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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-74202; File No. SR-OCC-2014-813]

February 4, 2015.

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of an Advance Notice, as Modified by Amendment No. 1, Concerning a Proposed Capital Plan for Raising Additional Capital That Would Support The Options Clearing Corporation's Function as a Systemically Important Financial Market Utility

Pursuant to Section 806(e)(1) of Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act entitled the Payment, Clearing, and Settlement Supervision Act of 2010 ("Payment, Clearing and Settlement Supervision Act" or "Clearing Supervision Act")[1] and Rule 19b-4(n)(1)(i)[2] under the Securities Exchange Act of 1934 ("Act") notice is hereby given that on December 29, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the advance notice as described in Items I and II below, which Items have been prepared by OCC.[3] On January 14, 2015, OCC filed Amendment No. 1 to the advance notice.[4] The Commission is publishing this notice to solicit comments on the advance notice from interested persons.

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1 12 U.S.C. 5465(e)(1).

2 17 CFR 240.19b-4(n)(1)(i).

3 In Items I and II below, OCC states that the purpose of this proposal is in part to facilitate compliance with the SEC Proposed Rules (as defined below) and address Principle 15 of the Principles for Financial Market Infrastructures ("PMFIs"). The Commission notes that the SEC Proposed Rules are pending. The Commission will evaluate the advance notice under the Clearing Supervision Act and the rules currently in force thereunder.

4 According to OCC, Amendment No. 1 to the SR-OCC-2014-813 ("Filing"): (i) updates OCC's plan for raising additional capital ("Capital Plan") in connection with negotiations between OCC and the options exchanges that own equity in OCC ("Stockholder Exchanges" or "stockholders") and that would

I. Clearing Agency's Statement of the Terms of Substance of the Advance Notice

This advance notice is filed by OCC in order to set forth a proposed Capital Plan for raising additional capital that would support OCC's function as a systemically important financial market utility and facilitate OCC's compliance with new regulatory requirements applicable to systemically important financial market utilities that have been proposed by the Commission but have not yet been adopted.

II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Advance Notice

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

(A) Clearing Agency's Statement on Comments on the Advance Notice Received from Members, Participants or Others

Written comments on the advance notice were not and are not intended to be solicited with respect to the advance notice and none have been received.

(B) Advance Notices Filed Pursuant to Section 806(e) of the Payment, Clearing and Settlement Supervision Act

The proposed change sets forth the Capital Plan under which the Stockholder Exchanges would make an additional capital contribution and commit to replenishment capital ("Replenishment Capital") in circumstances discussed below, and would receive, among other things, the right to receive dividends from OCC. In addition to the

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contribute additional capital under the Capital Plan, (ii) corrects typographical errors in the Filing, and (iii) updates the Term Sheet included as an exhibit to the Filing, which summarizes material features of the Capital Plan.

additional capital contribution and Replenishment Capital, the main features of the Capital Plan are: (i) a policy establishing OCC's fees at a level that would be sufficient to cover OCC's estimated operating expenses plus a "Business Risk Buffer" as described below ("Fee Policy"), (ii) the Refund Policy [sic], and (iii) a policy for calculating the amount of dividends to be paid to the options exchanges owning equity in OCC ("Dividend Policy"). The Capital Plan is proposed to be implemented on or about February 27, 2015, subject to all necessary regulatory approvals.[5]

PURPOSE OF THE PROPOSED CHANGE

The purpose of this proposed change is to implement the Capital Plan, which would significantly increase OCC's capital in connection with its increased responsibilities as a systemically important financial market utility, and which OCC believes would facilitate OCC's compliance with new regulatory requirements applicable to such systemically important financial market utilities that have been proposed by the Commission but have not yet been adopted.[6] For purposes of this filing, OCC has used the working assumption that the new requirements contained in the Commission's proposed amendments to Rule 17Ad-22 of the SEC Proposed Rules will be adopted substantially as proposed. The proposed change is intended to ensure OCC's ability to comply with Rule 17Ad-22, specifically paragraph (e)(15) thereof, when the SEC

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[5] The material features of the Capital Plan are summarized in the Term Sheet that is included as Exhibit 3. Certain details of the Term Sheet may change as a result of further negotiations or changes in financial figures, but OCC does not anticipate any material changes to the Capital Plan. OCC intends to separately file a proposed rule change seeking approval of changes to its By-Laws, Certificate of Incorporation and relevant agreements, including its Stockholders Agreement, necessary to implement the Capital Plan.

[6] *See* Securities Exchange Act Release No. 71699 (March 12, 2014), 79 FR 29507 (May 22, 2014) ("SEC Proposed Rules").

