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November 9, 2011

Via Electronic Mail

Ms. Elizabeth A. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, DC 20549-1090
rule-comments@sec.gov

Re: SR-FINRA-2011-057 Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing of Proposed Rule Change To Adopt New FINRA Rule 5123 (Private Placement of Securities)

Dear Ms. Murphy:

This letter is submitted by The Options Clearing Corporation ("OCC") in response to the Commission's recent release (the "Release")[1] requesting comment on the Financial Industry Regulatory Authority, Inc.'s ("FINRA") proposed rule 5123 (the "Proposed Rule") regarding the private placement of securities, submitted to the Commission pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Exchange Act"). As discussed herein, OCC believes that it is necessary and appropriate for FINRA to provide for exemptions from the Proposed Rule for offers and sales of (1) standardized options and (2) cleared over-the-counter options. We welcome this opportunity to provide our specific comments based upon OCC's experience and unique circumstances.

OCC Background

Founded in 1973, OCC is currently the world's largest clearing organization for financial derivatives. OCC is registered with the Commission as a securities clearing agency pursuant to Section 17A of the Exchange Act and with the Commodity Futures Trading Commission (the "CFTC") as a derivatives clearing organization under Section 5b of the Commodity Exchange Act. OCC clears securities options, security futures and other securities contracts subject to Commission jurisdiction, and commodity futures and commodity options subject to the CFTC's

[1] 76 FR 65758 (October 24, 2011).

jurisdiction. OCC clears derivatives for all nine U.S. securities options exchanges and five futures exchanges.[2]

Proposed FINRA Rule 5123

The Proposed Rule would prohibit a FINRA member or person associated with a FINRA member from offering or selling any security in an offering conducted in reliance on an available exemption from registration under the Securities Act of 1933, as amended (the "Securities Act") (which the Proposed Rule refers to as a "private placement"), or participating in the preparation of a private placement memorandum ("PPM"), term sheet or other disclosure document for such "private placement," unless the FINRA member or associated person provides a PPM or term sheet to each investor prior to sale that describes the anticipated use of offering proceeds, the amount and type of offering expenses, and the amount and type of compensation provided or to be provided to sponsors, finders, consultants, and FINRA members and their associated persons in connection with the offering. In a private placement for which no PPM or term sheet has been prepared, a FINRA member or person associated with a FINRA member would be required to prepare a document that contains the foregoing disclosures and to provide the document to each investor prior to sale. The Proposed Rule also provides for certain "notice" filings with FINRA by FINRA members. The Proposed rules would exempt certain offerings from the foregoing requirements. Among these exempt offerings are those made exclusively to "qualified purchasers", as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, as amended (the "Investment Company Act").

Standardized Options

The Proposed Rule should be amended to provide an exemption for standardized options. SEC Rule 9b-1(a)(4) defines "standardized options" as "options contracts trading on a national securities exchange, an automated quotation system of a registered securities association, or a foreign securities exchange which relate to options classes the terms of which are limited to specific expiration dates and exercise prices, or such other securities as the Commission may, by order, designate." Standardized options are offered and sold pursuant to an exemption from Securities Act registration provided by SEC Rule 238. Rule 238 exempts from the registration provisions of the Securities Act any standardized option that is issued by a clearing agency registered under Section 17A of the Exchange Act and traded on a national securities exchange registered pursuant to Section 6(a) of the Exchange Act.

Because standardized options are exchange-traded, offered continuously, and cleared by a registered clearing agency, offerings of standardized options lack many of the characteristics of "private placements" as described in the Proposed Rule. The explanatory materials accompanying the Proposed Rule indicate that its purpose is "to ensure that investors in private

[2] The participating options exchanges are BATS Exchange, Inc., C2 Options Exchange, Inc., Chicago Board Options Exchange, Inc., International Securities Exchange, LLC, NASDAQ OMX BX, Inc., NASDAQ OMX PHLX, Inc., NASDAQ Options Market, NYSE Amex LLC and NYSE Arca, Inc. OCC clears futures products traded on CBOE Futures Exchange, LLC, ELX Futures, LP, NASDAQ OMX Futures Exchange and NYSE Liffe US, as well as security futures contracts traded on OneChicago Exchange and options on futures contracts traded on NYSE Liffe US.

