statement.

<sup>96</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>97</sup> *See, e.g.*, MM Letter; SIFMA Letter; SIG Opposition Statement. In support of the alternative of raising capital through accumulative retained

Requirement at an appropriate level and set a reasonable dividend, each as determined by the Board. An increase in operating expenses would lead to an increase in the Target Capital Requirement, and therefore, could have the effect of reducing the rate of return in dividends.<sup>107</sup>

The Commission does not believe that the Capital Plan operates to increase fees, inflate operating expenses or drive up transaction costs in a manner inconsistent with the protection of investors or the public interest. The Commission notes that commenters' arguments ignore that the Capital Plan incorporates a lower Business Risk Buffer, which allows generally lower fees.<sup>108</sup> The Capital Plan provides OCC with sufficient shareholders' equity to substantially cover the potential costs related to OCC's business, operational, and pension risks, thus reducing the need for OCC's Board to budget for those risks when estimating the projected forward 12-month operating expenses (a key component of the formula for setting fees under the Fee Policy). Therefore, the Commission believes that clearing members and customers will benefit from the proposed Capital Plan because it will allow OCC to continue to provide clearing services at expected lower fees. In addition, there will be tax implications associated with retained earnings and dividend payments, which in turn affects refunds and the dividend rate under the Capital Plan. OCC therefore would be motivated to take applicable taxes into consideration in setting new fee schedules or declaring dividends or refunds. At the very least, the Commission does not believe that it is inevitable that the Capital Plan will lead to higher fees as the commenters assert.

<sup>107</sup> See OCC Letter II. The rate of return would be dependent on many factors, including clearing fees, which would be subject to the rule filing requirements of Section 19(b)(1) of the Exchange Act. The Commission also notes that OCC's status as the only registered clearing agency for listed options is not relevant in assessing the appropriate dividend rate under the Capital Plan, which is designed to address business, operational, and pension risks.

<sup>108</sup> In fact, OCC stated that it expected that the Capital Contributions from the Stockholder Exchanges will enable it to provide a significant refund of 2014 fees. OCC further expected that its current clearing fees will be reduced significantly based on the Business Risk Buffer of 25% beginning in 2015 with refunds restored, and that these lower fees will continue for the foreseeable future. See Notice at 5175. As described above, OCC declared a refund of 2014 fees and a 19% fee reduction. In addition, OCC also announced a special refund that represents the excess of 2015 pre-tax income over OCC's target revenue based on achievement of the 25% Business Risk Buffer. See OCC Press Release.

For the reasons provided above, the Commission does not believe that the potential dividend rate, the Dividend Policy, or the Capital Plan, is inconsistent with investor protection or the public interest. On the contrary, the Capital Plan will support the critical functions and continued operations of OCC, particularly during times when its capital position is impaired, and is, therefore, consistent with the protection of investors and the public interest under Exchange Act Section 17A(b)(3)(F).<sup>109</sup>

#### b. Capital Plan Is Consistent With Exchange Act Section 17A(b)(3)(I)

After considering the comments described above, the Commission finds that the Capital Plan does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act, and is therefore consistent with Exchange Act Section 17A(b)(3)(I).<sup>110</sup>

The Commission notes that Exchange Act Section 17A(b)(3)(I)<sup>111</sup> does not require the Commission to make a finding that OCC chose the option that imposes the least possible burden on competition. Rather, the Exchange Act requires that the Commission find that the Capital Plan does not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act, which involves balancing the competitive effects of the proposed rule change against all other relevant considerations under the Exchange Act.<sup>112</sup>

The Commission has considered all the comments, OCC's responses and alternate plans for raising capital described by commenters. As an initial matter, the Commission does not believe that the Dividend Policy, or the Capital Plan as a whole, creates a subsidy that unfairly advantages Stockholder Exchanges. The Commission notes that any potential dividends declared under the Dividend Policy are intended to be consideration for the Stockholder Exchanges' contribution or commitment to capital and compensation for their opportunity cost and risk of loss associated with such contribution and commitment.<sup>113</sup> Further, the

<sup>109</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>110</sup> *Id.*

<sup>111</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>112</sup> *Bradford Nat'l Clearing Corp. v. SEC*, 590 F.2d 1085, 1105 (D.C. Cir. 1978) (noting that to the extent that the legislative history provides any guidance to the Commission in taking competitive concerns into consideration in its deliberations on the national clearing system, it merely requires the SEC to "balance" those concerns against all others that are relevant under the statute).

<sup>113</sup> Each Stockholder Exchange has contributed \$30 million to OCC, which is capital that cannot be

Commission notes that the operation of the Capital Plan does not require dividends to be paid in any year, and under certain circumstances such as when Replenishment Capital is outstanding, OCC would not pay dividends. The Commission believes that various components of the Capital Plan operate to set reasonable dividends for the cost and risks associated with the Stockholder Exchanges' contributed and committed capital. Thus, the Commission does not believe that the Capital Plan imposes any costs that could be viewed as imposing a burden on competition not necessary or appropriate under the Exchange Act.

Similarly, the Commission does not believe that the Target Capital Requirement imposes a burden on competition not necessary or appropriate in furtherance of the purposes of the Exchange Act. The Commission notes that the Target Capital Requirement is designed to provide adequate capitalization, thereby substantially enhancing OCC's ability as a SIFMU to sustain non-default losses arising from business, operational, and pension risks. After reviewing the process used by OCC to establish the Target Capital Requirement, the Commission believes that the Target Capital Requirement is appropriately designed to capture identified and foreseeable business risks. OCC represents that it used various measures and took a methodical and reasoned approach to establish the Target Capital Requirement and the Commission does not believe that the Target Capital Requirement is or will be set at an unreasonable level.

Moreover, commenters have not explained how alternatives to the Dividend Policy or the Target Capital Requirement would be effective in promoting the significant interest under the Exchange Act in having a well-capitalized OCC to allow prompt clearance and settlement. A well-capitalized OCC provides support for

used for other purposes. Thus, each Stockholder Exchange has forgone the opportunity to deploy or invest that capital. Additionally, if OCC's capital were to fall below the "Hard Trigger," meaning that the initial Capital Contribution was lost, the Stockholder Exchanges would be required to provide Replenishment Capital, which, as discussed above, would likely be part of a recovery plan or otherwise in furtherance of winding down OCC's business. In such situations, the Stockholder Exchanges would be committing additional capital without any expectation that such capital will ever be repaid. See OCC Support Statement. Non-Stockholder Exchanges are in a different position than the Stockholder Exchanges in that they are not obligated to provide a Capital Contribution or commit to provide Replenishment Capital, and therefore do not bear the costs and risks of the financial obligations attendant with the Capital Contribution and Replenishment Capital.



the continued orderly operations of OCC and benefits clearing members, market participants and the options markets broadly. The Commission therefore finds that even if the dividends paid under the Dividend Policy or future costs incurred under the Target Capital Requirement or Capital Plan as a whole, as they are currently designed impose a burden on competition, that burden is necessary or appropriate in furtherance of the purposes of the Act.