Proposed Rules become effective. In addition, it is intended to address Principle 15 of the Principles for Financial Market Infrastructures published by the Bank for International Settlements and the International Organization of Securities Commissions, which provides, among other things, that a financial market utility should identify, monitor and manage its general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that it can continue to operate as a going concern. The proposal includes an infusion of substantial additional equity capital by the Stockholder Exchanges to be made prior to February 27, 2015, subject to regulatory approval, that when added to retained earnings accumulated by OCC in 2014 will significantly increase OCC's capital levels as compared to historical levels. Additionally, the proposed change includes the Replenishment Capital commitment, which would provide OCC access to additional equity contributed by the Stockholder Exchanges should OCC's equity fall close to or below the amount that OCC determines to be appropriate to support its business and manage business risk in compliance with Rule 17Ad-22, as discussed more fully below.

Background

OCC is a clearing agency registered with the Commission and is also a derivatives clearing organization ("DCO") regulated in its capacity as such by the Commodity Futures Trading Commission ("CFTC"). OCC is a Delaware business corporation and is owned equally by the Stockholder Exchanges, five national securities exchanges for which OCC provides clearing services.[7] In addition, OCC provides

[7] The Stockholder Exchanges are: Chicago Board Options Exchange, Incorporated; International Securities Exchange, LLC; NASDAQ OMX PHLX LLC; NYSE MKT LLC; and NYSE Arca, Inc.

clearing services for seven other national securities exchanges that trade options ("Non-Stockholder Exchanges"). In its capacity as a DCO, OCC also provides clearing services to four futures exchanges.

OCC has been designated systemically important by the Financial Stability Oversight Council pursuant to the Payment, Clearing and Settlement Supervision Act, and the Commission is OCC's "Supervisory Agency" under Section 803(8) of the Payment, Clearing and Settlement Supervision Act. OCC is therefore a "covered clearing agency" ("CCA") as defined in proposed amendments to the Commission's Rule 17Ad-22(a)(7) and would be required to comply with the provisions of proposed Rule 17Ad-22 applicable to CCA's, including paragraph (e)(15) thereof.[8]

Proposed Rule 17Ad-22(e)(15) provides:

> Each covered clearing agency shall establish, implement, maintain and enforce written policies and procedures reasonably designed to, as applicable: . . . Identify, monitor, and manage the covered clearing agency's general business risk and hold sufficient liquid net assets funded by equity to cover potential general business losses so that the covered clearing agency can continue operations and services as a going concern if those losses materialize, including by:
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> (i) Determining the amount of liquid net assets funded by equity based upon its general business risk profile and the length of time required to achieve recovery or orderly wind-down, as appropriate, of its critical operations and services if such action is taken;
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> (ii) Holding liquid net assets funded by equity equal to the greater of either (x) six months of the covered clearing agency's current operating expenses, or (y) the amount determined by the board of directors to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing

[8] *SEC Proposed Rules* at 32-33, FR 29507, 29515 (May 22, 2014).

> agency, as contemplated by the plans established under paragraph (e)(3)(ii) of this section, and which:
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> (A) shall be in addition to resources held to cover participant defaults or other risks covered under the credit risk standard in paragraph (b)(3) or paragraph (e)(4)(i)-(iii) of this section, as applicable, and the liquidity risk standard in paragraph (e)(7)(i) and (ii) of this section; and
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> (B) Shall be of high quality and sufficiently liquid to allow the covered clearing agency to meet its current and projected operating expenses under a range of scenarios, including adverse market conditions; and
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> (iii) Maintaining a viable plan, approved by the board of directors and updated at least annually, for raising additional equity should its equity fall close to or below the amount required under paragraph (e)(15)(ii) of this section.[9]

Over the last nine months, OCC has devoted substantial efforts to: 1) develop a 5-year forward looking model of expenses; 2) quantify maximum recovery and wind-down costs under OCC's Recovery and Wind-Down Plan; 3) assess and quantify OCC's operational and business risks; 4) model projected capital accumulation taking into account varying assumptions concerning business conditions, fee levels, buffer margin levels and refunds; and 5) develop an effective mechanism that provides OCC access to replenishment capital in the event of losses that could cause OCC to be non-compliant with the SEC Proposed Rules. Incorporating the results of those efforts, the proposed change is intended to provide OCC with the means to increase its stockholder equity and, in particular, to obtain timely compliance with Rule 17Ad-22(e)(15)[10] as proposed by the

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[9] *SEC Proposed Rules* at 417-418, FR 29507, 29616 (May 22, 2014).

[10] *SEC Proposed Rules* at 222-223, FR 29507, 29547-29548 (May 22, 2014).

Commission. A more detailed discussion of the manner in which the proposed change would allow OCC to comply with Rule 17Ad-22(e)(15) appears below.

OCC's Projected Capital Requirement

Using the methods described in detail below, OCC will annually determine a "Target Capital Requirement" consisting of (i) a "Baseline Capital Requirement" equal to the greatest of (x) six months operating expenses for the following year, (y) the maximum cost of the recovery scenario from OCC's Recovery and Wind-Down Plan, and (z) the cost to OCC of winding down operations as set forth in the Recovery and Wind-Down Plan, plus (ii) a "Target Capital Buffer" linked to plausible loss scenarios from operational risk, business risk and pension risk. OCC has determined that its currently appropriate "Target Capital Requirement" is $247 million, reflecting a Baseline Capital Requirement of $117 million, which is equal to six months of projected operating expenses, plus a Target Capital Buffer of $130 million. This Target Capital Buffer would provide a significant capital cushion to offset potential business losses.