placements are provided detailed information about the intended use of offering proceeds, the offering expenses and offering compensation." However, those matters are largely irrelevant to purchasers of standardized options, and standardized options are already subject to a well-established and robust disclosure regime directed towards sellers as well as buyers. Any investor seeking to trade standardized options must be given a disclosure document entitled "Characteristics & Risks of Standardized Options," also known as the options disclosure document or "ODD". The ODD serves an investor protection function similar to that of a PPM by providing prospective buyers and sellers with an in-depth explanation of the unique characteristics of each type of standardized option offered and the risks inherent to each. Pursuant to Rule 9b-1(b) under the Exchange Act, the ODD was filed with the SEC prior to its initial use. That rule requires that the ODD be kept current, and that amendments and supplements also be filed before use. Requiring the preparation and dissemination of a FINRA-mandated PPM in addition to the ODD would needlessly impose an additional regulatory burden on OCC's clearing members and potentially lead to duplicative and confusing overlaps in disclosure. We see no additional disclosure or investor protection benefit to be gained by subjecting offers and sales of standardized options to FINRA Rule 5123 and therefore ask that the Proposed Rule be amended to exempt standardized options offered pursuant to Rule 238.

Cleared Over-the-Counter Options

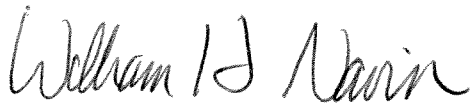
We believe the Proposed Rule should also be amended to provide an exemption for cleared over-the-counter options, provided that such options are offered and sold exclusively to "eligible contract participants" ("ECPs"), as defined in Section 3(a)(65) of the Exchange Act.

As described in an October 25, 2011 letter from OCC to Grace Vogel of FINRA (a copy of which is attached), OCC intends to begin clearing over-the-counter options in the near future. These "OTC Options" (as defined in the October 25 letter) will be cleared by OCC in a manner substantially similar to the manner in which standardized options are currently cleared. However, unlike standardized options, the OTC Options will not be traded on a securities exchange and therefore will not be "standardized options." OCC consequently does not anticipate that there will be an ODD for OTC Options. However, the OTC Options will be available exclusively to ECPs. The Proposed Rule provides exemptions for certain offerings that are sold exclusively to investors meeting various investor sophistication standards, including those who are "qualified purchasers" ("QPs"), as defined in Section 2(a)(51)(A) of the Investment Company Act. The QP and ECP standards were designed by Congress to serve essentially the same function within their respective statutes — as thresholds for determining whether an investor is sufficiently sophisticated to participate in a potentially risky investment without the investor protections provided for the retail public. The requirements for qualifying for QP or ECP status are similar, and in certain instances the standard for ECP status is more stringent (for example, a natural person must have more than $10,000,000 in amounts invested on a discretionary basis to qualify as an ECP, but need only have $5,000,000 in investments to qualify as a QP.) Therefore, we believe that offerings made exclusively to ECPs should be exempt from the Proposed Rule.

Conclusion

OCC appreciates the opportunity to comment on the Proposed Rule. We would be pleased to provide the Commission with any additional information or analysis that might be useful in determining the final form of the Proposed Rule.

Sincerely,



William H. Navin
Executive Vice President
and General Counsel

cc: Mary L. Shapiro
Chairman
Securities and Exchange Commission

Elisse B. Walter
Commissioner

Luis A. Aguilar
Commissioner

Troy A. Paredes
Commissioner

Daniel M. Gallagher
Commissioner

Attachment (1)

Michael A. Walinskas
Senior Vice President
Risk Management and Membership

October 25, 2011

Financial Industry Regulatory Authority, Inc.
1735 K Street
Washington, DC 20006
Attn: Grace B. Vogel
Executive Vice President, Member Regulation

Re: OTC Options to be Cleared by The Options Clearing Corporation

Ladies and Gentlemen:

The Options Clearing Corporation ("OCC") intends to begin clearing over-the-counter equity index options ("cleared OTC Options" or "OTC Options") as soon a possible, with a goal of beginning to clear OTC Options in the first quarter of 2012. Most of OCC's U.S. clearing members are members of the Financial Industry Regulatory Authority, Inc. ("FINRA") and, thus, subject to FINRA's rules. We believe certain amendments to FINRA's rules would be appropriate to clarify the proper application of existing rules to these new options, which contain characteristics of both listed and over-the-counter options. FINRA rules often have different provisions for listed and OTC options and contain various definitions distinguishing between the two. In some cases, cleared OTC options would fall into neither category under the definitions as drafted. In other cases, they would fall within what we perceive to be the wrong category. The purpose of this letter is to bring these instances to your attention and suggest solutions to these problems.

1. Background Information

OCC intends to clear the OTC Options in a manner that is highly similar to the manner in which it clears listed options, with only such modifications as are appropriate to reflect the unique characteristics of the cleared OTC Options. The initial OTC Options to be cleared by OCC will consist of equity index options. However, OCC may also clear OTC Options on individual equity securities in the future. The initial versions of the cleared OTC Options will be options on equity indices published by Standard & Poor's Financial Services LLC ("S&P").[1] The cleared OTC Options will have predominantly common terms and characteristics, but will also include unique terms negotiated by the parties. Transactions in the OTC Options will not be executed through the facilities of any exchange or exchange-like market but will instead be entered into bilaterally and submitted to OCC for clearance through one or more providers of trade affirmation services.[2]

OCC expects to clear OTC Options subject to the same basic rules and procedures that apply to listed index options. The cleared OTC Options are similar to exchange-traded standardized equity index

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[1] OCC's license agreement with S&P currently allows OCC to clear OTC Options on the S&P 500 Index, the S&P MidCap 400 Index and the S&P Small Cap 600 Index.

[2] The initial provider of the trade affirmation services in connection with the OTC Options will be MarkitServ.

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options called "FLEX Options" that are currently traded on certain options exchanges. FLEX Options are exchange-traded put and call options that allow for customization of certain terms.

A limited number of variable terms will be allowed for the cleared OTC Options, with a specified range of values that may be assigned to each, as agreed between the buyer and seller. The variable terms and permitted values will be specified in OCC's rules. Parties submitting transactions in cleared OTC Options for clearing by OCC will be able to customize seven discrete terms: (1) put or call; (2) option premium; (3) exercise price; (4) expiration date; (5) American or European exercise style; (6) size; and (7) method of calculating settlement value.[3]

Additional background information regarding OCC's proposed method for clearing OTC Options is set out in an Appendix to this letter. OCC would be pleased to provide further information and explanation as needed.

2. Regulatory Status of the Cleared OTC Options

The cleared OTC Options will be "securities" as defined in both the Securities Act of 1933 (the "Securities Act") and the Exchange Act.[4] OCC will be the "issuer" of the cleared OTC Options once a transaction in cleared OTC Options is accepted by OCC for clearing. Transactions in such options would be required to be cleared through a clearing member of OCC that is registered with the SEC as a broker-dealer or one of the small number of clearing members that are "non-U.S. securities firms" as defined in OCC's By-Laws. OCC is working with the SEC to secure exemptions for cleared OTC Options from registration under both the Securities Act and the Exchange Act. The cleared OTC Options will be neither "swaps" nor "security-based swaps" for purposes of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"),[5] although OCC anticipates that its proposed method of clearing OTC Options could be adapted for the clearance of security-based swaps as well.

Because they are not listed on a national securities exchange or foreign securities exchange, cleared OTC Options will not fall within the definition of a "standardized option" in Exchange Act Rule 9b-1 and will therefore not be the subject of an options disclosure document ("ODD") as provided for in that rule.[6] Rather, for this purpose, they will be treated as other over-the-counter options and, as is customary in the market for such options, transactions in such options will be limited to persons who

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[3] The method of determining the exercise settlement value of an OTC Option may be either (A) each day's final value of the SPX option traded on CBOE, such price to be provided by CBOE, or (B) the opening settlement value (SET), which is calculated by S&P using the opening sales price in the primary market for each component security on the last business day (usually a Friday) before the expiration date of the OTC Option.

