

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-72550; File No. SR-OCC-2014-802)

July 7, 2014

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of No Objection to Advance Notice Filing Concerning the Consolidation of the Governance Committee and Nominating Committee into a Single Committee, Changes to the Nominating Process for Directors, and Increasing the Number of Public Directors on The Options Clearing Corporation's Board of Directors

On May 8, 2014, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") advance notice SR-OCC-2014-802 ("Advance Notice") pursuant to Section 806(e)(1) of the Payment, Clearing, and Settlement Supervision Act of 2010 ("Clearing Supervision Act" or "Title VIII")¹ and Rule 19b-4(n)(1)(i) under the Securities Exchange Act of 1934 ("Exchange Act").² The Advance Notice was published for comment in the Federal Register on June 3, 2014.³ The Commission did not receive any comments on the Advance Notice publication. This publication serves as a notice of no objection to the Advance Notice.

I. Description of the Advance Notice

OCC is proposing to: (i) amend its By-Laws and Governance Committee Charter to combine the current Nominating Committee ("NC") and Governance Committee

¹ 12 U.S.C. 5465(e)(1).

² 17 CFR 240.19b-4(n)(1)(i). OCC is a designated financial market utility and is required to file advance notices with the Commission. See 12 U.S.C. 5465(e). OCC also filed the proposal contained in the Advance Notice as a proposed rule change under Section 19(b)(1) of the Exchange Act and Rule 19b-4 thereunder. See SR-OCC-2014-09. The Commission published notice of the proposed rule change in the Federal Register on May 30, 2014 and did not receive any comments on the proposal. See Exchange Act Release No. 34-72242 (May 23, 2014), 79 FR 31166 (May 30, 2014) (SR-OCC-2014-09).

³ Release No. 34-72268 (May 28, 2014), 79 FR 31998 (June 3, 2014) (SR-OCC-2014-802) ("Notice").

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

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

Certain provisions of Article III of OCC's By-Laws govern the role the NC plays in nominating persons as Member Directors⁵ on OCC's Board as well as the composition

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

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

and structure of the NC itself. The NC is required to endeavor to achieve balanced representation in its Member Director and Non-Director Member nominees, giving due consideration to business activities and geographic distribution.

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

OCC's Board currently has 19 members consisting of nine Member Directors, five Exchange Directors, three Public Directors, and two Management Directors.⁸ Based

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

⁷ This tiered structure eliminated the complete turnover of the members of the NC each year and fostered greater continuity among its elected members. Securities Exchange Act Release No. 29437 (July 12, 1991), 56 FR 33319 (July 19, 1991) (SR-OCC-91-11).

⁸ Public Directors may not be affiliated with any national securities exchange or national securities association or any broker or dealer in securities, and OCC's Executive Chairman and President, who are Management Directors. See OCC By-Laws Article III, Section 6A.

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

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

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

1. GNC Composition

The new GNC would be composed of a minimum of three total members: at least one Public Director, at least one Exchange Director and at least one Member Director. To reflect this change, OCC would eliminate in Section 4 of Article III of the By-Laws the requirement for six Non-Director Members, add requirements for at least one Member Director and one Exchange Director, and modify the current requirement for one Public Director to instead require that there must be at least one Public Director. The proposed composition for the GNC already mirrors the existing composition specified in the GC Charter. Therefore, no changes are proposed to the current GC Charter in that respect, other than the elimination of the requirements that the GNC have no fewer than five directors. In its filing with the Commission, OCC stated that limitation would be eliminated with the goal of providing the Board with greater flexibility to determine the optimal size and composition of the GNC, so long as the composition also facilitates diverse representation by satisfying the proposed requirement for at least one GNC representative from each of the Member Director, Exchange Director, and Public

Director categories. The prohibition on Management Directors serving on the GC would continue to apply to the GNC.

2. GNC Member Appointment Process and Term Limits

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

3. Number of Public Directors and Member Directors

OCC is proposing to amend its By-Laws to increase the number of Public Directors on its Board from three to five. It is also making certain other changes related to the overall composition of the Board and the classification and term of office of Public Directors. The proposed change in the number of Public Directors from three to five would reconstitute OCC's Board with a total of 21 directors. OCC believes that, as indicated in its initial proposal to add Public Directors to its Board,⁹ Public Directors broaden the mix of viewpoints and business expertise that is represented on the Board. Accordingly, OCC believes that the input and expertise of two more Public Directors will

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

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

The proposed changes would remove a provision that, under certain conditions, automatically adjusts the number of Member Directors serving on the Board. OCC's By-Laws currently require that if the aggregate number of Exchange Directors and Public Directors equals at least nine, the total number of Member Directors must be automatically adjusted to exceed that number by one.¹⁰ This provision would be removed.¹¹ OCC believes that its removal will provide the Board with greater flexibility to determine its optimal composition. The proposed changes also remove a provision that reduces the number of Member Directors if the number is above nine and exceeds the sum of the number of Exchange Directors and the number of Public Directors by more than one, because the number of Member Directors would be fixed at nine.