As of December 31, 2013, OCC had total shareholders' equity of approximately $25 million,[11] meaning that OCC proposes to add additional capital of $222 million to meet its 2015 Target Capital Requirement. In addition, OCC would be obligated under paragraph (e)(15)(iii)[12] of proposed Rule 17Ad-22 to maintain "a viable plan" for raising additional equity should its equity fall close to or below the amount required under

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[11] *See* OCC 2013 Annual Report, Financial Statements, Statements of Financial Condition, available on OCC's website, http://optionsclearing.com/components/docs/about/annual-reports/occ_2013_annual_report.pdf.

[12] *SEC Proposed Rules* at 418, FR 29507, 29616 (May 22, 2014).

paragraph (e)(15)(ii) of the Rule[13]; i.e., the Baseline Capital Requirement. OCC has determined that its viable plan for Replenishment Capital should provide for a "Replenishment Capital Amount" which would give OCC access to additional capital as needed up to a maximum of the Baseline Capital Requirement, which is currently $117 million.[14] Therefore, OCC's proposed Capital Plan would provide OCC in 2015 with ready access to approximately $364 million in equity capital as follows:

Baseline Capital Requirement	$117,000,000
Target Capital Buffer	$130,000,000
Target Capital Requirement	$247,000,000
Replenishment Capital Amount	$117,000,000
Total OCC Capital Resources	$364,000,000

Procedures Followed in Order to Determine Capital Requirement

Various measures were used in determining the appropriate level of capital necessary to comply with the SEC Proposed Rules. An outside consultant conducted a "bottom-up" analysis of OCC's risks and quantified the appropriate amount of capital to be held against each risk. The analysis was comprehensive across risk types, including credit, market pension, operation, and business risk. Based on internal operational risk scenarios and loss modeling at or above the 99% confidence level, OCC's operational risk was quantified at $226 million and pension risk at $21 million, resulting in the total Target Capital Requirement of $247 million. Business risk was addressed by taking into consideration that OCC has the ability to fully offset potential revenue volatility and

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13 *SEC Proposed Rules* at 417, FR 29507, 29616 (May 22, 2014).

14 The obligation to provide Replenishment Capital will be capped at $200 million, which OCC projects will sufficiently account for increases in its capital requirements for the foreseeable future.

manage business risk to zero by adjusting the levels at which fees and refunds are set and by adopting a "Business Risk Buffer" of 25% when setting fees. Other risks, such as counterparty risk and on-balance sheet credit and market risk, were considered to be immaterial for purposes of requiring additional capital based on means available to OCC to address those risks that did not require use of OCC's capital. As discussed in more detail below in the context of OCC's Fee Policy, the Business Risk Buffer of 25% is achieved by setting OCC's fees at a level intended to achieve target annual revenue that will result in a 25% buffer for the year after paying all operating expenses.

An analysis was also performed to identify OCC's risk in terms of the regulatory requirements set forth in proposed Rule 17Ad-22(e)(15)(ii). This analysis estimated that, currently, OCC's maximum recovery costs would be $100 million and projected wind-down costs would be $73 million. OCC's projected expenses for 2015 are $234 million, so that six months projected expenses are $234 million/2 = $117 million. The greater of recovery or wind-down costs and six months of operating expenses is therefore $117 million, and OCC's Baseline Capital Requirement (minimum regulatory requirement) is therefore $117 million. OCC then computed the appropriate amount of a Target Capital Buffer from operational risk, business risk, and pension risk. This resulted in a determination that the current Target Capital Buffer should be $130 million. Thus, the Target Capital Requirement is $117 million + $130 million = $247 million.

Overview of, and Basis for, OCC's Proposal to Acquire Additional Equity Capital

In order to meet its Target Capital Requirement, and after consideration of available alternatives, OCC's Board approved a proposal from OCC's Stockholder

Exchanges under which OCC would meet its Target Capital Requirement of $247 million in early 2015 as follows:

Shareholders' Equity as of 1/1/2014	$ 25,000,000
Shareholders Equity Accumulated Through Retained Earnings[15]	$ 72,000,000
Additional Contribution from Stockholder Exchanges	$150,000,000
Target Capital Requirement	$247,000,000
Replenishment Capital Amount	$117,000,000
Total OCC Capital Resources	$364,000,000

