

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55681; File No. SR-OCC-2007-03)

April 27, 2007

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Amendment No. 5 of the Restated Participant Exchange Agreement

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,¹ notice is hereby given that on March 13, 2007, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared substantially by OCC. OCC filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act² and Rule 19b-4(f)(4)³ thereunder so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would amend the Restated Participant Exchange Agreement (“RPEA”) between and among OCC and its six participant exchanges, which are the American Stock Exchange LLC, the Boston Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the International Securities Exchange, LLC (“ISE”), NYSE Arca, Inc., and the Philadelphia Stock Exchange, Inc.

¹ 15 U.S.C. 78s(b)(1).

² 15 U.S.C. 78s(b)(3)(A)(iii).

³ 17 CFR 240.19b-4(f)(4).

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 such statements.

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

The proposed rule change amends Sections 2(g) and 23 of the RPEA that obligates the participant exchanges to indemnify OCC against specified losses incurred in connection with the introduction of new products.

1. Background

New derivative products pose a variety of legal risks to OCC. While OCC generally declines to clear a product if it believes that there are valid concerns as to the product's legality, there can be no assurance that a product's legality will not be later challenged. Litigating such matters can be expensive, and an adverse outcome or settlement could result in substantial liabilities to OCC.

New products sometimes raise intellectual property ("IP") issues. For example, in January 2005 when the ISE proposed to trade unlicensed options on SPDRs, Standard & Poor's parent company, the McGraw-Hill Companies, sued ISE and OCC asserting that a license was required not only to trade options on a proprietary index but also options on an exchange trade

fund (“ETF”) based on a proprietary index.⁴ In May 2005, when ISE proposed to trade unlicensed options on DIAMONDS, Dow Jones & Company filed a similar action against ISE and OCC.⁵ (The two lawsuits were later consolidated and eventually dismissed by court order, which order was upheld on appeal.⁶) More recently, ISE and OCC were sued by the Chicago Board Options Exchange, Incorporated (“CBOE”) and two co-plaintiffs that asserted that ISE had proposed to trade unlicensed options on the S&P 500 Index and the Dow Jones Industrial Average in violation of exclusive license arrangement between CBOE and each of its co-plaintiffs.⁷

The current RPEA between and among OCC and the six options exchanges obligates the exchanges to indemnify OCC against specified losses (e.g., losses resulting from an exchange’s violation of the Act or the RPEA or failure to make adequate disclosure regarding a product that it trades). However, the current RPEA does not generally obligate the exchanges to indemnify OCC against losses resulting from a product’s illegality or against IP liability.⁸

⁴ The McGraw-Hill Companies, Inc. v. International Securities Exchange, Inc. and The Options Clearing Corporation, 05 Civ. 112 (HB) (U.S.D.C. S.D.N.Y.) In consideration of OCC’s agreeing to clear unlicensed SPDR options, ISE agreed to indemnify OCC against any resulting liabilities or expenses.

⁵ Dow Jones & Company, Inc. v. International Securities Exchange, Inc. and The Options Clearing Corporation, 05 CV 4954 (U.S.D.C. S.D.N.Y.) As in the SPDR case, *id.*, ISE agreed to indemnify OCC against any resulting liabilities or expenses.

⁶ Dow Jones & Co. v. International Securities Exchange, Inc., 451 F.3d 295 (2d Cir. 2006).

⁷ Chicago Board Options Exchange, Incorporated, et al v. International Securities Exchange, LLC and The Options Clearing Corporation, 06 CH 24798, Circuit Court of Cook County, Ill., Chancery Division.

⁸ OCC’s clearing agreement for futures products, which was drafted more recently than the RPEA, contains broader indemnification provisions. It obligates the futures exchange to indemnify OCC against losses resulting from the exchange’s violation of “any law or governmental regulation” and contains an express indemnity for IP liability.

2. Discussion

OCC is not obligated to clear a product if doing so would be illegal or would violate the IP rights of others.⁹ However, legal issues are not always identifiable in advance. For example, claims that a new product violates IP rights of third parties may not surface until after the product is already trading. Even when an issue is identified in advance, OCC's assessment of its seriousness may be erroneous.

For these reasons, no matter how carefully OCC analyzes new products, there will often be some legal risk. To mitigate this risk, OCC and its participant exchanges are amending the RPEA to obligate an exchange that introduces a new product to provide indemnification similar to that required of futures exchanges for which OCC provides clearing services.¹⁰ The terms of the amendment reflect the agreement of each participant exchange to severally, and not jointly, indemnify OCC and specified affiliates against losses and expenses incurred in connection with any action based on any options claim (i.e., a claim that the exchange does not have the right to trade an option or that the trading of such option by the exchange, that the issuance of such option by OCC or that the clearance and settlement of trades therein or exercises thereof by OCC would violate the IP or other rights of a third party).¹¹ In addition, the amendment redesignates

⁹ Section 3 of the RPEA provides that if a proposed underlying interest does not fall within certain specified categories, OCC cannot be required to clear options on it without the approval of its Board. Even when the interest does fall within the specified categories (e.g., a securities index), OCC could not be required to clear options on it if doing so would be unlawful.

¹⁰ See e.g., Filings No. SR-OCC-2006-18 (futures clearing agreement with PBOT) and 2003-06 (futures clearing agreement with CFE).

¹¹ New Sections 23(c) through (g) of the RPEA.

and makes certain technical changes in preexisting indemnification provisions.¹²

OCC believes that the proposed change is consistent with Section 17A of the Act of 1934 and the rules promulgated thereunder because it reduces the legal exposure borne by OCC in connection with issuing and clearing new derivative products introduced by its participant exchanges and thereby strengthening OCC's ability to perform its duties as a registered clearing agency. OCC further states that the proposed change contributes to the safeguarding of securities and funds in the custody or control of OCC and that the proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

B. Self-Regulatory Organization's Statement on Burden on Competition

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

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

OCC has not solicited or received written comments relating to the proposed rule change. OCC will notify the Commission of any written comments it receives.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act¹³ and Rule 19b-4(f)(4)¹⁴ thereunder because it effects a change in an existing OCC service that does not adversely affect the safeguarding of securities or funds in OCC's custody or control or for which it is responsible and does not significantly affect the respective rights or obligations of OCC or persons using the service. At any time within 60 days of the filing of the

¹² See Section 1 of Amendment No. 5 and redesignated Sections 23(c) and (h) of the RPEA.

¹³ 15 U.S.C. 78s(b)(3)(A)(iii).

¹⁴ 17 CFR 240.19b-4(f)(4).

proposed rule change, the Commission may summarily abrogate such rule if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

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 No. SR-OCC-2007-03 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington DC 20549-1090.

All submissions should refer to File No. SR-OCC-2007-03. 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, 100 F Street, NE, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at OCC's principal office and on OCC's Web site at <http://www.theocc.com/publications/rules/proposed_changes/proposed_changes.jsp>. 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 submission should refer to File No. SR-OCC-2007-03 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.¹⁵

Florence E. Harmon
Deputy Secretary

¹⁵ 17 CFR 200.30-3(a)(12).