OCC is also proposing certain amendments to its Stockholders Agreement, Board of Directors Charter and Fitness Standards for Directors, Clearing Members and Others. In each case, conforming changes would be made to recognize the merger of the NC and GC into the GNC as a standing Committee of the Board and reflect the role it would play in OCC's director nomination process. The proposed modifications to the Board Charter and Fitness Standards would reflect the increase in the number of Public Directors

¹⁰ OCC By-Laws Article III, Section 1.

¹¹ OCC also proposes to make corresponding changes to Article III, Section 3 of its By-Laws under which it would remove provisions that provide for the classification and term of office of Member Directors where the number of Member Directors increases based on the provision in Article III, Section 1 that OCC proposes to delete.

serving on the Board from three to five and the removal of the provision that currently is designed under certain conditions to automatically adjust the number of Member Directors serving on the Board. The criteria specified in the Fitness Standards for Directors, Clearing Members and Others for use in considering individuals nominated to be Member Director would also be revised for consistency with the criteria proposed to be added to Article III, Section 5 of the By-Laws, discussed below, designed to achieve balanced Board representation.

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

B. Proposed Amendments to By-Laws Only

As explained in more detail below, certain of the proposed changes would require amendments only to OCC's existing By-Laws. One such example is that Sections 2 and 5 of Article III of the By-Laws would be amended to remove prohibitions against representation of the same Clearing Member Organization on the Board and the NC.¹² This barrier would be eliminated since GNC members will be selected from among the members of the Board under the new approach.

1. Balanced Representation

The NC's responsibility to endeavor to achieve balanced representation among Clearing Members on the Board would be carried over to the GNC. Specifically, the GNC would be required to ensure that (1) not all of the Member Directors are from

¹² A Clearing Member Organization is a Clearing Member that is a legal entity rather than a natural person.

members having the largest volume of business with OCC during the prior year and (2) the mix of Member Directors includes members primarily engaged in agency trading on behalf of retail investors.

2. Nomination and Election Process

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

3. Public Directors

Proposed changes to Section 6A of Article III of the By-Laws would require the GNC to nominate Public Directors for election by OCC's stockholders and to use OCC's fitness standards in making such nominations. Presently, OCC's Executive Chairman nominates Public Directors with Board approval. Changes are also proposed to help

clarify the class structure and term limits of Public Directors that are independent of changes proposed to facilitate the formation of the GNC.¹³

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

4. Disqualifications and Filling Vacancies and Newly Created Directorships

The disqualification provisions in Article III, Section 11 of the By-Laws would be revised to reflect that any determination to disqualify a director would be effective and result in a vacancy only if the GNC makes a recommendation for disqualification in addition to an affirmative vote for disqualification by a majority of the whole Board. The By-Laws currently provide that if a Member Director vacancy is filled by the Board, the person filling the vacancy will serve until the next scheduled election for the relevant class of Member Director and a successor is elected. However, if the term for that class of Member Director extends beyond the Board's next annual meeting the vacancy must

¹³ These changes would specify that, aside from the Class II Public Director who was elected to the Board at the 2011 annual meeting, two other Public Directors were appointed to the Board prior to its 2013 annual meeting, one designated as a Class I Public Director and the other designated as a Class III Public Director. Generally, the three year terms for Public Directors with staggered expiration for each class would be preserved; however, an exception would be added for the initial Class I and III Public Directors.

be filled by a person who is recommended by the Nominating Committee. Proposed changes to these terms in respect of the GNC would require the Board in all cases to appoint a person who is recommended by the GNC. Similarly, Public Director vacancies would be required to be filled by the Board as generally provided for in Section 6A of Article III of the By-Laws, including with regard to candidates being nominated by the GNC using OCC's fitness standards for directors. Provisions concerning filling vacancies with respect to the NC would be deleted, consistent with its elimination in favor of the GNC.

5. Ministerial Changes

The proposed changes to Article III of the By-Laws also include certain ministerial changes. A reference to stockholder exchanges in the interpretation and policy to Section 6 would be replaced by the defined term Equity Exchanges, and a reference in Section 14 to notice by telegram would be changed to facsimile to reflect current means of communication.