The additional contribution of the Stockholder Exchanges would be made in respect of their Class B Common Stock on a *pro rata* basis. The Stockholder Exchanges will also commit to provide additional equity capital up to the Replenishment Capital Amount, which is currently $117 million, in the event Replenishment Capital is needed. While the Replenishment Capital Amount will increase as the Baseline Capital Requirement increases, it would be capped at a total of $200 million that could be outstanding at any point in time. OCC has estimated that the Baseline Capital Requirement would not exceed this amount before 2022. When the limit is being approached, OCC would revise the Capital Plan as needed to address future needs. In consideration for their capital contributions and replenishment commitments, the Stockholder Exchanges will receive dividends as described in the Dividend Policy discussed below for so long as they remain stockholders and maintain their contributed

[15] *See* Proposed Rule Change by The Options Clearing Corporation to Reflect the Elimination of a Discount to the Clearing Fee Schedule, Securities Exchange Act Release No. 71769 (March 21, 2014), 79 FR 17214 (March 27, 2014) (SR-OCC-2014-05) (Filing for immediate effectiveness of a proposed rule change with the Commission to reinstate OCC's permanent clearing fee schedule for securities options and securities futures that became effective May 1, 2007 ("Permanent Schedule Reinstatement Filing")). The $72 million is after giving effect to the approximately $40 million refund referred to below.

capital and commitment to replenish capital up to the Replenishment Capital Amount, subject to the $200 million cap.

Fee, Refund, and Dividend Policies

Upon reaching the Target Capital Requirement, the Capital Plan requires OCC to set its fees at a level that utilizes a Business Risk Buffer of 25%. The purpose of this Business Risk Buffer is to ensure that OCC accumulates sufficient capital to cover unexpected fluctuations in operating expenses, business capital needs, and regulatory capital requirements. Furthermore, the Capital Plan requires OCC to maintain Fee, Refund, and Dividend Policies, described in more detail below, which are designed to ensure that OCC's shareholders' equity remains well above the Baseline Capital Requirement. The required Business Risk Buffer of 25% is below OCC's 10-year historical pre-refund average buffer of 31%. The target will remain 25% so long as OCC's shareholders' equity remains above the Target Capital Requirement amount. The reduction in buffer margin from OCC's 10-year average of 31% to 25% reflects OCC's commitment to operating as an industry utility and ensuring that market participants benefit as much as possible from OCC's operational efficiencies in the future. This reduction will permit OCC to charge lower fees to market participants rather than maximizing refunds to clearing members and dividend distributions to Stockholder Exchanges. OCC will review its fee schedule on a quarterly basis to manage revenue as closely to this target as possible.[16] For example, if the Business Risk Buffer is materially above 25% after the first quarter of a particular year, OCC may decrease fees for the

[16] If OCC's fee schedule needs to be changed in order to achieve the 25% Business Risk Buffer, OCC would file a proposed rule change seeking approval of the revised fee schedule.

remainder of the year, and conversely if the Business Risk Buffer is materially below 25% at this time, OCC may increase fees for the remainder of the year.

The Capital Plan would allow OCC to refund approximately $40 million from 2014 fees to clearing members in 2015 and to reduce fees in an amount to be determined by the Board, effective in the second quarter 2015. OCC will announce new fee levels early in 2015 and will make them effective following notification to clearing members and any necessary approval by the Commission. OCC will endeavor to provide clearing members with no less than 60-day advance notice of the effectiveness of changes to fee levels, particularly those that result in increases to fee levels. No dividends will be declared until December 2015 and no dividends will be paid until 2016.

Changes to the Fee, Refund or Dividend Policies will require the affirmative vote of two-thirds of the directors then in office and approval of the holders of all of OCC's outstanding Class B Common Stock. The formulas for determining the amount of refunds and dividends under the Refund and Dividend Policies, respectively, which are described in more detail below, are based on, among other things, the current tax treatment of refunds as a deductible expense. The Refund and Dividend Policies would each provide that in the event that refunds payable under the Refund Policy are not tax deductible, the policies would be amended to restore the relative economic benefits between the recipients of the refunds and the Stockholder Exchanges.[17]

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[17] This sentence and the previous sentence relate to a provision added to the Refund and Dividend Policies and designed to preserve the original business understanding between OCC and the Stockholder Exchanges even if refunds are no longer deductible.

Fee Policy

Under the Fee Policy, in setting fees each year, OCC would 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 .75. Establishing a Business Risk Buffer at 25% would allow OCC to manage the risk that fees would generate less revenue than expected due to lower-than-expected trading volume or other factors, or that expenses would be higher than projected. The Fee Policy also will include provisions from existing Article IX, Section 9 of the By-Laws to the effect that the fee schedule may also include additional amounts necessary to (i) maintain such reserves as are deemed reasonably necessary by the Board to provide facilities for the conduct of OCC's business and to conduct development and capital planning activities in connection with OCC's services to the options exchanges, Clearing Members and the general public, and (ii) accumulate such additional surplus as the Board may deem advisable to permit OCC to meet its obligations to Clearing Members and the general public; however, these provisions will be used only in extraordinary circumstances and to the extent that the Board has determined that the required amount of such additional reserves or additional surplus will exceed the full amount that will be accumulated through the Business Risk Buffer (prior to payment of refunds or dividends) so OCC's fees will ordinarily be based on its projected operating expenses and the Business Risk Buffer of 25%.