[4] Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act both define a "security" to include "any put, call, straddle, option, or privilege on any security . . . or group or index of securities[.]"

[5] Section 1a(47)(A)(i) of the Commodity Exchange Act ("CEA"), as added by Section 721(a)(21) of Dodd-Frank, defines "swaps" broadly to include options on indices. However, Section 1a(47)(B)(iii) of the CEA excludes from the "swap" definition any option on any index of securities that is subject to the Securities Act and the Exchange Act. A contract that is excluded from the definition of a "swap" under Section 1a(47)(B) (other than Section 1a(47)(B)(x)) is not a "security-based swap" for purposes of Section 3a(68) of the Exchange Act.

[6] We are currently engaged in discussions with the SEC about obtaining relief from Securities Act and Exchange Act registration for the cleared OTC Options. However, we do not currently anticipate that such relief would be obtained by including the OTC Options within the definition of a "standardized option" under Exchange Act Rule 9b-1(a)(4).

qualify as sophisticated investors. OCC proposes to require that trading in cleared OTC Options be limited, as will be the case for security-based swaps, to "eligible contract participants" ("ECPs") as defined in the Exchange Act and the CEA. Because trading in cleared OTC Options will be limited to ECPs, OCC believes that it is appropriate to treat them for this purpose in a manner similar to existing OTC options and does not expect to seek an amendment to Rule 9b-1 to bring them within its coverage.

3. FINRA Rules That May Require Amendment for Cleared OTC Options

We have identified below certain FINRA rules that we believe may need to be revised in order to apply appropriately to cleared OTC Options. As a threshold matter, we note that under definitions in FINRA's options rule (*i.e.*, **Rule 2360**), a cleared OTC Option would be neither a "conventional index option,"[7] nor a "conventional option,"[8] and would be both a "standardized equity option"[9] and a "standardized index option."[10] We believe this result is appropriate given that the cleared OTC Options will be substantially similar to other options currently cleared by OCC, except with respect to the venue in which transactions in such options are executed and some additional ability to customize terms.[11] We do not believe any amendment to these definitions is necessary.

The following FINRA rules are those that we have identified as possibly needing to be amended:

- **Rule 0180** (Temporary exemption for security-based swaps.) This rule, which expires on January 17, 2012, currently exempts security-based swaps from many FINRA rules. Presumably the exemption could be extended as needed to provide more time for security-based swap rules to be put in place and could be extended to apply to cleared OTC Options. While OCC does not presently believe that such a temporary exemption would necessarily be required for cleared OTC Options, FINRA might consider granting similar temporary relief with respect to the cleared OTC Options if more time is required to make appropriate amendments to FINRA rules to provide for cleared OTC Options.

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7 Rule 2360(a)(8) defines a "Conventional Index Option" as "any options contract *not issued, or subject to issuance, by* The Options Clearing Corporation that, as of the trade date, overlies a basket or index of securities that: (A) Underlies a standardized index option; or (B) Satisfies the following criteria: (i) The basket or index comprises 9 or more equity securities; (ii) No equity security comprises more than 30% of the equity security component of the basket's or index's weighting; and (iii) Each equity security comprising the basket or index: a. is a component security in either the Russell 3000 Index or the FTSE All-World Index Series; or b. has 1. market capitalization of at least $75 million or, in the case of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, $50 million; and 2. trading volume for each of the preceding six months of at least one million shares or, in the case of each of the lowest weighted component securities in the basket or index that in the aggregate account for no more than 10% of the weight of the index, 500,000 shares." (emphasis added)

8 Rule 2360(a)(9) defines a "Conventional Option" as "any option contract *not issued, or subject to issuance, by* The Options Clearing Corporation." (emphasis added)

9 Rule 2360(a)(31) defines a "Standardized Equity Option" as "any equity options contract *issued, or subject to issuance by*, The Options Clearing Corporation that is not a FLEX Equity Option." (emphasis added)

10 Rule 2360(a)(32) defines a "Standardized Index Option" as "any options contract *issued, or subject to issuance by*, The Options Clearing Corporation that is based upon an index." (emphasis added)

11 Transactions in cleared OTC Options may also be subject to certain minimum size requirements, minimum duration, and other limitations imposed under license agreements through which OCC has obtained, or may in the future obtain, the right to clear OTC Options on proprietary indexes.