C. Proposed Amendments to the GC Charter Only

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

1. GNC Purpose

The statement of purpose in the GC Charter would be revised to reflect the GNC's larger scope of responsibilities. The existing GC purpose of reviewing the overall corporate governance of OCC would be maintained, along with language clarifying that this review would be performed on a regular basis and that recommendations concerning Board improvements should be made when necessary. The GNC Charter would also

provide that the GNC assists the Board in identifying, screening and reviewing individuals qualified to serve as directors and by recommending candidates to the Board for nomination for election at the annual meeting of stockholders or to fill vacancies. The GNC Charter would also specify that the GNC would develop and recommend to the Board, and oversee the implementation of, a Board Code of Conduct.

2. GNC Membership and Organization

The requirement in the GC Charter that the GC hold four meetings annually would be modified to also permit the GNC to call additional meetings as it deems appropriate.¹⁴ The GC Charter requirement for regular reporting to the Board on Committee activities by the GC chair or a designee would be revised in favor of placing the reporting responsibility solely on the GNC Chair and requiring the GNC Chair to make timely reports to the Board on important issues discussed at GNC meetings. Taking into consideration certain pre-established guidelines in the GNC Charter, the GNC Chair would also be given responsibility for determining whether minutes should be recorded at any executive session. Aside from this exception for executive sessions, GNC meeting minutes would be required to be recorded. The GNC Charter would also create a position to be filled by an OCC officer who would assist the GNC and liaise between it and OCC's staff.

3. GNC Authority

As in the case of the existing GC, the GNC would have authority to inquire into any matter relevant to its purpose and responsibilities in the course of carrying out its duties. The GNC Charter would further specify that in connection with any such inquiry

¹⁴ This would bring the Governance and Nominating Committee Charter in line with the Charters of OCC's other Board Committees.

the GNC would have access to all books, records, facilities and personnel of OCC.

Unlike the existing GC Charter, the GNC Charter would not provide express authority for the GNC to rely on members of OCC's management for assistance. Instead, this relationship between the GNC and OCC's management would be more specifically addressed through the role of the newly created staff liaison position. Additional revisions to the GC Charter would also establish that the GNC Chair would not have discretion to take unilateral action on behalf of the Committee, even in special circumstances.

4. Board Composition

Without limiting the GNC to particular activities, the GNC Charter would specify certain responsibilities meant to guide the GNC in achieving its purposes, including with respect to its role in the development of the Board's composition. The GNC's Charter would require it to pursue development of a Board comprised of individuals who have a reputation for integrity and represent diverse professional backgrounds as well as a broad spectrum of experience and expertise. The GNC Charter would also prescribe more detailed responsibilities designed to further this goal. For example, the GNC would be required to conduct periodic reviews of the composition of the Board against the goal, including whether the Board reflects the appropriate balance of types of directors, business specialization, technical skills, diversity and other qualities.¹⁵

The GNC would be required to recommend policies and procedures to the Board for identifying and reviewing Board nominee candidates, and it would implement and oversee the effectiveness of those policies, including with regard to criteria for Board

¹⁵ The GNC would also review director conflicts of interest and the manner in which any such conflicts are to be monitored and resolved.

nominees. Using criteria approved by the Board, the GNC would identify, screen and review persons who it determines are qualified to serve as directors. This process would also extend to incumbent directors concerning any potential re-nomination. In all cases, the GNC would only recommend candidates to the Board for nomination for election after consulting with OCC's Executive Chairman.

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

5. Governance Practices

The GNC would have responsibility for reviewing the Board's Charter for consistency with regulatory requirements, transparency of the governance process and other sound governance practices. Currently, this is a GC function, and certain GC Charter amendments are proposed to help further detail the GNC's review responsibilities. These include a general responsibility to recommend changes, as the GNC deems appropriate, to the Board concerning Committee Charters. This would include the GNC Charter, which the GNC would be required to review annually.¹⁶ In connection with a periodic review of Board Committee structure, the GNC would advise the Board regarding related matters of structure, operations and charters. Furthermore, and in each case after consultation with OCC's Executive Chairman, the GNC would

¹⁶ As part of the annual review, the GNC would also submit the GNC Charter to the Board for re-approval, including any changes the GNC deems advisable.

recommend to the Board for its approval certain directors for Committee service as well as for assignment as Committee chair persons.

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

6. Other Proposed GC Charter Amendments

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

II. Discussion and Commission Findings

Although Title VIII does not specify a standard of review for an advance notice, the Commission believes that the stated purpose of Title VIII is instructive.¹⁷ The stated

¹⁷ See 12 U.S.C. 5461(b).

purpose of Title VIII is to mitigate systemic risk in the financial system and promote financial stability by, among other things, promoting uniform risk management standards for systemically-important financial market utilities (“FMUs”) and strengthening the liquidity of systemically important FMUs.¹⁸

Section 805(a)(2) of the Clearing Supervision Act¹⁹ authorizes the Commission to prescribe risk management standards for the payment, clearing, and settlement activities of designated clearing entities and financial institutions engaged in designated activities for which it is the supervisory agency or the appropriate financial regulator. Section 805(b) of the Clearing Supervision Act²⁰ states that the objectives and principles for the risk management standards prescribed under Section 805(a) shall be to:

- promote robust risk management;
- promote safety and soundness;
- reduce systemic risks; and
- support the stability of the broader financial system.