The Commission further notes that whether OCC would accumulate sufficient capital to reach the Target Capital Requirement through the accrual of fees was unknown at the time OCC proposed the Capital Plan. OCC's Board considered this alternative and determined that accumulation of clearing fees would take several years to achieve the Target Capital Requirement.<sup>114</sup> The Capital Plan immediately addressed the risk of a significant event impairing OCC's capital, even though such an event has not in fact occurred.<sup>115</sup>

Finally, the existence of alternative ways for OCC to raise capital does not render the Capital Plan inconsistent with the Exchange Act. The Commission notes that the Board considered various alternative ways to raise capital and that the Board determined that the Capital Plan was in the best interests of OCC because it was designed to provide immediate access to capital through the Capital Contribution and was supported by the agreement to provide Replenishment Capital.<sup>116</sup> In addition, in evaluating the relative competitive effects of the Capital Plan and alternative sources of capital, the Commission reiterates that it does not

<sup>114</sup> See OCC Support Statement (noting that, under the current fee schedule, it would take until mid-2017 to organically accumulate \$364 million in capital. As a result, OCC concluded that organic accumulation of capital through fee increases was not a durable solution to its substantial capital needs).

<sup>115</sup> Petitioners' comments, when contending OCC was close to achieving its Target Capital Requirement of \$247 million, did not acknowledge or accept that the total resource requirement under the Capital Plan was \$364 million, including the Replenishment Capital commitment of \$117 million. See SIG Support Statement and KCG Support Statement. OCC also stated that, as of August 31, 2015, without the \$150 million Capital Contribution under the Capital Plan, OCC's adjusted shareholders' equity would be approximately \$149 million or less than half of the \$364 million in total capital resources available under the Capital Plan, and significantly less than the \$247 million Target Capital Requirement. See OCC Support Statement.

<sup>116</sup> The Commission also notes that the Board determined that the Capital Plan contains certain aspects and features that the alternatives would not be able to achieve (such as characterization of the net liquid assets raised by OCC as equity instead of debt).

believe that the Capital Plan will necessarily lead to increased fees or transaction costs. Accordingly, the Commission finds the burdens imposed by the Capital Plan, if any, are necessary or appropriate in furtherance of the purposes of the Exchange Act.

For reasons stated above, the Commission finds that the Capital Plan is consistent with Exchange Act Section 17A(b)(3)(I).<sup>117</sup>

## 2. Capital Plan Provides for an Equitable Allocation of Reasonable Dues, Fees, and Other Charges Among the Participants

Commenters assert that the Capital Plan is inconsistent with Exchange Act Section 17A(b)(3)(D)<sup>118</sup> because it would result in unreasonable fees and cause an inequitable allocation of future clearing fees.<sup>119</sup> Commenters argue that the Capital Plan does not provide for the equitable allocation of reasonable dues, fees, and other charges among its participants because the fees unfairly discriminate against Non-Stockholder Exchanges, are potentially excessive, or present conflicts.<sup>120</sup> Commenters argue that the Capital Plan unfairly discriminates against the Non-Stockholder Exchanges because whereas all exchanges contribute equally to fees, only the Stockholder Exchanges are eligible to receive dividend payments.<sup>121</sup>

Commenters question whether the Board can fairly guide OCC on budget efficiencies in setting the fees.<sup>122</sup> Commenters also argue that the rule filing process for fee changes, which requires submission to the Commission, public comment, and Commission review fails to adequately protect investors against dues, fees, or other charges that are not reasonable because, at the time of filing, there is no way to

<sup>117</sup> 15 U.S.C. 78q-1(b)(3)(I).

<sup>118</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>119</sup> See SIG Petition; MM Letter; KCG Opposition Statement; BATS Opposition Statement.

<sup>120</sup> See SIG Petition; MM Letter; BATS Petition; KCG Opposition Statement.

<sup>121</sup> See BATS Petition.

<sup>122</sup> See SIG Opposition Statement (questioning whether the Board would be able to ensure that budgets are not inflated and that no more revenues than needed are collected, because Stockholder Exchanges would be conflicted and would unduly influence Board votes to approve larger budgets that would enrich themselves via dividend payments). See also MM Letter at 13 (arguing "If the SEC allows the five owners to monetize OCC in this fashion, the conflicts of interest will diminish the prospect that OCC will perform efficiently to keep transaction fees low and operating expenses under control. . . . Given the potential of the dividend to increase with the size of OCC's budget, we are concerned where transaction fees may go in the future.")

calculate whether a fee change will later result in excess dividends.<sup>123</sup>

As more fully discussed above, OCC counters that there is no unfair discrimination or inequitable allocation of fees because the parties' obligations are different, as only the Stockholder Exchanges face substantial risk of loss from their capital contributions, and commit to Replenishment Capital.<sup>124</sup> OCC also argues that in addition to the fee change rule filing process, the Commission could summarily act to suspend any such fee if necessary or appropriate in furtherance of the purposes of the Exchange Act.<sup>125</sup>

The Commission finds that the Capital Plan is consistent with Exchange Act Section 17A(b)(3)(D).<sup>126</sup> Exchange Act Section 17A(b)(3)(D) provides that the rules of a clearing agency must provide for equitable allocation of fees among its participants and for reasonable fees and charges. With respect to equitable allocation, the Capital Plan as a whole, and the Fee Policy in particular, do not change the way that the fees are allocated among clearing members, and fees for similarly-situated market participants are equitable. While Stockholder Exchanges may receive dividends, nothing in the Exchange Act precludes OCC from paying dividends to the Stockholder Exchanges, who have made substantial contributions to improve OCC's capital base. Although end of year refunds to clearing members will be reduced by 50% to allocate money to pay for dividends, those dividends are compensation for the financial risks and obligations incurred by the Stockholder Exchanges under the Capital Plan and all clearing members share in refunds.

With respect to the reasonableness of fees, the Commission does not believe that the Capital Plan as a whole and the Fee Policy in particular, results in unreasonable dues, fees, and other charges. After setting its annual Target Capital Requirement, the Fee Policy requires OCC to set fees at levels to ensure that it can cover operational expenses, business and regulatory capital needs, and maintain shareholder equity. Reductions to, and the quarterly review of, the Business Risk Buffer will enable OCC to charge lower fees and make reductions as appropriate to manage revenue as close to its target as possible. These changes are designed to give market participants the benefit of lower upfront transaction costs,

<sup>123</sup> See BATS Petition; BATS Opposition Statement; KCG Opposition Statement.

<sup>124</sup> See OCC Support Statement.

<sup>125</sup> See OCC Stay Brief.