Under the proposed change, OCC would calculate its annual revenue target as follows:

Annual Revenue Target = Forward 12 Months Expense Forecast/(1-.25).

Because OCC's clearing fee schedules typically reflect different rates for different categories of transactions, fee projections would include projections as to relative volume in each such category. The clearing fee schedule would therefore be set to achieve a blended or average rate per contract sufficient, when multiplied by total projected contract volume, to achieve the Annual Revenue Target. Under extraordinary circumstances, OCC would then add any amount determined to be necessary for additional reserves or surplus and divide the resulting number by the projected contract volume to determine the applicable average fee per cleared contract needed to achieve the additional amounts required. Consistent with past practice, OCC would notify its clearing members of the fees it determines it would apply for any particular period by describing the change in an information memorandum distributed to all clearing members. Consistent with past practice, OCC would also notify regulators of the fees it determines it would apply for any particular period by filing an amendment to its Schedule of Fees as a proposed rule change for immediate effectiveness under Section 19(b)(3)(A) of the Act and Rule 19b-4(f)(2) thereunder.[18]

Refund Policy

Under the Refund Policy, except at a time when Replenishment Capital is outstanding as described below, OCC would declare a refund to Clearing Members in December of each year, beginning in 2015, in an amount equal to 50% of the excess, if any, of (i) pre-tax income for the year prior to the refund over (ii) the sum of (x) the

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[18] *See, e.g.*, the Permanent Schedule Reinstatement Filing, *supra* n. 14 [sic]; Proposed Rule Change by The Options Clearing Corporation to Reduce the Per Contract Clearing Fee for Routing Trades Executed in Accordance with the Options Order Protection and Locked/Crossed Market Plan to $.01 per Contract, Securities Exchange Act Release No. 68025 (October 12, 2012), 77 FR 63398 (October 16, 2012) (SR-OCC-2012-18).

amount of pre-tax income after the refund necessary to produce after-tax income sufficient to maintain shareholders' equity at the Target Capital Requirement for the following year plus (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. Such refund will be paid in the year following the declaration after the issuance of OCC's audited financial statements, provided that (i) the payment does not result in total shareholders' equity falling below the Target Capital Requirement, and (ii) such payment is otherwise permitted by applicable Delaware law and applicable federal laws and regulations. OCC would not be able to pay a refund on a particular date unless dividends were paid on the same date. If Replenishment Capital has been contributed and remains outstanding, OCC would not pay refunds until such time as the Target Capital Requirement is restored through the accumulation of retained earnings. Refunds in accordance with the Refund Policy would resume once the Target Capital Requirement is restored and all Replenishment Capital is repaid in full, provided that the restoration of the Target Capital Requirement and the repayment of Replenishment Capital occurred within 24 months of the issuance date of the Replenishment Capital. If, within 24 months of the issuance date of any Replenishment Capital, such Replenishment Capital has not been repaid in full or shareholders' equity has not been restored to the Target Capital Requirement, OCC would no longer pay refunds to clearing members, even if the Target Capital Requirement is restored and all Replenishment Capital is repaid at a later date.

Dividend Policy

The Dividend Policy would provide that, except at a time when Replenishment Capital is outstanding as described below, OCC would declare a dividend on its Class B

Common Stock in December of each year in an aggregate amount equal to the excess, if any, of (i) after-tax income for the year, after application of the Refund Policy (unless the Refund Policy has been eliminated, in which case the refunds shall be deemed to be $0) 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. Such dividend will be paid in the year following the declaration after the issuance of OCC's audited financial statements, provided that (i) the payment does not result in total shareholders' equity falling below the Target Capital Requirement, and (ii) such payment is otherwise permitted by applicable Delaware law and applicable federal laws and regulations. If Replenishment Capital has been contributed and remains outstanding, OCC would not pay dividends until such time as the Target Capital Requirement is restored.

OCC's Status as an Industry Utility

OCC has always been operated on an "industry utility" model. The Stockholder Exchanges have heretofore contributed only minimal capital to OCC.[19] OCC's By-Laws currently require that OCC set its clearing fees at a level that is designed to cover operating expenses and to maintain such reserves and accumulate such additional capital as are deemed reasonably necessary for OCC to meet its obligations to its clearing members and the public. Clearing fees that are collected in excess of these amounts are

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[19] OCC's common stock and paid in capital total $2,659,999. See OCC 2013 Annual Report, Financial Statements, Statements of Financial Condition, available on OCC's website, http://optionsclearing.com/components/docs/about/annual-reports/occ_2013_annual_report.pdf.

refunded annually on a *pro rata* basis to the clearing members who paid them. Under this model, OCC has never paid dividends to the Stockholder Exchanges. However, OCC has paid significant refunds to clearing members each year. OCC is aware that a portion -- possibly a significant portion -- of those refunds are not passed through by the clearing members to their end user customers. Accordingly, by adopting an approach that includes paying dividends to the Stockholder Exchanges that have invested a significant amount of additional capital ($150 million) but that also reduces the historical pre-refund average buffer of 31% by adopting a Business Risk Buffer of 25%, OCC believes that the proposed approach maintains, and perhaps better aligns with, an industry utility model.

