

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49929; File No. SR-OCC-2004-04)

June 28, 2004

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change to Reduce the Thresholds Applied to Equity Options for Purposes of Exercise by Exception Processing on Expiration

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹, notice is hereby given that on March 19, 2004, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II, and III below, which items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

OCC is seeking to amend its rules to reduce the threshold amounts applied to equity options for purposes of exercise by exception processing on expiration.

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

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.²

(A) Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

¹ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by OCC.

The purpose of the proposed rule change is to amend OCC's Rule 805, "Expiration Date Exercise Procedure," which describes its expiration date exercise procedures including exercise by exception processing. Specifically, OCC proposes to reduce the threshold amounts used to determine equity options that are in the money for purposes of exercise by exception processing.

Background

OCC has for years maintained an "exercise by exception" procedure. Under that procedure, options that are in the money at expiration by more than a specified threshold amount are exercised automatically unless the clearing member carrying the position instructs otherwise. Equity options are determined to be in the money or not based on the difference between the exercise price and the closing price of the underlying equity interest on the last trading day before expiration. The current threshold for equity options is \$.75 in a clearing member's customers' account and \$.25 in any other account (*i.e.*, firm and market makers' accounts).

Discussion

OCC's Roundtable has proposed that the threshold amounts for equity options be reduced to \$.25 for customers' accounts and \$.15 in all other accounts.³ The Roundtable believes that reducing these thresholds will streamline expiration processing.

In response to the Roundtable's proposal, OCC analyzed equity options exercise information from the November 2003, December 2003, and January 2004 expirations. OCC's analysis determined that clearing members exercised 93% to 97% of equity option contracts

³ OCC's Roundtable is an OCC-sponsored advisory group comprised of representatives from OCC's participant exchanges, OCC, a cross-section of OCC clearing members, and industry service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and lower costs in the options industry.

carried in their customers' accounts that were in the money by \$.25 to \$.74 (*i.e.*, the change in the "in the money" amount represented by the proposed customer account threshold). OCC's analysis also determined that exercise activity in the proposed "other account" range (*i.e.*, with an in the money amount of \$.15 to \$.24) supported the proposed threshold change.

OCC also surveyed all clearing members to obtain their views and comments on the proposed change. Survey results demonstrated strong support across the membership for the change. Of 116 clearing members, 105 responded to the survey with 96 clearing members in favor of the threshold change.⁴ Clearing members supporting the change confirmed the Roundtable's view that it would significantly reduce the number of instructions they are required to input on expiration, thereby shortening the timeframe for completing instructions to OCC.

OCC contacted each firm that opposed the threshold change. These firms expressed a concern about having to input more "do not exercise" instructions. All of these firms agreed that they could adapt to the change if supported by the majority of clearing members. OCC reviewed the positions carried by these firms and determined that, on average, they carry position in fewer than ten expiring series that are below the current threshold of \$.75. This review led OCC to

conclude that the threshold change would result in only a slight increase in processing time for these firms and that they would not be unduly burdened by its implementation.

⁴ OCC also contacted clearing members that did not respond to its survey. These firms expressed no opinion on the matter.

The clearing member survey also asked firms to provide an estimate of the time needed to accommodate the threshold change based upon supplied timeframes.⁵ The majority of firms indicated that they could complete the necessary systems development and customer notifications within six months. OCC contacted any firm that commented on the proposed timeframes, and all expressed the view that their efforts would be completed in the six-month time period.

The Roundtable has requested of OCC that this change be implemented for the September 2004 expiration. OCC therefore requests that the Commission approve this rule filing by September 1, 2004, and authorize OCC to implement the threshold change thereafter based upon its assessment of clearing member readiness. If OCC determines that clearing members need additional time to complete preparations for the threshold change, OCC will implement the threshold change in accordance with such time needed. OCC anticipates implementation no later than for the October 2004 expiration. OCC will provide at least ten days' advanced notice to clearing members of the effective date for the new threshold amounts. Such notice will be provided through information memoranda and other forms of electronic notice such as e-mail.

OCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act⁶ and the rules and regulations thereunder applicable to OCC because it will promote the prompt and accurate clearance and settlement of securities transactions by increasing OCC's efficiency in processing exercise information of options on expiration.

⁵ The supplied timeframes were zero to three months and four to six months from the time of the survey.

⁶ 15 U.S.C. 78q-1.

(B) Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change will impose any burden on competition.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

As referenced in Item II(A), written comments were received in connection with the clearing member survey conducted by OCC. No other written comments were received, and no other written comments are intended to be solicited with respect to the proposed rule change, and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within thirty-five days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to ninety days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve such proposed rule change or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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-2004-04 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-OCC-2004-04. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change 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 inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC and on OCC's web site at <http://www.optionsclearing.com>. 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-2004-04 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland
Deputy Secretary

⁷ 17 CFR 200.30-3(a)(12).