- **FINRA Rule 2360–Options**:

  - **Rule 2360(a)(14)** defines the "expiration date" of an option contract issued by OCC as "the day and time fixed by [OCC's rules] for the expiration of all option contracts having the same expiration month as such option contract." This will not be the case for cleared OTC Options, which may have customized expiration dates within the limits established in OCC's rules. In fact, the rule is also inaccurate with respect to other OCC-issued options, including FLEX options that also have customized expiration dates and certain options that expire on a weekday. The problem could be eliminated by amending the FINRA rule to define the "expiration date" of an option issued by OCC, in relevant part, as ". . . the day and time fixed ~~by~~**in accordance with** the rules of The Options Clearing Corporation for the expiration of ~~all~~ such option contracts~~ having the same expiration month as such option contract~~."

  - **Rule 2360(a)(16)** defines a "FLEX Equity Option" as "any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract *consistent with the rules of the exchange on which the options contract is traded.*" [emphasis added] We suggest that FINRA consider amending the definition to clarify that all FLEX Equity Options are listed on exchanges in order to avoid any possible confusion with respect to the application of the definition to the OTC Options.

  - **Rule 2360(b)(16)(D)** requires FINRA members to obtain written agreements from each customer that such customer is "aware of and agrees to be bound by FINRA rules applicable to the trading of option contracts and, if he desires to engage in transactions in options issued by The Options Clearing Corporation, that the customer has received a copy of the current disclosure document(s) . . . and that he is aware of and agrees to be bound by the rules of The Options Clearing Corporation." As noted above, we do not expect that the ODD delivery regime will apply to the cleared OTC Options and therefore FINRA should consider amending this rule as follows, in relevant part: ". . . the customer has received a copy of **the current version of any applicable** ~~current~~ disclosure document(s) . . ."

  - **Rule 2360(b)(16)—Opening of Accounts.** Subparagraph (A) of this provision ("Approval Required") states: "No member or person associated with a member shall accept an order from a customer to purchase or write an option contract *relating to an options class that is the subject of an options disclosure document*, or approve the customer's account for the trading of such option, unless the broker or dealer furnishes or has furnished to the customer the appropriate options disclosure document(s) and the customer's account has been approved for options trading in accordance with the provisions of subparagraphs (B) through (D) hereof." [Emphasis added.] We therefore interpret the account opening process, including the provisions of subparagraphs (B) through (D),[12] to apply only to trading in a class of options that is the subject of an ODD. As noted above, we do not anticipate that cleared OTC Options will be subject to Exchange Act Rule 9b-1 or that there will be an ODD for such options. Accordingly, it appears to us that the provisions of **Rule 2360(b)(16)(A)-(D)** will be inapplicable to cleared OTC Options. We believe that this is an appropriate result given that trading in

[12] These subparagraphs address the following matters: (B) diligence in opening accounts, (C) verification of customer background and financial information, and (D) account agreements.

such options will be limited to ECPs. However, an alternative provision could be adopted in a new sub-paragraph **(F)** to **Rule 2360(b)(16)** stating, "No member or person associated with a member shall accept an order from a customer to purchase or write a [cleared OTC Option], or approve the customer's account for the trading of such option, unless the broker or dealer has verified that the customer is an [ECP]." (Terms not yet defined in FINRA rules are bracketed.)

