March 30, 2021

VIA EMAIL

Vanessa Countryman, Secretary
U.S. Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090

Re: File No. SR-OCC-2021-0003: Release No. 34-91199
Skin-in-the-Game

Dear Ms. Countryman:

Susquehanna International Group, LLP ("SIG") submits this letter to comment on the above-referenced rule-filing by the Options Clearing Corporation ("OCC"). The subject OCC proposal would provide a minimum persistent level of pre-funded equity capital as skin-in-the-game ("SITG") that OCC would utilize to help cover default losses or liquidity shortfalls (the "Proposal"). For the reasons noted below, SIG submits that the Proposal is inconsistent with Securities Exchange Act (the "Exchange Act") section 17A(b), and, therefore, should be disapproved by the Commission in its current form.

SIG supports a proper capitalization of OCC as well as the concept of SITG by the owners of a central counterparty ("CCP") as an incentive to prudent management. The instant Proposal, however, would serve to wrongfully redefine OCC's shareholder equity account in a manner diametrically different from its current acknowledged status. Indeed, characterizing unrebated excess clearing fee revenue as the shareholder equity comprising SITG is woefully incorrect in light of the fact that virtually all clearing fee revenue is paid by option market participants (rather than exchange shareholders), with the excess fees over expenses otherwise rebated back by OCC.

At the outset, it is important to remember that OCC was established as a monopoly organization in order to serve as a market utility. At that time, the interests of all OCC stakeholders were aligned, because OCC was owned by non-profit exchanges that were in turn owned by their market participant memberships that paid OCC clearing fees. In keeping with this public utility model that was, and remains, the basis for OCC's monopoly, excess clearing fees were wholly refunded to OCC clearing members. In

consideration of this, it has always been recognized and accepted by concerned parties that monies held as excess OCC capital are excess fees not yet rebated, as opposed to retained earnings. To the extent that any such funds were not rebated and thereby resided in the shareholder equity account as retained earnings, it was always as a buffer to address potential short-term operational shortfalls and not in any way for the benefit of shareholders.

In this regard, over the first approximately 40 years since OCC's formation, relatively small amounts (generally in the range of $25 million or less) were retained on hand in the event of such shortfalls. Throughout those years, however, OCC never had to draw on these funds to cover any shortfalls. In essence, the funds served as a short term buffer in the event of unexpected operational shortfalls; given that clearing fee increases could generally be instituted very quickly if such a need ever arose. Thus, the idea put forth that unrebated fees would satisfy shareholder's SITG is troubling. Equally troubling is the fact that OCC is currently holding in excess of $325 million of unrebated fees. Option volume has grown tremendously in recent years (it has nearly doubled in the past year) and thereby afforded OCC many opportunities and reasons to significantly reduce clearing fee rates. This should be an immediate area of focus for OCC.

Decades after OCC's inception, the de-mutualization of the OCC shareholder exchanges into for-profit entities created a principled misalignment of interests. This conflict is greatly constrained by the fact that the shareholders are not entitled to receive dividends from OCC's excess fee income, but the potential remains for the conflict to be actualized via the inappropriate conversion of these unrebated excess fees into shareholders' equity. This legacy must also be considered in light of the concerns noted below regarding the Proposal.

As an initial matter, OCC's Clearing Fund adequately addresses the prospect of a Clearing Member default or liquidity shortfall, and OCC concedes that its current Capital Management Policy already provides for a Target Capital amount that meets its regulatory obligations and serves market participants and the public interest.[1] OCC's basis for setting a minimum level of excess capital is its consideration of a European Market Infrastructure Regulation ("EMIR") requirement that does not apply to OCC, but that OCC wishes to nonetheless satisfy as part of its request for third country CCP recognition in Europe and the United Kingdom so that European bank-owned clearing members need not set aside additional capital for exposure to OCC.[2]

While the concept of SITG in principle is laudable, OCC's Proposal fails its essential purpose and places a significant unwarranted burden on the investing public. The minimum level of excess equity capital that OCC seeks would be funded by (1) excess clearing fee income held by OCC that otherwise would have been rebated, and (2)

[1] Rule filing, p. 3. OCC's current Capital Management Policy effectively provides for excess capital above its Target Capital amount already, as it prohibits clearing fee refunds unless OCC capital is above 110% of its Target Capital.