<sup>126</sup> 15 U.S.C. 78q-1(b)(3)(D).

especially those customer end users who do not receive passed through refunds from the clearing member.<sup>127</sup>

In addition, any future fee change or increase will be subject to the rule filing requirements under Section 19(b) of the Exchange Act and Rule 19b-4 thereunder. The Commission believes that these filing requirements provide appropriate protection against future fee increases despite commenters' assertions to the contrary. The Exchange Act rule filing requirements for fee changes provide an opportunity for public comment<sup>128</sup> and an opportunity for the Commission to review the change, summarily suspend it and institute proceedings to ultimately approve or disapprove the change,<sup>129</sup> as applicable, to ensure an SRO's rules meet regulatory requirements. The Commission believes that various components of the Capital Plan, including the Dividend Policy, Refund Policy and Fee Policy, operate to maintain fees and dividend payments, if any, at appropriate levels based on the Target Capital Requirement established for the year, Business Risk Buffer, and other considerations, such as applicable taxes and OCC's industry utility role to provide refunds. The Commission's review of any future filings by OCC on its new fee schedule will determine whether the future fee changes are consistent with the applicable Exchange Act requirements, taking into account all relevant facts in addition to the Fee Policy under the Capital Plan.

The Commission therefore, disagrees with commenters' assertions that the fee filings will not adequately protect investors against dues, fees, or other charges that are not reasonable.

For the reasons discussed above, the Commission finds that the Capital Plan is consistent with the Exchange Act Section 17A(b)(3)(D)<sup>130</sup> because it provides for the equitable allocation of reasonable dues, fees, and other charges among its participants.

### 3. Facilitating Prompt and Accurate Settlement and Safeguarding of Securities and Funds Under Exchange Act Section 17A(b)(3)(A)

Section 17A(b)(3)(A) of the Exchange Act<sup>131</sup> requires that a registered clearing agency be so organized and have the capacity to be able to facilitate the prompt and accurate settlement of securities transactions and to safeguard securities and funds in its custody or

control or for which it is responsible. Commenters<sup>132</sup> acknowledged OCC's fundamental need to raise additional capital to support OCC's operations.<sup>133</sup>

OCC asserts that the Capital Plan is structured to provide OCC with sufficient capital (at a lower fee structure for market participants) to fund unpredictable business, operational, and pension events that might impair capital.<sup>134</sup> OCC noted that in the absence of the Capital Plan, clearing members' funds would be put at risk should OCC be unable to withstand an adverse capital event.<sup>135</sup> Additionally, OCC asserts that the Capital Plan is structured to replenish capital during an adverse capital event, thereby ensuring OCC's business continuity.<sup>136</sup>

Taking these comments into account, the Commission finds that the Capital Plan is consistent with Exchange Act Section 17(A)(b)(3)(A). The Capital Plan supports OCC's business continuity (thereby facilitating the integrity of the clearing agency and its functions) by raising additional capital and obtaining a commitment from the Stockholder Exchanges to provide potential Replenishment Capital should it become necessary. In this manner, the Capital Plan ensures that OCC, especially during a significant event that impairs its capital, would have the capacity to facilitate and promote the prompt and accurate settlement of securities transactions and to safeguard securities and funds in its custody or control or for which it is responsible. Accordingly, the Commission finds that the Capital Plan is consistent with Exchange Act Section 17A(b)(3)(A).

### 4. Commission's Consideration of SRO Rules' Promotion of Efficiency, Competition and Capital Formation Under Exchange Act Section 3(f)

Section 3(f) of the Exchange Act<sup>137</sup> directs that the Commission, when it is reviewing a rule of a self-regulatory organization, must consider whether such rule promotes efficiency, competition, and capital formation. Commenters argue that the Commission should not approve the Capital Plan because the Capital Plan introduces inefficiencies through costs, including tax liabilities, and imposes burdens on

competition.<sup>138</sup> One commenter argues that the Capital Plan is inefficient from a tax perspective because the dividend payments to Stockholder Exchanges subject a significant portion of OCC's profits to taxes, which is an inefficient use of industry funds.<sup>139</sup> In response, OCC noted that the Board considered the alternative of raising capital through accumulating pre-tax clearing fee revenues to a certain amount in after-tax net equity, but concluded that the Capital Plan was superior because it would increase certainty of OCC's compliance with PFMI and Commission's proposed Rule 17Ad-22(e)(15) in a timely way.<sup>140</sup>

The Commission has considered whether the Capital Plan promotes efficiency, competition, and capital formation, and discusses efficiency and capital formation below. The Commission has discussed the impact of the Capital Plan on competition in Section III.B.1 above.

With respect to the promotion of efficiency, the Commission first notes that under the Capital Plan, OCC has both immediate and ongoing access to cash to meet its Target Capital Requirement. From a timing standpoint, the Capital Plan is more immediate and expedient than several of the alternatives, such as raising capital from Non-Stockholder Exchanges, clearing members or third-parties, each of which would have necessitated governance changes over a period of time. Similarly, raising capital through the accumulation of fees was forecasted by OCC to take several years and would be subject to clearing volume volatility risks.

Second, the Capital Plan efficiently allocates costs for operational risk management among market participants. Having the Stockholder Exchanges bear the business, operational, and pension risks up front by making Capital Contributions and committing to Replenishment Capital in exchange for future dividend payments incents them, as owners of OCC, to prudently manage and minimize these risks, to avoid the loss of their capital contributions.

Third, on an ongoing basis, OCC intends to use clearing fees to maintain the Target Capital Requirement. This aspect of the Capital Plan apportions the costs of the Capital Plan to the clearing firms in relation to their clearing activity. Thus, the Capital Plan seeks to align the costs and benefits to clearing firms in accordance with their level of clearing activity. The Commission has

<sup>127</sup> No commenters to the Notice raised specific concerns that the Capital Plan was inconsistent with Exchange Act Section 17A(b)(3)(A).

<sup>128</sup> See BATS Letter I at 2; BOX Letter I at 1; KCG Letter I at 2; SIG Letter I at 2.

<sup>129</sup> See OCC Letter I; OCC Stay Brief.

<sup>130</sup> See OCC Support Statement.

<sup>131</sup> See OCC Stay Brief; Notice at 5176.

<sup>132</sup> 15 U.S.C. 78q-1(b)(3)(f).

<sup>133</sup> BATS Opposition Statement; BOX Petition for Review; KCG Petition for Review.

<sup>134</sup> See SIG Opposition Statement.

<sup>135</sup> See OCC Support Statement.

<sup>127</sup> See Notice at 5175.

<sup>128</sup> 15 U.S.C. 78s(b)(1).

<sup>129</sup> 15 U.S.C. 78s(b)(3).

<sup>130</sup> 15 U.S.C. 78q-1(b)(3)(D).

<sup>131</sup> 15 U.S.C. 78q-1(b)(3)(A).

considered that, under the Capital Plan, OCC expects to continue to pay refunds to clearing members from a portion of OCC's net income. This feature would preserve some of the key attributes of OCC's business model as a market utility.