- **Rule 2360(b)(16)(E)—Uncovered Short Option Contracts**. This rule sets forth certain procedures, approvals, and disclosure requirements that must be met in order to permit a customer to write uncovered options. We assume that subparagraph (E) was intentionally omitted from the list of provisions in subparagraphs (B) through (D) that must be met in order to approve an account for options trading because not all accounts that are approved for trading in options will be approved for uncovered option writing. However, the omission of subparagraph (E) from the list of provisions in subparagraph (A) could be interpreted to mean that it is a stand-alone requirement that applies to the writing of *any* option regardless of whether it is a standardized option subject to the ODD requirement. We are uncertain as to whether or not the rule is so interpreted by FINRA. If so, then it presumably would apply as well to uncovered writing of cleared OTC Options. Whatever the intention, it may be useful to amend subparagraph (E) to make the scope of its application clear with respect to options not covered by subparagraph (A) including, but not limited to, cleared OTC Options.

- **Rule 2360(b)(17)—Maintenance of Records**. Subparagraph (B) requires FINRA members to maintain background and financial information "of customers who have been approved for options trading[.]" As the options account approval rule (**Rule 2360(b)(16)(A)**, described above) requires approval only for accounts in which options are traded that are "the subject of an options disclosure document," we do not believe **Rule 2360(b)(17)(B)** would apply to the cleared OTC Options. However, this rule by its terms could be read to apply to accounts approved for trading cleared OTC Options: "Background and financial information of customers who have been approved for options trading shall be maintained . . ." We ask FINRA to consider amending Rule 2360(b)(17)(B) to read, in relevant part: "Background and financial information of customers who have been approved for options trading **pursuant to Rule 2360(b)(16)(A)** shall be maintained . . ." This would clarify that the rule is not intended to apply to accounts for which the customer has been approved to trade the cleared OTC Options.

- **Rule 2360(b)(23)(A)(ii)** provides that, unless waived by OCC, expiring standardized options will be subject to OCC's "exercise-by-exception" procedures. As currently proposed, cleared OTC Options that are in the money will be automatically exercised if in the money by any amount and will not be subject to exercise-by-exception procedures. Automatic exercise applies to certain listed options as well. Accordingly, we suggest that FINRA revise the rule to read, in relevant part: "**Except as otherwise provided in the rules of The Options Clearing Corporation, and u**~~U~~nless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception ('Ex-by-Ex') procedure under The Options Clearing Corporation Rule 805." **Rule 2360(b)(23)(A)(v)** also is drafted in a manner that assumes OCC's exercise-by-exception procedure applies to all standardized equity options cleared by OCC. FINRA should consider amending that rule, in relevant part, to read: "In those instances when The Options Clearing Corporation has waived the Ex-by-Ex procedure for an options class **to which such procedure otherwise applies**, members must . . ."

- **FINRA Rule 4210—Margin Requirements**:

  - As FINRA's margin rules for options (**Rule 4210(f)(2)**) are currently drafted, the cleared OTC Options would not fall within the definition of either "listed,"[13] or "OTC."[14] As the cleared OTC Options will be substantially similar to listed options currently cleared by OCC and will be guaranteed by OCC, we believe it is appropriate to treat them as listed options for purposes of the margin rules. We therefore suggest that FINRA revise the definition of "listed" in **Rule 4210(f)(2)(A)(xxvi)** as follows: "The term 'listed' as used with reference to a call or put option contract means an option contract that is traded on a national securities exchange **or**~~and~~ issued and guaranteed by a registered clearing agency." To avoid confusion, it may also be helpful to replace the term "listed," for purposes of this rule, with the term "cleared."

  - As FINRA's portfolio margin rule (**Rule 4210(g)**) is currently drafted, the cleared OTC Options would be treated as "unlisted derivatives,"[15] and not as "listed options."[16] As the cleared OTC Options will be substantially similar to listed options currently cleared by OCC and will be guaranteed by OCC, we believe it is more appropriate to treat them as listed options for purposes of FINRA's portfolio margin rules. We therefore suggest that FINRA revise the definition of "listed option" in **Rule 4210(f)(2)(A)** as follows: "The term 'listed option' means any equity-based or equity index-based option traded on a registered national securities exchange **or issued by a registered clearing agency**." Again, to avoid confusion, FINRA might also consider replacing the term "listed" with the term "cleared." We also suggest that FINRA revise the definition of "unlisted derivative" in **Rule 4210(f)(2)(H)** as follows: "The term 'unlisted derivative' means any equity-based or equity index-based ~~unlisted~~ option, forward contract, or security-based swap that can be valued by a theoretical pricing model approved by the SEC **and that is neither traded on a registered national securities exchange, nor issued by a registered clearing agency**."