The Commission has adopted risk management standards under Section 805(a)(2) of the Clearing Supervision Act²¹ (“Clearing Agency Standards”).²² The Clearing Agency Standards became effective on January 2, 2013 and require registered clearing

¹⁸ Id.

¹⁹ 12 U.S.C. 5464(a)(2).

²⁰ 12 U.S.C. 5464(b).

²¹ 12 U.S.C. 5464(a)(2).

²² Rule 17Ad-22, 17 CFR 240.17Ad-22. Exchange Act Release No. 68080 (October 22, 2012), 77 FR 66220 (November 2, 2012) (S7-08-11).

agencies that perform central counterparty (“CCP”) services to establish, implement, maintain, and enforce written policies and procedures that are reasonably designed to meet certain minimum requirements for their operations and risk management practices on an ongoing basis.²³ As such, it is appropriate for the Commission to review advance notices against these Clearing Agency Standards and the objectives and principles of these risk management standards as described in Section 805(b) of the Clearing Supervision Act.²⁴

The proposed changes in the Advance Notice may result in changes that will improve OCC’s overall risk management process, and therefore may promote robust risk management. A Board-level committee likely will be in a better position to make well-informed nomination decisions. Members of the GNC will themselves be members of the Board, and, thus, have personal insight and experience into the types of experience and credentials that would be useful on the Board and be better able to assess the current needs of the Board. A Board comprised of Directors with more relevant skills and credentials that are better able to evaluate OCC’s risks may promote more robust risk management.

²³ The Clearing Agency Standards are substantially similar to the risk management standards established by the Board of Governors of the Federal Reserve System (“Federal Reserve”) governing the operations of designated DFMUs that are not clearing entities and financial institutions engaged in designated activities for which the Commission or the Commodity Futures Trading Commission is the Supervisory Agency. See *Financial Market Utilities*, 77 FR 45907 (August 2, 2012).

²⁴ 12 U.S.C. 5464(b).

Adding two Public Directors to the Board and eliminating the provision which ensured the number of Member Directors would outnumber the combined number of Exchange and Public Directors by one may also result in improved risk management processes and therefore may promote robust risk management. Additional emphasis on Public Directors may result in more independent views on the risks OCC presents being brought to the Board's attention for discussion and management of those risks. Moreover, the combined GNC and the additional emphasis on Public Directors should also aid in identifying any risks and inefficiencies in the current governance structure and making recommendations to the full Board to help mitigate those risks and eliminate any such inefficiencies.

The GNC's periodic reviews of the composition of the Board, including whether the Board reflects the appropriate balance of types of directors, business specialization, technical skills, diversity and other qualities, may help the GNC achieve balanced representation and a diversity among Member Directors. Maintaining balanced representation and having diversity among Member Directors may help the Board better evaluate and identify the risks OCC presents, and improve overall risk management.

In addition, the changes proposed in the Advance Notice may reduce OCC's contribution to systemic risk because they enhance the transparency of OCC's governance arrangements. The Commission believes that providing additional insight into OCC's governance arrangements may have this effect by allowing Members and other market participants to better assess risks at OCC, to comment on OCC's operations, and otherwise to advocate for improved overall risk management.

Commission Rule 17Ad-22(d)(8), adopted as part of Clearing Agency Standards, requires that a registered clearing agency establish, implement, maintain, and enforce written policies and procedures reasonably designed to “have governance arrangements that are clear and transparent to fulfill the public interest requirements in Section 17A of the Exchange Act applicable to clearing agencies, to support the objectives of owners and participants, and to promote the effectiveness of the clearing agency’s risk management procedures.”²⁵ The Commission believes that the changes proposed in this advance notice should help OCC fulfill these transparency requirements.

III. Conclusion

IT IS THEREFORE NOTICED, pursuant to Section 806(e)(1)(I) of the Clearing Supervision Act,²⁶ that the Commission DOES NOT OBJECT to advance notice proposal (SR-OCC-2014-802) and that OCC is AUTHORIZED to implement the proposal as of the date of this notice or the date of an order by the Commission approving a proposed rule change that reflects rule changes that are consistent with this advance notice proposal (SR-OCC-2014-09), whichever is later.

By the Commission.

Kevin O’Neill
Deputy Secretary

²⁵ 17 CFR 240.17Ad-22(d)(8).

²⁶ 12 U.S.C. 5465(e)(1)(I).