The Commission recognizes that, as commenters note, OCC will fund the cost of raising of capital by paying dividends, when eligible, to the Stockholder Exchanges. However, the Commission observes that other methods of raising capital similarly would incur costs to OCC and its participants. For example, raising capital through retained earnings involves costs related to applicable taxes as well as additional time to accumulate sufficient capital, during which time OCC will be exposed to business, operational and pension risks without sufficient capital to protect itself.<sup>141</sup> Similarly, raising capital through other instruments such as issuance of perpetual preferred shares or common stock to Non-Stockholder Exchanges, clearing members or third-party investors, involves costs related to the transaction itself (e.g. underwriting), dividend payments, and applicable taxes. And, unlike the Replenishment Capital provided under the Capital Plan, such instruments would not provide readily available capital during a critical event, wind-down or recovery period.

The Commission also has considered whether the Capital Plan promotes efficiency from the tax perspective. The Commission notes that similar tax consequences would exist if OCC had chosen to raise equity by issuing common stock or preferred stock to Non-Stockholder Exchanges, clearing members or third-party investors, because in each of these cases, OCC anticipates paying dividends to these parties in exchange for their investments, which will be subject to withholding tax prior to making dividend payments. Moreover, tax consequences are only one aspect of a consideration of efficiency in these circumstances.

The Commission also has considered whether the Capital Plan will promote capital formation. As discussed throughout this order, the Capital Plan is designed to enable OCC to withstand business, operational, and pension risks

<sup>141</sup> OCC represents that, in considering alternatives, OCC's Board determined that the Capital Plan was financially superior to accumulating capital through fees, which would have required nearly \$593 million in pre-tax clearing fees in order to grow \$364 million in after-tax net equity. In addition, OCC estimated at the time such amount would take until mid-2017 to achieve. See OCC Support Statement.

that may significantly affect OCC's ability to provide prompt clearance and settlement services. It also provides an incentive for OCC to prudently manage its risks by allocating these risks between Stockholder Exchanges and clearing participants. As OCC is the only clearing agency for listed standardized options in the U.S., it plays a crucial role in financial stability. A well-functioning equity options market provides an infrastructure necessary for trading both equity options and other equity investment products, which are used by companies and businesses to raise capital. The Commission believes that an adequately capitalized OCC should promote market confidence in OCC's ability to continuously serve the options market, which in turn facilitates prompt clearance and settlement of options transactions and promotes capital formation.

#### 5. Other Issues Raised by Commenters

Commenters also raise certain procedural concerns with respect to the Capital Plan. Specifically, commenters argue that the process OCC underwent to approve the Capital Plan failed to comply with its own rules.<sup>142</sup> Commenters also argue that the Capital Plan should not have been approved under delegated authority and the Delegated Order failed to fulfill the Commission's obligation to engage in "reasoned decision-making" under the Administrative Procedure Act ("APA").<sup>143</sup> The Commission considers and discusses each of these comments below.

##### (i) Compliance With Self-Regulatory Organization's Own Rules as Required Under Exchange Act Section 19(g)(1)

Section 19(g)(1) of the Exchange Act<sup>144</sup> requires, in part, that every self-regulatory organization shall comply with its own rules. Form 19b-4 requires each SRO to complete all actions required to be taken under its constitution, articles of incorporation, by-laws, rules or corresponding instruments prior to filing a proposed rule change. Several commenters argue that OCC failed to comply with its By-Laws and such failure might have adversely affected the quality of the

<sup>142</sup> See, e.g., BATS Letter II; MIAx Letter II; BOX Petition; BATS Petition; MIAx Petition.

<sup>143</sup> See e.g., SIG Opposition Statement (stating that the case *NetCoalition v. SEC*, 615 F.3d 525 (D.C. Cir. 2010) and the APA, 5 U.S.C. 551 *et seq.*, obligate the Commission to engage in "reasoned decision-making").

<sup>144</sup> 15 U.S.C. 78s(g)(1).

Board's deliberations and the validity of its ultimate approval of the Capital Plan.

Commenters argue that OCC failed to abide by Article XI of its By-Laws,<sup>145</sup> when it approved the Capital Plan with three instead of five public directors on the Board.<sup>146</sup> Commenters also assert that OCC violated its Code of Conduct (including its Conflict of Interest Policy).<sup>147</sup> Commenters argue that directors representing the Stockholder Exchanges should have been recused from the Board's vote and their failure to do so invalidates the vote and the Board's approval of the Capital Plan.<sup>148</sup> Commenters also argue that OCC violated its Interpretation and Policy .01 (to Article VIIB of its By-Laws), which requires OCC to notify Non-Stockholder Exchanges regarding matters of competitive significance as determined by the Executive Chairman to afford them an opportunity to make presentations to the Board, because OCC failed to notify Non-Stockholder Exchanges of the Capital Plan, which in commenters' view, carries significant competitive effect on Non-Stockholder Exchanges.<sup>149</sup>

OCC responds that the Board was not prevented from approving the Capital Plan because of Board vacancies.<sup>150</sup> OCC stated that the Capital Plan's approval was in accordance with its By-Laws. OCC further maintains that the Board's vote approving the Capital Plan was consistent with Delaware law and that neither its own By-Laws nor Delaware law requires a director to recuse himself or herself when directors on both sides of a question have

<sup>145</sup> Article XI, Section I of OCC's By-Laws provides that OCC's By-Laws may be amended at any time by the Board upon the affirmative vote of two-thirds of the directors then in office (but not less than a majority of the number of directors).

<sup>146</sup> See BATS Letter II; MIAx Letter II; BOX Petition; BATS Petition; MIAx Petition; see also SIG Opposition Statement (arguing that Stockholder Exchanges exercised control over the approval process and improperly exercised their veto power, or threatened to exercise their veto power, in a manner that prevented OCC from considering any plans that involved equity participation, even if such proposals may have been less costly).

<sup>147</sup> See BATS Petition; BOX Petition. See also OCC Code of Conduct for OCC Directors, which provides that a director shall disclose any actual, potential or apparent conflict of interest in a matter to be acted on by the Board to the Executive Chairman and OCC's General Counsel prior to the discussion or presentation of the matter, where possible in advance of the meeting, and shall be recused if requested by the Chair of the meeting.

<sup>148</sup> See BATS Letter II; MIAx Letter II; SIG Letter I; SIG Letter II; BATS Opposition Statement (stating that the five directors representing the Shareholder Exchanges did not recuse themselves despite their conflict of interest due to their financial motivations for approving the Capital Plan).

<sup>149</sup> BATS Opposition Statement; MIAx Petition; SIG Petition; BATS Letter III; BOX Letter II.