- **Application for Approval of Change in Ownership, Control, or Business Operations—NASD Rule 1017**

  - NASD Rule 1017(a)(5) requires members to file an application for approval of any "material change in business operations." We believe it is unclear under the rule as drafted whether a member engaging in trading or effecting transactions in the new OTC Options would be required to file pursuant to Rule 1017(a)(5).

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13 Rule 4210(f)(2)(A)(xxvi) defines "listed . . . as used with reference to a call or put option contract [as] an option contract that is *traded on a national securities exchange* and issued and guaranteed by a registered clearing agency." (emphasis added)

14 Rule 4210(f)(2)(A)(xxxii) defines "OTC . . . as used with reference to a call or put option contract [as] an over-the-counter option contract that is not traded on a national securities exchange and is *issued and guaranteed by the carrying broker-dealer*." (emphasis added)

15 Rule 4210(g)(2)(H) defines an "unlisted derivative" as "any equity-based or equity index-based *unlisted* option, forward contract, or security-based swap that can be valued by a theoretical pricing model approved by the SEC." (emphasis added)

16 Rule 4210(g)(2)(A) defines a "listed option" as "any equity-based or equity index-based option *traded on a registered national securities exchange*." (emphasis added)

- **Private Placements of Securities—Proposed FINRA Rule 5123 (SR-2011-057)**

    - On October 4, FINRA filed with the SEC a proposal to adopt new **FINRA Rule 5123**, which would require FINRA members and their associated persons that offer or sell applicable "private placements" or participate in the preparation of private placement memoranda ("PPMs"), term sheets or other disclosure documents in connection with such private placements, to provide relevant disclosures to each investor prior to sale describing the anticipated use of offering proceeds, and the amount and type of offering expenses and offering compensation. Rule 5123 also would require that the PPM, term sheet or other disclosure document, and any exhibits to such documents, be filed with FINRA no later than 15 calendar days after the date of the first sale, and any material amendments to such document, or any amendments to the disclosures mandated by the Rule, be filed no later than 15 calendar days after the date such document is provided to any investor or prospective investor. Absent an exemption, Rule 5123 would apply to offers and sales of the OTC Options by FINRA members.[17] However, proposed Rule 5123(c) would exempt sales made exclusively to "qualified purchasers", as defined in Section 2(a)(51)(A) of the Investment Company Act of 1940, as amended, from Rule 5123. As the "eligible contract participant" requirement, which must be met by purchasers of the OTC Options, is generally a more stringent standard than the "qualified purchaser" standard,[18] we believe sales to ECPs should also be exempted from the rule. FINRA should therefore consider adding at the end of sub-section (c) a new paragraph, as follows:: "**(H) eligible contract participants, as defined in Section 1a(18) of the Commodity Exchange Act.**"

4. Conclusion

Except as noted above, we have not identified any other provisions of the FINRA rules that appear to require revision as a result of the advent of cleared OTC Options. However, if FINRA believes that there are additional rules not identified above that should be addressed, we would welcome the opportunity to discuss them. We would like to arrange a time to meet with appropriate members of your staff as soon as possible to discuss the matters raised in this letter. OCC would like to begin clearing the OTC Options in the first quarter of 2012. In the meantime, if you have any questions or comments or require further information, please do not hesitate to contact me at (312) 322-4451or mwalinskas@theocc.com, or James R. McDaniel, a partner with Sidley Austin LLP, our outside counsel, at (312) 853-2665 or jmcdaniel@sidley.com.

Thank you for your attention to this matter.