Given the very large increase in capital that OCC has determined to be appropriate in order to assure compliance with regulatory requirements and meet the increased responsibilities imposed upon it as a systemically important financial market utility, OCC has determined that the best alternative available to it is to obtain a substantial further capital contribution from the Stockholder Exchanges. This cannot be accomplished without modification of the past practice of not providing dividends to stockholders. Accordingly, it would be necessary for OCC to establish the new Fee Policy, Refund Policy, and Dividend Policy. Because of the Business Risk Buffer being set at 25%, the combination of the Fee, Refund and Dividend Policies will effectively cap the dividends to be paid to the Stockholder Exchanges at a level that the Board (with the advice of outside financial experts) has determined results in a reasonable rate of return on contributed capital, particularly in comparison to the implied cost of capital to the clearing members and their customers of instead pursuing an approach which required the

accumulation of retained earnings through higher fees and no refunds for several years. OCC will continue to refund a significant percentage of excess clearing fees to clearing members, thereby benefiting both clearing members and their customers. The Capital Plan therefore effectively preserves OCC's industry utility model of providing its services in an efficient manner, but enhances the benefits to the end user customers by charging lower initial fees as a result of the decrease in the buffer margin from OCC's 10-year average of 31% to 25%.

Clearing members and customers will benefit from the proposed Capital Plan because it will allow OCC to continue to provide clearing services at low cost. As noted, OCC expects that this capital infusion from stockholders will enable OCC to provide a significant refund of 2014 fees. OCC further expects 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.

Stockholder Exchanges will benefit from the dividend return they receive and, perhaps more importantly, they will be assured that OCC will be in a position to provide clearing services for their markets on an on-going basis within the same basic structure that has served these markets well since their inception and without the need to radically change the structure to address potential demands of outside equity investors. Non-Stockholder Exchanges will also benefit by continuing to receive OCC's clearing services for their products on the same basis as they presently do.[20]

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[20] Non-Stockholder Exchanges contribute capital by purchasing a promissory note in the principal amount of $1,000,000. *See* Section 2 of Article VIIB of OCC's By-Laws. The required Capital Contribution of Non-Stockholder exchanges will not change under the Capital Plan.

OCC also believes that the Capital Plan will better align the interests of Stockholder Exchanges and clearing members with respect to expenses, since changes to the level of operating expenses directly affect the Target Capital Requirement. In sum, OCC believes that the present proposal represents a fair and reasonable balancing of the interests of the Stockholder Exchanges, the other exchanges for which OCC provides clearing services, clearing members, customers, and the general public while providing an immediate infusion of capital and a structure within which OCC can meet its obligations to the public as a systemically important financial market utility, as well as the requirements under the SEC Proposed Rules.

Replenishment Capital Plan

OCC proposes to put in place a Replenishment Capital Plan whereby OCC's Stockholder Exchanges are obligated to provide on a *pro rata* basis a committed amount of Replenishment Capital should OCC's total shareholders' equity fall below the hard trigger (as defined below). The aggregate committed amount for all five Stockholder Exchanges in the form of Replenishment Capital that could be outstanding at any time would be capped at the excess of (i) the lesser of (A) the Baseline Capital Requirement, which is currently $117 million, at the time of the relevant funding or (B) $200 million, over (ii) amounts of outstanding Replenishment Capital ("Cap"). The $200 million figure in the Cap formula takes into account projected growth in the Baseline Capital Requirement for the foreseeable future. The commitment to provide Replenishment Capital would not be limited by time, but only by the Cap. Replenishment Capital could be called in whole or in part after the occurrence of a "hard trigger" event described below, subject to the Cap. If the Baseline Capital Requirement approaches or exceeds

$200 million, the Board can consider, as part of its annual review of the Replenishment Capital Plan that is required by the SEC Proposed Rules, alternative arrangements to obtain replenishment capital in excess of the $200 million committed under the Replenishment Capital Plan. In addition, the Refund Policy and the Dividend Policy will provide that, in the absence of obtaining any such alternative arrangements, the amount of the difference will be subtracted from amounts that would otherwise be available for the payment of refunds and dividends.

Replenishment Capital contributed to OCC under the Replenishment Capital Plan would take the form of a new class of common stock ("Class C Common Stock") of OCC to be issued to the Stockholder Exchanges solely in exchange for Replenishment Capital contributions.