<sup>150</sup> OCC Motion to Lift Stay; OCC Support Statement.

potential conflicts but have fully disclosed those conflicts to the Board.<sup>151</sup> With respect to the comment of failure to notify Non-Stockholder Exchanges of the Capital Plan, OCC responds that it did not violate its own By-Laws because there were no material competitive consequences resulting from the Capital Plan that would have triggered prior notice to or an opportunity for the Non-Stockholder Exchanges to make presentations. In OCC's view, the Capital Plan does not alter the manner in which Non-Stockholder Exchanges receive clearing services.<sup>152</sup>

The Commission notes that the standard for approving a proposed rule change of a self-regulatory organization is that the proposed rule change is consistent with the requirements of the Exchange Act, and rules and regulations thereunder.<sup>153</sup> While the Commission will not approve a proposed rule change of a self-regulatory organization before the self-regulatory organization has completed all action required to be taken under its constitution, articles of incorporation, by-laws, rules or corresponding instruments,<sup>154</sup> OCC represented that it did so here, working through its internal governance process and obtaining its Board's approval of the Capital Plan in accordance with its By-Laws prior to filing the proposed rule change. OCC also represents that the Capital Plan received approval from twelve directors, thus satisfying the requirement of two-thirds approval by directors then in office in accordance with its By-Laws.<sup>155</sup> Nor do commenters challenge OCC's representations that it engaged in that process. Rather, they raise separate questions as to whether the Board nonetheless failed to comply with its responsibilities under relevant corporate governance principles. Such questions are not appropriately

addressed by the Commission in the context of reviewing this rule filing.

(ii) Delegated Authority and Commission's Reasoned Analysis

The Commission has delegated to the Director of the Division of Trading and Markets the authority to "publish notices of proposed rule changes filed by self-regulatory organizations and to approve such proposed rule changes."<sup>156</sup> Although commenters raise no legal authority to challenge the use of delegated authority, they state that the Capital Plan raises significant issues of policy that are more appropriate for Commission review.<sup>157</sup> Because the Commission is setting aside the Delegated Order, and issuing this Order, this issue is moot.

Commenters also argue that the Delegated Order failed to fulfill its obligation to engage in "reasoned decision-making," or failed to examine the relevant data and articulate a satisfactory explanation for its action, including a rational connection between the facts found and the choice made.<sup>158</sup> The Commission does not address these comments because it is itself engaging in a *de novo* review, which includes the appropriate inquiry and analysis as directed by the Exchange Act.

#### IV. Other Motions and Filings

As discussed above, shortly after the issuance of the Review Order and Stay Order, Petitioners filed the Reinstitution Motion on September 15, 2015, requesting that the Commission reinstate the automatic stay.<sup>159</sup> OCC filed the OCC Reinstitution Response on September 22, 2015 and commenters filed the Memo in Further Support on September 25, 2015.<sup>160</sup>

<sup>156</sup> See 17 CFR 200.30-3(a)(12).

<sup>157</sup> See BATS Letter II; BATS Petition; BOX Petition; KCG Letter I; KCG Petition; MIAx Petition; SIG Letter I; SIG Petition.

<sup>158</sup> See SIG Opposition Statement (citing *NetCoalition*, 615 F.3d 525 to argue that the process by which an administrative agency reaches a result must be logical and rational and the Court's task is to ensure that the agency has examined the relevant data and articulated a satisfactory explanation for its action including a "rational connection between the facts found and the choice made" when evaluating whether the agency action is arbitrary or capricious under Section 706(2)(A) of the APA, 5 U.S.C. 706(2)(A)).

<sup>159</sup> See Reinstitution Motion; see also Expedition Motion (arguing, *inter alia*, that the dividend payments, refund and fee reduction would be impracticable to claw back, such dividend payments and refund are likely imminent, and the Commission should expedite its ruling on the Reinstitution Motion).

<sup>160</sup> See OCC Reinstitution Response; Memo in Further Support of Reinstitution; see also SIG Letter III (arguing, *inter alia*, that OCC's December 2015 declaration of a refund and dividend further supports the argument that the Commission should reinstate the automatic stay).

On October 7, 2015, BATS, BOX, KCG, MIAx and SIG filed a motion ("Evidentiary Motion") pursuant to Rule 452 of the Rules of Practice.<sup>161</sup> Rule 452 provides that a motion for leave to adduce additional evidence must show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously. Rule 452<sup>162</sup> further states that if the Commission determines to accept additional evidence, it may, among other things, remand or refer the proceeding to a hearing officer for the taking of additional evidence as appropriate. The Evidentiary Motion requests that the Commission refer its review of the Capital Plan to a hearing officer to conduct an evidentiary hearing and to allow for discovery in advance of any such hearing.<sup>163</sup>

Additionally, one commenter filed a motion on October 7, 2015, requesting that the Commission order an oral argument pursuant to Rule 451<sup>164</sup> of the Rules of Practice.<sup>165</sup> The commenter argues that oral argument should be granted because such argument would significantly aid the Commission's decisional process in reviewing the Delegated Order given that the Capital Plan involves intense factual and legal disputes and the voluminous briefing and submissions this commenter and other petitioners have submitted to

<sup>161</sup> Motion for an Order Referring this Matter to a Hearing Officer and Directing Discovery in Advance of Hearing and Supporting Brief (October 7, 2015) ("Evidentiary Motion") (citing 17 CFR 201.452, which provides, *inter alia*, that the Commission may allow the submission of additional evidence and may remand or refer the proceeding to a hearing officer to take additional evidence as appropriate).

<sup>162</sup> 17 CFR 201.452.

<sup>163</sup> BATS, BOX, KCG, MIAx, and SIG filed this motion. See Evidentiary Motion. See also Memorandum in Support of Motion for an Order (1) Referring This Matter to a Hearing Officer for the Taking of Additional Evidence, and (2) Directing Discovery in Advance of the Hearing (October 7, 2015) ("Evidentiary Memo in Support"); SIG Letter III (arguing, *inter alia*, that OCC's December 2015 declaration of a refund and dividend further supports the argument that the Commission should grant the Evidentiary Motion).

<sup>164</sup> 17 CFR 201.451.

<sup>165</sup> See Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan (October 10, 2015) ("Oral Argument Motion") (citing 17 CFR 201.451, which provides, in part, that the Commission may order an oral argument if it determines that the presentation of facts and legal arguments in the briefs and record and the decisional process would be significantly aided by oral argument). See also Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan (October 10, 2015) ("Oral Argument Memo in Support").

<sup>151</sup> OCC Motion to Lift Stay; OCC Support Statement.

<sup>152</sup> OCC Motion to Lift Stay; OCC Stay Brief.

<sup>153</sup> See Exchange Act Section 19(b)(2)(C), 15 U.S.C. 78s(b)(2)(C).

<sup>154</sup> See General Instruction to Form 19b-4, Item E.