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17 We are discussing with the SEC the proper registration/exemption of the OTC Options under the Securities Act. However, as the OTC Options will be "securities" for purposes of the Securities Act and none of the exemptions currently listed in proposed Rule 5123(c) are likely to apply to the OTC Options, we believe the rule as currently written would apply to offers and sales of the OTC Options by FINRA members.

18 For example, an individual generally must have $10 million in "amounts invested on a discretionary basis" in order to qualify as an "eligible contract participant," but qualifies as a "qualified purchaser" with only $5 million in "investments."

Sincerely,

Michael A. Walinskas
Senior Vice President
Risk Management and Membership

cc: Wayne P. Luthringshausen (OCC)
William H. Navin (OCC)
Michael McClain (OCC)
James R. McDaniel (Sidley Austin LLP)

APPENDIX

Additional Description of Cleared OTC Options

OCC will calculate clearing margin for the OTC Options using its STANS margin system on the same basis as with listed index options. OCC does not presently contemplate imposing higher financial standards for clearing OTC Options. However, clearing members must be approved by OCC to clear OTC Options. Cleared OTC Options may be carried in a clearing member's firm account or in its securities customers' account, as applicable. Although customer positions in cleared OTC Options will be carried in the customers' account (an omnibus account), OCC will use a "customer ID" to identify positions of individual customers based on information provided by clearing members.[19] Positions are not presently intended to be carried in individual customer sub-accounts, and positions in OTC options will be margined at OCC in the omnibus customers' account on the same basis as listed options. If a clearing member takes the other side of a transaction with its customer in an OTC Option, the transaction will result in the creation of a long or short position (as applicable) in the clearing member's customers' account and the opposite short or long position in the clearing member's firm account. It is not currently anticipated that transactions in cleared OTC Options would be eligible for inclusion in market-maker accounts, although it is possible that market-makers in listed options could use cleared OTC Options to offset risk. Such trades should be includable in the applicable market-maker account as a regulatory matter, although this functionality may not be available immediately.

Each party to an OTC Option trade will enter the trade data into the system of MarkitSERV or another trade affirmation vendor (the "OTC Trade Source"). The OTC Trade Source will "match" or "affirm" the trade.[20] It will be permissible for parties to submit trades for clearance that were entered into bilaterally at any time in the past provided that the eligibility for clearance will be determined as of the date the trade is submitted to OCC for clearance, although this functionality may not be available at initial launch.[21] The OTC Trade Source will process the trade and submit it as a matched trade to OCC for clearing. If OCC accepts the trade, OCC will so notify the OTC Trade Source, which will notify the submitting parties. Customers of clearing members may have direct access to the OTC Trade Source for purposes of entering or affirming trade data and receiving communications regarding the status of transactions, in which case mechanisms will be put in place for a clearing member to authorize a customer to enter a trade for the clearing member's customers' account or for the clearing member to affirm a trade once entered.

OCC and MarkitSERV will adopt procedures to permit a customer that has an account with Clearing Member A ("CM A") to enter into an OTC Option transaction with Clearing Member B ("CM

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19 Such customer IDs are necessary in order to allow OCC to comply with the terms of OCC's license agreement with S&P.

20 If a trade is "matched", both sides of the trade will be entered into MarkitServ and the trade details will be compared and matched by MarkitServ. If a trade is "affirmed", a dealer will enter the trade details into MarkitServ and the other party to the trade will then view the information and affirm it if it is correct. Whichever method is used, OCC will receive a matched trade from MarkitServ.

21 OCC's license agreement with S&P imposes certain minimum requirements relating to time remaining to expiration of the OTC Option.

B") and have the position included in its account at CM A and cleared in CM A's customers' account at OCC.

Cleared OTC Options will be fungible with each other to the extent that there are cleared OTC Options in the system with identical terms. However, OCC will not treat cleared OTC Options as fungible with index options listed on any exchange, even if an OTC Option has terms identical to the terms of the exchange-listed option.

Clearing members that carry customer positions in cleared OTC Options will be subject to all OCC rules governing cleared options generally, as well as all applicable rules of the SEC and of any self-regulatory organization, including FINRA, of which they are a member.