[2] Id. at footnote 13.

the unvested balance of its executive deferred compensation plan ("EDCP"). It would not be funded by its shareholders or in any way be comprised of funds to which its shareholders are entitled, and so would not in any meaningful way constitute true SITG of the shareholders.

This incongruity is highlighted by OCC's proffer of unvested EDCP to help cover default losses and liquidity shortfalls. OCC noted, "[i]n particular, OCC believes that the inclusion of the EDCP Unvested Balance is a powerful alignment of interest between management and Clearing Members."[3] This alignment is obvious and serves the essential purpose of SITG: OCC management is exposed to risk of pecuniary harm if it does not manage market default risk responsibly. This is true SITG by OCC executive staff.

By contrast, under the Proposal, the exchange owners of OCC would suffer no such risk of pecuniary harm, because their so-called SITG would be funded by unrebated excess clearing fee income, and not from funds in any way linked to the shareholder exchanges.[4] As such, the shareholder exchanges are indifferent if these funds are drawn upon to cover a default. Instead, it is the market participants, who were denied a rebate of their excess fees, who bear the risk of imprudent decisions by the exchanges in their capacity as the OCC shareholders and of their designee board members. In short, under OCC's Proposal, **it is the public's skin in OCC's game**.

This subverts both the purpose and the essence of SITG, as it merely affects a form-over-substance transfer of unrebated fees to the equity account in lieu of clearing fund monies to cover defaults and liquidity shortfalls; and in the process converts these excess fees into free money to the benefit of OCC's exchange shareholders.[5] Accordingly, rather than expose OCC equity shareholders to risk as true SITG, the OCC Proposal has the opposite effect. It confers an unmerited benefit on OCC shareholders and a consequent unwarranted burden on the investing public who ultimately pay the clearing fees priced, in part, to facilitate the shareholder windfall.

Looking forward, the OCC Proposal, if approved, could incentivize OCC's shareholder exchanges and their board designees to inflate its Target Capital in order to increase the value of the 25% minimum excess capital requirement -- an obvious conflict

[3] Id, p. 5.

[4] Of the approximate $62M that would be qualified as SITG at OCC's current Target Capital level, about $60M (or 96.8%) would be unrebated excess clearing fee income and about $2M (or 3.2%) would be EDCP unvested balance.

[5] The regulatory objective underpinning the introduction of SITG was summarized as aiming at "ensuring that the owners and shareholders of a CCP exercise an appropriate oversight on its activities and risk management practices." (see *Communication from the Commission concerning position of the Council on the adoption of a Regulation of the European Parliament and of the Council on a framework for the recovery and resolution of central counterparties*, 18.11.2020).

of interest.[6] This, in turn, would lead to clearing fee rate increases to fund the growing SITG balance and the associated federal income taxes on this "income" (i.e., unrebated fees). Worse, it would create a wrongful precedent for the prospect of mischaracterizing excess clearing fee income generally as shareholder equity.

Accordingly, excess clearing fee income should not be used to fund OCC shareholder equity as SITG or otherwise. If such funds are used for purposes of SITG, they should be segregated in a restricted SITG account to be drawn upon only in the case of a clearing member default and which account does not inure, directly or indirectly, to the benefit of the OCC shareholders. While this would not remedy the instant Proposal's failure to serve the underlying purpose of SITG (i.e., owner incentive for prudent management), it would at least avoid the wrongful conversion of market participant money to the benefit of OCC shareholders.

Exchange Act Section 17A(b)(3)(D) states that the rules of a clearing agency must "provide for the equitable allocation of reasonable dues, fees, and other charges among its participants." To the extent OCC fees, dues, and other charges are used to finance the equity windfall of OCC shareholders and their commercial interests, they are per se unreasonable.

Section 17A(b)(3)(F) provides that the rules of a clearing agency must be designed "to protect investors and the public interest". For the reasons noted above, the OCC Proposal contravenes, rather than upholds, the protection of investors and the public interest.

Accordingly, SIG respectfully opposes the above-referenced rule filing and urges the Commission to disapprove the Proposal. We thank the Commission for its consideration.

Sincerely,

Richard J. McDonald

Richard J. McDonald

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[6] The same conflict of interest may similarly materialize as efforts to increase the SITG balance beyond the instant 25% threshold, as an increase to unmerited shareholder equity,