The Replenishment Capital Plan would be part of OCC's overall Capital Plan. In implementing the Replenishment Capital Plan, OCC's management would monitor OCC's levels of shareholders' equity to identify certain triggers, or reduced capital levels, that might require action. OCC has identified two key triggers – a soft trigger and a hard trigger – and proposes that OCC take certain steps upon the occurrence of either as described in more detail below.

The "soft trigger" for re-evaluating OCC's capital would occur if OCC's shareholders' equity falls below the sum of (i) the Baseline Capital Requirement and (ii) 75% of the Target Capital Buffer. The soft trigger would be a warning sign that OCC's capital had fallen to a level that required attention and responsive action to prevent it from falling to unacceptable levels. Upon a breach of the soft trigger, OCC's senior management and the Board would review alternatives to increasing capital, and take

appropriate action as necessary, including increasing fees or decreasing expenses, to restore shareholders' equity to the Target Capital Requirement.

The "hard trigger" for making a mandatory Replenishment Capital call would occur if shareholders' equity falls below 125% of the Baseline Capital Requirement ("Hard Trigger Threshold"). The hard trigger would be a sign that corrective action more significant and with a more immediate impact than increasing fees or decreasing expenses should be taken to increase OCC's capital, either as part of a recovery plan or a wind-down plan for OCC's business. OCC's shareholders' equity would have to fall more than $100,000,000 below the fully funded capital amount described above in order for the Hard Trigger Threshold to be breached. As a result, OCC views the breach of the Hard Trigger Threshold as unlikely and occurring only as a result of a significant, unexpected event. Upon a breach of the Hard Trigger Threshold, the Board would have to determine whether to attempt a recovery, a wind-down of OCC's operations or a sale or similar transaction, subject in each case to any necessary stockholder consent.[21] If the Board decides to wind-down OCC's operations, OCC would access the Replenishment Capital in an amount sufficient to fund the wind-down, as such amount would be determined by the Board, and subject to the Cap described above. If the Board decides to attempt a recovery of OCC's capital and business, OCC would access the Replenishment Capital in an amount sufficient to return shareholders' equity to an amount equal to $20 million above the Hard Trigger Threshold, subject to the Cap described above.

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[21] The requirement for stockholder consent would arise under OCC's Restated Certificate of Incorporation, which would provide that any decision to attempt a recovery would require separate approval by the stockholders, while a decision to wind-down would require separate approval by the stockholders.

While Replenishment Capital is outstanding, no refunds or dividends would be paid and, if any Replenishment Capital remains outstanding for more than 24 months or the Target Capital Requirement is not restored during that period, changes would be made to how OCC calculates refunds and dividends, as described in more detail above under Refund Policy and Dividend Policy. In addition, while Replenishment Capital is outstanding, OCC would first utilize the entire amount of Available Funds to repurchase, on a *pro rata* basis from each Stockholder, to the extent permitted by applicable Delaware and federal law and regulations, outstanding shares of Class C Common Stock as soon as practicable after completion of the financial statements following the end of each calendar quarter at a price equal to the original amount paid for such shares, plus an additional "gross up" amount to compensate the holders of the Class C Common Stock for taxes on dividend income (if any) that they may have to recognize as a result of such repurchase.[22] For this purpose, "Available Funds" would equal, as of the end of any calendar quarter, the excess, if any, of (x) shareholders' equity over (y) the Minimum Replenishment Level. The "Minimum Replenishment Level" would mean $20 million above the Hard Trigger Threshold, so that OCC's shareholders' equity would remain at or above the Minimum Replenishment Level after giving effect to the repurchase.

Compliance with Rule 17Ad-22(e)(15)

The capital base described above will permit OCC to hold at all times cash and other assets of high quality and sufficiently liquid to allow OCC to meet its current and projected operating expenses under a range of scenarios, including adverse market

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[22] Based on current federal rates, if the full amount of the payment is classified as a dividend and the recipient is entitled to a dividends received deduction, this gross up is estimated to be approximately 12% of the payment.

conditions. In compliance with proposed Rule 17Ad-22(e)(15),[23] OCC proposes at all times to hold liquid net assets funded by equity sufficient to cover potential general business losses so that OCC can continue operations and services as a going concern if those losses materialize, which assets will always be greater than either (x) six months of the covered clearing agency's current operating expenses, or (y) the amount determined by the Board to be sufficient to ensure a recovery or orderly wind-down of critical operations and services of the covered clearing agency, as contemplated by the plans established under paragraph (e)(3)(ii)[24] of the proposed Rule. These assets will be held in addition to resources held to cover participant defaults or other risks covered under the credit risk standard in paragraph (b)(3) or paragraph (e)(4)(i)-(iii)[25] of proposed Rule 17Ad-22, as applicable, and the liquidity risk standard in paragraph (e)(7)(i) and (ii)[26] of that proposed rule.

