



UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

DIVISION OF
MARKET REGULATION

June 15, 2000

Mr. William H. Navin
Executive Vice President and General Counsel
The Options Clearing Corporation
440 South LaSalle Street, Suite 2400
Chicago, Illinois 60605-1050

Re: Definition of "Customer" for Purposes of the Hypothecation Rules

Dear Mr. Navin:

This responds to your letter dated August 26, 1999, in which you request on behalf of The Options Clearing Corporation ("OCC")¹ that the Division of Market Regulation ("Division") allow certain OCC Clearing Members² to treat certain affiliates as non-customers for purposes of Rules 8c-1³ and 15c2-1⁴ (the "hypothecation rules") of the Securities Exchange Act of 1934 ("Exchange Act").

Based on your letter and conversations with the staff of the Division, I understand the following facts to be pertinent to your request. The hypothecation rules prohibit, among other things, the commingling of customer securities with the securities of non-customers of a broker-dealer under a lien for a loan made to such broker-dealer. The term "customer" is

¹ OCC issues, clears, and settles all standardized options currently traded on national securities exchanges. Unlike trades in equity securities that clear or settle at several registered clearing agencies, OCC provides common clearing facilities for all listed securities options. OCC provides comprehensive options clearance and settlement services for its clearing members, including the maintenance of book-entry ownership interests in options for clearing members. Each OCC clearing member, in turn, may maintain several accounts with OCC.

² See Article I, Section 1 of OCC's By-Laws, which defines the term "Clearing Member."

³ 17 C.F.R. § 240.8c-1.

⁴ 17 C.F.R. § 240.15c2-1.

Mr. William H. Navin
June 15, 2000
Page 2

defined in paragraph (b)(1) of the hypothecation rules and excludes any general or special partner or any director or officer of such broker-dealer, or any participant, as such, in any joint, group or syndicate account with such broker-dealer or with any partner, officer, or director thereof. Accordingly, affiliates of a broker-dealer that are not otherwise excluded by paragraph (b)(1) are customers whose securities positions cannot be commingled with the securities positions of non-customers of the broker-dealer.

In your letter, you request that the Division not recommend enforcement action to the Securities and Exchange Commission ("Commission") if OCC Clearing Members hypothecate securities positions of certain affiliates ("Member Affiliates") that are customers for purposes of the hypothecation rules. In connection with your request, you propose to define a Member Affiliate as an affiliated entity of the Clearing Member that controls, is controlled by, or is under common control with the Clearing Member. A Member Affiliate that is not a broker-dealer and that wishes to permit the hypothecation of its securities would be required to consent to being treated as a non-customer under Rule 15c3-3⁵ of the Exchange Act by the Clearing Member and to agree to have its claims subordinated to the claims of the Clearing Member's Rule 15c3-3 customers in a liquidation under the Securities Investor Protection Act of 1970 ("SIPA"). You also propose to require Clearing Members to obtain from each non-broker-dealer Member Affiliate whose securities positions will be hypothecated an executed written non-conforming subordination agreement ("Agreement"), the minimum conditions of which are set forth below, in a form approved by the Clearing Member's Designated Examining Authority.⁶

Included within each Agreement, which shall be filed with the Clearing Member's Designated Examining Authority prior to the hypothecation of the Member Affiliate's securities positions, will be a written acknowledgment by the Member Affiliate that its securities account is not covered by SIPA and that any credit balances in the account are not subject to foreign customer protection. In addition, appropriate disclosure of these two points will be made by the Member Affiliate if the assets being pledged are not proprietary. The Agreement also will contain a written representation that the subordinated assets (funds and securities) are not those of U.S. customers. Further, an opinion of counsel will be filed with each Agreement to the effect that the Member Affiliate is legally authorized to subordinate all of its claims against such Clearing Member to the claims of other Rule 15c3-3 customers.

⁵ 17 C.F.R. § 240.15c3-3.

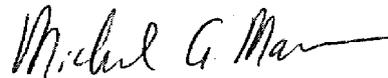
⁶ Non-conforming subordination agreements are subordination agreements that do not meet the requirements of Appendix D of Rule 15c3-1.

Mr. William H. Navin
June 15, 2000
Page 3

Under your proposal, Clearing Members will be able to hypothecate Member Affiliates' securities positions and include such positions in either their firm accounts or proprietary cross-margining accounts at OCC, which you believe will result in more favorable clearing margin treatment.

Based on the foregoing, the Division will not recommend enforcement action to the Commission if OCC Clearing Members hypothecate Member Affiliates' securities positions under your proposal described above without treating Member Affiliates as "customers" for purposes of Rules 8c-1 and 15c2-1. Please note that this is a staff position with respect to enforcement only and does not purport to express any legal conclusions. This position is based solely on the foregoing description. Factual variations could warrant a different response, and any material change in the facts must be brought to the Division's attention. This position may be withdrawn or modified if the staff determines that such action is necessary for the protection of investors, in the public interest, or otherwise in furtherance of the purposes of the securities laws.

Sincerely,



Michael A. Macchiaroli
Associate Director

cc: Ms. Jean Cawley, Options Clearing Corporation
Mr. Raymond Hennessy, New York Stock Exchange
Mr. Richard Lewandowski, Chicago Board Options Exchange
Mr. James McDaniel, Sidley & Austin
Mr. James McNeil, American Stock Exchange