<sup>155</sup> According to OCC, eighteen directors were in office at the time the Capital Plan was approved by the Board and sixteen directors were present at the meeting when the vote approving the Capital Plan took place, which constituted a quorum. See OCC's By-Laws Article III, Section 13. Further, OCC's Code of Conduct does not on its face require interested Board members to recuse themselves, but rather to immediately bring to the attention of the Executive Chairman and the General Counsel any matters that may involve conflicts of interest or be reasonably perceived by others to raise questions about potential conflicts. See Code of Conduct for OCC Directors. The record further indicates that material facts regarding the directors' interests were disclosed and known to the Board prior to the vote on the Capital Plan. See OCC Support Statement.

address these complex factual and legal disputes.<sup>166</sup>

OCC filed a brief in opposition to the Evidentiary Motion on October 15, 2015, arguing that the commenters failed to demonstrate that the legal requirements for granting the motion are satisfied and prompt affirmation of the Capital Plan is necessary for OCC to be prudently capitalized at a level appropriate for a SIFMU.<sup>167</sup> OCC also filed a Brief in Opposition to Motion for Oral Argument on October 15, 2015, arguing the motion for an oral argument should be denied as it is unnecessary because all interested parties have had multiple opportunities to submit evidence and arguments to the Commission, and that oral argument would only serve to unduly delay resolution of the Commission's review of the Delegated Order.<sup>168</sup>

The Commission received a reply memorandum in further support of the commenter's motion for oral argument on October 20, 2015.<sup>169</sup> On the same day, commenters also filed a reply in further support of its Evidentiary Motion.<sup>170</sup>

The Commission has considered these motions, including OCC's oppositions and the movants' reply memoranda. For the reasons discussed below, these motions are denied.

#### A. Reinstitution Motion

Commenters filed the Reinstitution Motion, requesting that the Commission

<sup>166</sup> See Evidentiary Motion (also arguing that, if the evidentiary hearing takes place and discovery is conducted in advance of the hearing, oral argument addressing the discovery, evidence adduced at the evidentiary hearing, evidentiary findings and their significance would be invaluable to the Commission's review). See also Evidentiary Memo in Support.

<sup>167</sup> See OCC's Brief in Opposition to Motion for Referral to Hearing Officer and Discovery ("OCC Evidentiary Hearing Opposition"). Specifically, OCC argues that Petitioners failed to show, with particularity, that the additional evidence sought to introduce is material and that they had reasonable grounds for failure to adduce the evidence previously, and merely raised a number of so-called "open issues" and "unanswered questions" while they have had opportunities to develop the record in the prior proceeding. See OCC Evidentiary Hearing Opposition.

<sup>168</sup> OCC Brief in Opposition to Motion for Oral Argument (October 15, 2015) ("OCC Oral Argument Motion").

<sup>169</sup> SIG filed this motion. Reply Memorandum in Further Support of Motion for Oral Argument in Connection with the Commission Review of the Staff's Order Approving OCC's Capital Plan (October 20, 2015) ("Oral Argument Memo in Further Support").

<sup>170</sup> Reply Memorandum in Further Support of Petitioners' Motion for an Order (1) Referring this Matter to a Hearing Officer for the Taking of Additional Evidence, and (2) Directing Discovery in Advance of the Hearing (October 20, 2015) ("Evidentiary Memo in Further Support"); see also SIG Letter III.

restitute the automatic stay on the ground that there is no compelling reason to implement the Capital Plan because OCC's current capital level is approaching the Target Capital Requirement and will soon exceed that amount and it would be extremely impracticable to reverse the implementation of the Capital Plan if the Delegated Order were subsequently reversed.<sup>171</sup> These commenters reiterated their arguments following OCC's announcement of its declaration of refunds, dividends, and fee reduction pursuant to the Capital Plan and requested the Commission to expedite its ruling on the Reinstitution Motion.<sup>172</sup>

OCC responds that the Reinstitution Motion restated issues that had already been argued at length, considered and denied by the Commission and the Petitioners have not shown any manifest error, change in law or other recognized basis for the Commission to reconsider the Stay Order.<sup>173</sup> OCC further argues that the Petitioners failed to provide any other valid basis for the Commission to overturn the Stay Order, which was based on a finding that there is a compelling public interest in strengthening OCC's capitalization and for the stay to be lifted.<sup>174</sup>

Because the Commission by this Order is engaging in a substantive review and approving the Capital Plan directly, the Reinstitution Motion and Expedition Motion are hereby moot.

#### B. Evidentiary Motion

Rule 452 governs the allowance of the submission of additional evidence.<sup>175</sup> Specifically, Rule 452 of the Commission's Rules of Practice describes discretionary standards by which the Commission may allow additional evidence, noting that motions for allowing the submission of additional evidence must: (i) Show with particularity that the requested evidence is material, and (ii) that reasonable grounds existed for the failure to adduce this evidence previously.<sup>176</sup>

In the Evidentiary Motion, the commenters request that the Commission: (i) Refer this matter to a hearing officer, and (ii) direct discovery in advance of the hearing.<sup>177</sup> They argue

<sup>171</sup> See Reinstitution Motion.

<sup>172</sup> See Expedition Motion; see also SIG Letter III.

<sup>173</sup> See OCC Reinstitution Response.

<sup>174</sup> See *id.*

<sup>175</sup> See 17 CFR 201.451.

<sup>176</sup> 17 CFR 201.451. Commenters also cited the Commission's Rules of Practice, Rule 100(c) as authority for the Commission to authorize pre-hearing discovery. See 17 CFR 201.100(c).

<sup>177</sup> See Evidentiary Motion; see also Memorandum in Support and Evidentiary Memo in Further Support.

that the current record before the Commission is insufficient for the Commission to find that the Capital Plan is consistent with the requirements of the Exchange Act under Exchange Act Section 19(b)(2)(C)(i).<sup>178</sup>

Commenters rely on *NetCoalition v. SEC*<sup>179</sup> to suggest that the Commission needs to supplement the factual record.<sup>180</sup> Commenters also rely on *Chamber of Commerce of U.S. v. SEC*<sup>181</sup> and the case's emphasis on consideration of alternatives.<sup>182</sup> Specifically, commenters note that the Delegated Order fails to mention multiple alternative capital raising plans that commenters proposed, including the CBOE proposal.<sup>183</sup>

Additionally, commenters question whether OCC's Board approval process operated in a manner consistent with the public interest and seeks additional evidence about that approval process.<sup>184</sup>

Commenters also argue that OCC will effectively achieve its Target Capital Requirement within six months without implementing the Capital Plan.<sup>185</sup> Due to an alleged lack of data and supposed "opacity in the record concerning OCC's current and projected capital levels," commenters assert that discovery and an evidentiary hearing are necessary and that the replenishment capital calculation needs to be supported factually.<sup>186</sup>

OCC responds to these comments by noting that the commenters fail to meet

<sup>178</sup> See Evidentiary Memo in Support (citing 17 CFR 201.100(c) as providing that the Commission "may by order direct, in a particular proceeding, that an alternative procedure shall apply or that compliance with an otherwise applicable rule is necessary"); (noting that factual record is not developed adequately regarding: (i) Exchange Act Section 17A(b)(3)(D); (ii) Exchange Act Section 17A(b)(3)(F); and (iii) Exchange Act Section 17A(b)(3)(J)). See also 15 U.S.C. 78s(b)(2)(C)(i).