OCC believes that the Replenishment Capital Plan described above together with OCC's ability to set fees and retain earnings as described above will assure OCC's ability to remain at all times in compliance with the requirements of proposed Rule 17Ad-22(e)(15),[27] including providing the basis for maintaining a viable capital plan for replenishment capital in compliance with subparagraph (e)(15)(iii)[28] of the rule.

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[23] *SEC Proposed Rules* at 417, FR 29507, 29616 (May 22, 2014).

[24] *SEC Proposed Rules* at 408, FR 29507, 29613 (May 22, 2014).

[25] *SEC Proposed Rules* at 408-409, FR 29507, 29614 (May 22, 2014).

[26] *SEC Proposed Rules* at 412-413, FR 29507, 29615 (May 22, 2014).

[27] *SEC Proposed Rules* at 417-418, FR 29507, 29616 (May 22, 2014).

[28] *SEC Proposed Rules* at 418, FR 29507, 29616 (May 22, 2014).

STATUTORY BASIS FOR THE ADVANCE NOTICE

OCC believes that the proposed change is consistent with Section 805(b) of the Clearing Supervision Act[29] because the proposed change will reduce systemic risk.[30] OCC believes that implementation of the Capital Plan will provide OCC with an immediate injection of capital and future committed capital to help ensure that it can continue to provide its clearing services if it suffers business losses as a result of a decline in revenues or otherwise. OCC believes that the proposed change, as described above, is necessary for it to meet the capital requirements under the proposed amendments[31] to Rule 17Ad-22. For these same reasons, the proposed change will reduce systemic risk because it will promote confidence that OCC will be able continue operating even if it suffers business losses.

ANTICIPATED EFFECT ON AND MANAGEMENT OF RISK

OCC believes that the proposed change will reduce OCC's overall level of risk because it will help ensure that OCC will be able to continue to provide its clearing services even if it suffers significant business losses. As described above, the proposed change includes a significant infusion of permanent capital. In addition, each feature of the Capital Plan would help ensure that OCC's capital is sufficient on an ongoing basis to allow it to withstand business losses, whether resulting from a decline in revenue or otherwise. The Fee Policy would provide for the Business Risk Buffer, which is designed to ensure that fees will be sufficient to cover projected operating expenses. The

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[29] 12 U.S.C. 5464(b).

[30] 12 U.S.C. 5464(b)(3).

[31] *See generally* Securities Exchange Act Release No. 71699 (March 12, 2014), 79 FR 29507 (May 22, 2014).

Refund Policy and Dividend Policy both would allow for refunds of fees or payment of dividends, respectively, only to the extent that they would allow OCC to maintain shareholders' equity at the Target Capital Requirement. They would also prohibit refunds and dividends when Class C Common Stock is outstanding under the Replenishment Capital Plan and OCC was in the process of rebuilding its capital base. In addition, the Replenishment Capital Plan would establish a mandatory mechanism for the contribution of additional capital by OCC's stockholder exchanges in the event capital fell below desired levels. Together these features of the Capital Plan help ensure that OCC maintains levels of capital sufficient to allow it to absorb substantial business losses and meet its increased responsibilities imposed upon it as a systemically important financial market utility, which in turn helps reduce OCC's overall level of risk.

III. Date of Effectiveness of the Advance Notice and Timing for Commission Action

The designated clearing agency may implement this change if it has not received an objection to the proposed change within 60 days of the later of (i) the date that the Commission receives the notice of proposed change, or (ii) the date the Commission receives any further information it requests for consideration of the notice. The designated clearing agency shall not implement this change if the Commission has an objection.

The Commission may, during the 60-day review period, extend the review period for an additional 60 days for proposed changes that raise novel or complex issues, subject to the Commission providing the designated clearing agency with prompt written notice of the extension. The designated clearing agency may implement a change in less than 60 days from the date of receipt of the notice of proposed change by the Commission, or the

date the Commission receives any further information it requested, if the Commission notifies the designated clearing agency in writing that it does not object to the proposed change and authorizes the designated clearing agency to implement the change on an earlier date, subject to any conditions imposed by the Commission.

The designated clearing agency shall post notice on its website of proposed changes that are implemented.

The proposal shall not take effect until all regulatory actions required with respect to the proposal are completed.[32]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (http://www.sec.gov/rules/sro.shtml); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-OCC-2014-813 on the subject line.

Paper Comments:

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

All submissions should refer to File Number SR-OCC-2014-813. This file number should be included on the subject line if e-mail is used. To help the Commission process

[32] *See* note 5, *supra*.

and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (http://www.sec.gov/rules/sro.shtml). Copies of the submission, all subsequent amendments, all written statements with respect to the advance notice that are filed with the Commission, and all written communications relating to the advance notice between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website http://www.optionsclearing.com/about/publications/bylaws.jsp. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2014-813 and should be submitted on or before [INSERT DATE 15 DAYS FROM PUBLICATION IN THE FEDERAL REGISTER].

By the Commission.

Brent J. Fields,
Secretary.

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