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Invested in America

August 21, 2014

By Electronic Mail (rule-comments@sec.gov)
Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: OCC Request for Comment on SEC File No. SR-OCC-2014-15

Dear Ms. Murphy:

The Securities Industry and Financial Markets Association ("SIFMA")[1] appreciates the opportunity to comment on the above-referenced filing, which is a proposed rule change filed by The Options Clearing Corporation ("OCC") with the Securities and Exchange Commission ("Commission").[2] The OCC has filed a proposed rule change, that coupled with the related system modifications, will curtail use of a trading strategy know as "dividend plays" in the options industry. Specifically, OCC proposed to add an interpretation and policy to Rules 801 and 805, respectively, stating that "OCC will process all sales of options in a Market-Maker's account prior to the exercise of any long call options in the account to ensure that only net long positions in a particular series may be exercised."[3] For the reasons outlined below, SIFMA strongly agrees with OCC's request to curtail the trading strategy known as "dividend plays", and accordingly, SIFMA believes it is appropriate that the Commission approve OCC's added interpretation and policy to OCC Rules 801 and 805.

On December 3, 2012, SIFMA wrote a letter to OCC, stating that the Listed Options Trading Committee had concerns about the strategy known as "dividend trading." SIFMA recommended that OCC's Board of Director's review "dividend trades" due to the operational risk associated with processing them. SIFMA highlighted that "the risk of engaging in dividend trade strategies outweighs any potential profit for those who

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[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA"s mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

[2] *See* Securities Exchange Act Release No. 34-72677 (July 25, 2014), 79 FR 44480 (July 31, 2014).

[3] *Id.*

participate in this strategy."[4] In its filing, OCC states that "following receipt of the SIFMA letter, OCC initiated a comprehensive review of dividend plays."[5] SIFMA applauds the rigorous approach taken by OCC to evaluate the risk and other factors associated with "dividend trade" strategies, and whether any issues or unintended consequences would occur as a result of changing the processing sequence for Market-Makers. In its filing, OCC acknowledges that "dividend plays may be perceived negatively in the marketplace and have been criticized as unfair to retail investors and as distorting options transactions volume."[6] OCC determined "that while it should not take action to eliminate or restrict dividend plays based on these factors, nor should it facilitate these transactions."[7]

When traders execute a dividend play, they exercise 100% of their long call options, which "increases the overall percentage of open interest that gets exercised. OCC's standard assignment processing closes out a large portion of a traders' short position established that day, but will also close out a large portion of other, pre-existing market participants short positions. The larger the position taken by a trader executing a dividend play compared to the pre-existing open interest, the higher the proportion of pre-existing open interest that will be closed out, and a larger share of unassigned short positions will be left to the dividend play trader. For every short call position that is not assigned, a trader executing the dividend play does not have to deliver stock and is able to capture the dividend payment for the shares of stick it remains long."[8]

OCC states that the vast majority of dividend play activity occurs in Market-Maker accounts and as OCC states in their filing, the processing sequence utilized by OCC, makes it possible for market makers to execute conventional dividend plays. "OCC processes exercises after option purchases, but before options sales. This processing sequence permits a market maker executing a dividend play to buy and sell equal quantities of equal options of a given series and exercise the purchased call options even thought the market makers position is neutral."[9]

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[4] *See* Letter from Ellen Greene, Vice President of SIFMA, to Wayne Luthringshausen, Chairman and CEO of OCC, available at SIFMA.org http://www.sifma.org/issues/item.aspx?id=8589942317.

[5] See 79 FR at 44481.

[6] *See* SIFMA letter page 1.

[7] *See* 79 FR at 44482.

[8] *Id.*

[9] *See* FR at 44481.

In its rule proposal, the OCC has requested permission to modify the processing sequence, for options in Market-Maker accounts. "If OCC processed sales before exercises, market-makers' purchases and sales on a given day would offset each other, and when OCC processed the exercises, there would be no net long call positions to exercise. This would make the conventional dividend play impossible. However, OCC processes exercises before sales in order to reduce operational risk for clearing members clearing options transactions other than Market-Maker accounts."[10]

OCC explains in the filing that positions in accounts other than Market-Maker accounts are carried on a gross basis, which allows an account to be both long and short in the same series. Consequently, trades must be marked as opening or closing transactions for processing purposes. If OCC were to process sales before purchases in accounts other than Market-Maker accounts, a processing error could occur which would cause the exercise instructions to be rejected, potentially resulting in substantial losses. However, OCC states that coding errors do not present any issues or heightened risk for OCC because positions are carried for Market-Makers on a net basis and trades do not have to be coded as opening or closing.

In its filing, The OCC discussed JBO Participants' accounts, because the definition of "Market-Maker Account" under Article 1 of OCC's By-Laws includes JBO Participants' accounts. "At this time, OCC will not apply the new processing sequence to these accounts until they can adequately identify, on a subaccount basis, the transactions of a JBO Participant within JBO Participant accounts, in which case JBO Participants accounts shall be considered Market-Maker accounts."[11] SIFMA recommends that OCC continue their efforts to prevent and eliminate "dividend play" strategies so that traders are unable to exploit other approaches that allow them to utilize this strategy.

SIFMA strongly agrees with the OCC's proposed rule change, coupled with the related system modifications to reduce the use of a trading strategy known as "dividend plays." Accordingly, SIFMA believes it is appropriate that the Commission approve SR-OCC 2014-15.

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SIFMA greatly appreciates the SEC's consideration of SIFMA's comments in reference to the above. If you have any questions, please do not hesitate to contact me at (212) 313-1287 or egreene@sifma.org.

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[10] *Id.*

[11] *See* 79 FR at 44482.

Respectfully Submitted,

Elle Greene

Ellen Greene
Vice President

cc: Mary Jo White, Chairman, SEC
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