<sup>179</sup> *NetCoalition v. SEC*, 615 F.3d 525.

<sup>180</sup> See Evidentiary Memo in Support (arguing that the Commission should refer the Delegated Order to an administrative law judge so that the law judge can consider a fully developed record).

<sup>181</sup> 412 F.3d 133 (D.C. Cir. 2005).

<sup>182</sup> Evidentiary Memo in Support.

<sup>183</sup> See Evidentiary Memo in Support; Evidentiary Memo in Further Support (arguing that, under *Chamber of Commerce*, the Commission must explore alternatives; specifically, that the Commission must consider "facially reasonable alternatives" raised by a party, or provide reasons for not doing so).

<sup>184</sup> See Evidentiary Memo in Support (citing Exchange Act Release No. 50699 (November 18, 2004), 69 FR 71126, 71140 (December 8, 2004) ("The Commission believes that independent directors must be provided with the opportunity to discuss any important matters regarding the exchange or association in a frank and open manner, free from the presence of management. Therefore, the Commission proposed that the independent directors of the exchange's or association's board meet regularly in executive session").

<sup>185</sup> See Evidentiary Memo in Support.

<sup>186</sup> See Evidentiary Memo in Further Support.

the Rule 452 standards; specifically: (i) That the motion fails to identify any material evidence with particularity, and (ii) that the motion fails to provide a reasonable basis to explain the commenters' failure to obtain the requested information earlier.<sup>187</sup>

OCC states that, instead of identifying material evidence with particularity, commenters provided a sweeping list of discovery requests without an attempt to articulate why this information is material.<sup>188</sup> Specifically, OCC notes that the motion raises three types of inquiries, each of which fails to meet the Rule 452 materiality standard: (i) Inquiries into alternatives; (ii) inquiries into the Board's process for approval of the Capital Plan; and (iii) inquiries into OCC's Target Capital Requirements.<sup>189</sup> OCC further notes that Rule 452 requires a motion for leave to adduce additional evidence to "show with particularity that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence previously."<sup>190</sup>

The Commission has determined that the information the Evidentiary Motion seeks to discover is not material to its review of the Capital Plan for purposes of determining whether the Capital Plan is consistent with the Exchange Act. The Evidentiary Motion requests information regarding: (i) Whether OCC considered less expensive alternatives to the Capital Plan; (ii) whether OCC's Board approval process was designed to serve the Stockholder Exchanges rather than the public interest; and (iii) whether OCC will achieve its Target Capital Requirement within six months without the Capital Plan's implementation. As discussed above, the existence of alternatives to the Capital Plan does not render the Capital Plan inconsistent with the Exchange Act, and the record fully establishes that OCC considered other alternatives to the Capital Plan. Additionally, the record indicates that OCC engaged in the required process to approve the Capital Plan, and questions regarding whether that process complied with relevant corporate governance principles are not appropriately addressed by the Commission in the context of reviewing this rule filing. Finally, the Commission notes that whether OCC would accumulate sufficient capital to reach the Target Capital Requirement was unknown at the time OCC proposed the

Capital Plan and commenters' after-the-fact assertions about OCC capital levels include capital contributions made pursuant to the Capital Plan. The record also shows that the Capital Plan provides for the immediate infusion of capital and a commitment to provide Replenishment Capital, which OCC states could not be achieved in the same manner by other means.<sup>191</sup>

The Commission has evaluated the record and, for reasons discussed above, finds that the Capital Plan is consistent with the Exchange Act requirements, and rules and regulations thereunder, applicable to OCC, and the Commission finds that the introduction of additional information is not necessary. Consequently, under Rule 452, the Commission denies the Evidentiary Motion.

### C. Oral Argument Motion

Rule 451<sup>192</sup> of the Commission's Rules of Practice provides that the Commission may order oral argument if the Commission determines that the presentation of the facts and the legal arguments in the briefs and record and decisional process would be significantly aided by oral argument.

A commenter states that an oral argument is proper under Rule 451.<sup>193</sup> Specifically, the commenter contends that an oral argument would allow the Commission to resolve the factual disputes regarding: (i) OCC's proposed capital target assumptions; (ii) OCC's actual financial condition; (iii) OCC's Board approval process; and (iv) the availability of alternative plans.<sup>194</sup> The commenter argues that, even if the Commission denies the other discovery motion,<sup>195</sup> an oral argument would still

allow the Commission to address multiple factual issues that remain in dispute in the current record.<sup>196</sup>

The commenter further argues that OCC has failed to show the negative impact of an oral argument.<sup>197</sup> Specifically, the commenter states that OCC does not identify any harm that could result from any delay associated with the scheduling of an oral argument.<sup>198</sup> The commenter also notes that oral argument would allow the Commission to satisfy concerns under the APA.<sup>199</sup> Finally, the commenter states that OCC's recent submissions reflect the need to supplement an evolving record.<sup>200</sup>

OCC responds that the commenter's motion does not satisfy the requirements of Rule 451, stating that the Commission has routinely denied oral argument when the issues raised can be determined by the record and papers filed by the parties.<sup>201</sup> OCC also notes that the motion does not demonstrate any facts or legal standards that the Commission cannot consider adequately on the written submissions.<sup>202</sup> Further, OCC argues that the Commission should deny the motion for oral argument because: (i) Commenters already had multiple opportunities to submit arguments and information; and (ii) oral argument would unduly delay resolution of the Commission's review.<sup>203</sup>

Pursuant to the Rules of Practice, the Commission considers matters properly before it on the basis of the papers filed by the parties without oral argument unless it determines that the presentation of facts and legal arguments in the briefs and record and

Additional Evidence, and (2) Directing Discovery in Advance of the Hearing (October 7, 2015); see also Memorandum in Support of Motion for an Order (1) Referring This Matter to a Hearing Officer for the Taking of Additional Evidence, and (2) Directing Discovery in Advance of the Hearing (October 7, 2015).

<sup>196</sup> See Oral Argument Memo in Support.

<sup>197</sup> See Oral Argument Memo in Further Support.

<sup>198</sup> See Oral Argument Memo in Further Support.

<sup>199</sup> See Oral Argument Reply Memo (noting that oral argument would allow a fuller explanation of the Capital Plan's issues necessary to satisfy the APA's requirement for "reasoned decision-making").

<sup>200</sup> See Oral Argument Reply Memo (suggesting that OCC's recent submission of an affidavit by its Executive Chairman reflects information that was not previously discussed, and therefore, unaddressed by commenters).

<sup>201</sup> See OCC Oral Argument Opposition Brief (October 15, 2015) ("OCC Oral Argument Opposition") (citing *In the Matter of D.E. Wine Inv., Inc., et al.*, File No. 3-8535, Exchange Act Release No. 43929 (Feb. 6, 2001); and *In the Matter of the Application of Cleantech Innovations, Inc.*, File No. 3-14640, Exchange Act Release No. 69968, at 17 n.67 (July 11, 2013)).

<sup>202</sup> See OCC Oral Argument Opposition.

<sup>203</sup> See OCC Oral Argument Opposition.

<sup>191</sup> See OCC Letter II and OCC Support Statement.

<sup>192</sup> 17 CFR 201.451 (stating that the Commission "on its own motion or the motion of a party or any other aggrieved person entitled to Commission review, may order oral argument with respect to any matter . . . [t]he Commission will consider appeals, motions and other matters properly before it on the basis of the papers filed by the parties without oral arguments unless the Commission determines that the presentation of the facts and the legal arguments in the briefs and record and decisional process would be significantly aided by oral argument").

<sup>193</sup> See Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan (October 7, 2015) ("Oral Argument Motion"); Memorandum in Support of Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan (October 7, 2015) ("Oral Argument Memo in Support"); see also Reply Memorandum in Further Support of Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan (October 21, 2015) ("Oral Argument Reply Memo").

<sup>194</sup> See Oral Argument Memo in Support.

<sup>195</sup> See Motion for an Order (1) Referring This Matter to a Hearing Officer for the Taking of

<sup>187</sup> See OCC's Brief in Opposition to Motion for Referral to Hearing Officer and Discovery (October 15, 2015) ("OCC Evidentiary Hearing Opposition").

<sup>188</sup> See *id.*

<sup>189</sup> See *id.*

<sup>190</sup> See *id.* (citing 17 CFR 201.452).

the decisional process would be significantly aided by oral argument.<sup>204</sup> The Commission notes the record is extensive, and contains significant amounts of data and information related to the Capital Plan. As a result, the Commission does not believe that either the presentation of facts and legal arguments in the briefs and record or the decisional process would be significantly aided by oral argument. Accordingly, the Commission denies the Oral Argument Motion.

## V. Conclusion

It is therefore ordered that the earlier action taken by delegated authority, Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) is set aside and pursuant to section 19(b)(2) of the Exchange Act SR-OCC-2015-02 is approved. All pending motions in this matter are hereby denied.

For the reasons stated above, it is hereby:

*Ordered* that the earlier action taken by delegated authority, Securities Exchange Act Release No. 74452 (March 6, 2015), 80 FR 13058 (March 12, 2015) is hereby set aside; and

*It is further ordered* that SR-OCC-2015-02 is hereby approved pursuant to section 19(b)(2) of the Exchange Act; and

*It is further ordered* that the Motion to Reinstitute Automatic Stay is *denied as moot*; and

*It is further ordered* that the Motion to Expedite the Commission's Ruling on the Pending Motion to Reinstitute the Automatic Stay is *denied as moot*; and

*It is further ordered* that the Motion for an Order (1) Referring this Matter to a Hearing Officer for the Taking of Additional Evidence, And (2) Directing Discovery in Advance of the Hearing is *denied*; and

*It is further ordered* that the Motion for Oral Argument in Connection with the Commission's Review of the Staff's Order Approving OCC's Capital Plan and Supporting Brief is *denied*.

By the Commission.

**Brent J. Fields,**  
Secretary.

[FR Doc. 2016-03265 Filed 2-17-16; 8:45 am]

**BILLING CODE 8011-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-77121; File No. SR-Phlx-2016-22]

### Self-Regulatory Organizations; NASDAQ PHLX LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Regarding Rule 505 and Rule 506

February 11, 2016.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on February 5, 2016, NASDAQ PHLX LLC ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of the Substance of the Proposed Rule Change

The Exchange is filing with the Commission a proposal to delete Rule 505 (Allocation, Reallocation and Transfer of Issues) and update Rule 506 (Allocation Application).<sup>3</sup>

The text of the proposed rule change is available on the Exchange's Web site at <http://nasdaqomxphlx.cchwallstreet.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange 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. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

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

<sup>3</sup> References to rules are to Phlx rules unless otherwise noted.

#### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

The Exchange proposes to update its rules to delete Rule 505 (Allocation, Reallocation and Transfer of Issues) and update Rule 506 (Allocation Application).

Rules 505 and 506 were approved more than three decades ago,<sup>4</sup> at which time Exchange options trading was strictly on-floor open outcry through specialists. Exchange options trading developed into a robust hybrid system that is currently largely electronic and off-floor<sup>5</sup> but continues to have on-floor specialists<sup>6</sup> and open outcry trading. The Exchange is now consolidating its Rules 505 and 506.<sup>7</sup> Having found that some of the concepts in Rule 505 are obsolete and that others belong in Rule 506, the Exchange is deleting Rule 505. Simultaneously, the Exchange is updating Rule 506 to make it more easily readable and to transfer certain concepts from Rule 505 to Rule 506. These changes are described below.

##### Deletion of Rule 505

The Exchange has concluded that with the placement of certain concepts from Rule 505 into Rule 506, Rule 505 is no longer needed. The Exchange believes that it is desirable to discuss the process of allocation or reallocation application, allocation, reallocation, and transfer in one rule, namely Rule 506. Moreover, "leasing" is not practiced on the Exchange and obsolete language in Rule 505 in respect of leasing is no longer needed.<sup>8</sup> The Exchange proposes to therefore delete Rule 505, and to update and clarify Rule 506 to be more descriptive and to add several concepts from deleted Rule 505.

##### Updating of Rule 506

First, Rule 506 is updated to make it clear to the reader that the rule applies to the process of allocation application

<sup>4</sup> See, e.g., Securities Exchange Act Release No. 37019 (August 17, 1982), 47 FR 37019 (August 24, 1982) (SR-Phlx-81-1) (approval order).

<sup>5</sup> Electronic traders include market makers that are streaming quote traders ("SQTs"), remote streaming quote traders ("RSQTs"), and off-floor specialists ("Remote Specialists"). See Rules 1014(b)(ii)(A), 1014(b)(ii)(B), and 1020.

<sup>6</sup> Remote Specialists do not have a physical presence on the floor of the Exchange. Rule 1020.

<sup>7</sup> While the vast majority of options rules are found in Rule 1000 and higher of the Exchange's rule book, some older options-related rules, such as Rules 505 and 506, are in the Exchange's rule book below Rule 1000.

<sup>8</sup> "Leasing" is the now-obsolete practice or one specialist leasing, or renting, an allocated issue to another specialist.

<sup>204</sup> See 17 CFR 201.451.