

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57584; File No. SR-OCC-2007-16)

March 31, 2008

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Late Exercises

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on December 7, 2007, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission the proposed rule change as 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 persons.

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

The proposed rule change would amend OCC’s rules relating to the submission of late items and the fees associated with filing exercise notices after the start of critical processing.

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 purpose of this rule filing is to amend OCC’s (1) Rule 801 to modify the fee applied to exercise notices that are accepted by OCC after the start of critical processing, (2) Rule 805 to

¹ 15 U.S.C. 78s(b)(1).

make conforming changes to the filing fees applied to the submission of supplementary exercise notices tendered after critical processing, and (3) Rule 205 to clarify the unusual or unforeseen circumstances when OCC may extend the cut-off time for submitting instructions to OCC.

1. Background

Rule 801 addresses the exercise of options other than at expiration. Subject to specified exceptions and conditions, Rule 801(d) grants certain individuals² the discretion to permit a clearing member to file, revoke, or modify any exercise notice after the prescribed deadline for the purpose of correcting a bona fide error. However, the requesting clearing member is liable to OCC for a late filing fee in escalating increments and time segments. Currently, these fees are:

- (i) a fee of \$5,000 for any request accepted between the prescribed deadline and the start of critical processing (provided that the request does not materially affect such start time)³ and
- (ii) a filing fee of \$20,000 per line item listed on any exercise notice accepted for filing after the start of critical processing, with 50% of the fee to be distributed to the assigned clearing member or on a pro rata basis if more than one clearing member is assigned.⁴

Clearing members with short positions that have been assigned a late exercise are to receive notification thereof by 8:00 a.m. CT.

2. Discussion

At the March, 2007, OCC Roundtable meeting,⁵ a clearing member raised the issue of

² Those individuals are OCC's Chairman, Management Vice Chairman, President, or a designee of such officer.

³ The current deadline for submitting exercise notices is 7:00 p.m. CT.

⁴ OCC will accept exercises until as late as 6:30 a.m. However, OCC will not accept a request to revoke or modify an exercise after the start of critical processing.

⁵ 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

processing late exercises other than at expiration. The firm questioned the fairness of this process to option writers, noting that unexpectedly receiving additional assignments in the morning financially impacted the firm because its practice is to promptly review assignments from nightly processing and to hedge those obligations before the U.S. markets open. Expressing the view that late exercises permit a clearing member to shift liability for its own operational errors to another, the firm proposed that late exercises be eliminated to remedy this inequity and to cause clearing members to improve back office operations. After discussion, the Roundtable participants agreed to review the matter within their respective organizations and to revisit the topic at their next meeting.

In connection with its consideration of the matter, OCC reviewed the purpose served by permitting such exercises and recent processing of late exercise requests. Late exercises have long been allowed under OCC's rules to prevent clearing members from suffering severe economic losses due to bona fide operational errors. OCC determined that only a few late exercise requests were received during the period January 2006, through March 2007.⁶ Specifically, there were five requests for late exercises from five different firms relating to 14 line items with values ranging from \$124,000 to \$270,000. All requests were received after the start of critical processing, requiring OCC to run supplemental exercise procedures after nightly processing had been completed. Such processing was initiated following the 6:30 a.m. (CT) cut-

service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and lower costs in the options industry.

⁶ From April 2007 to October 2007 there were no requests to submit a late exercise although in each of June and September 2007, OCC received an inquiry regarding a possible submission. However, the clearing members involved elected not to formally file such a request.

off time for late exercise requests,⁷ and all assigned firms were notified before the 8:00 a.m. (CT) deadline. As specified in Rule 801(d), fifty percent of the \$20,000 per line item filing fee was distributed to assigned clearing members.

Although no late exercise requests were received between the deadline for submitting exercises and the start of critical processing during the above-referenced review period, OCC also determined that, upon request, its operations staff would extend the deadline by a reasonable period in the event an exchange, clearing member, or OCC experienced system or operational problems that prevented one or more clearing members from submitting exercises on a timely basis.⁸ The payment of the applicable filing fee in such instances was not required nor has it typically been required for requests received before the start of critical processing.

After carefully weighing the purpose and recent uses of the late exercise rule versus the fairness issue, OCC determined that it would be appropriate to retain the late exercise rule with certain modifications. Accordingly, OCC proposes to raise the filing fee for late exercise requests submitted post-critical processing from \$20,000 to \$75,000 per line item.⁹ This change is intended to provide an incentive for firms to improve back office processing by increasing the cost of filing late exercise requests after the start of critical processing as well as to provide

⁷ Systemic and operational constraints preclude OCC from processing late exercise requests at an earlier time.

⁸ Subject to OCC's need to start critical processing, the deadline for submitting exercise notices may be extended if "unforeseen conditions" prevent their submission by a clearing member (OCC Rule 205). OCC has concluded that its authority to extend such deadlines should more explicitly reference systemic or operational problems or other unforeseen conditions experienced by additional industry participants that may impact the timely submission of exercise notices.

⁹ OCC's management's proposal was presented at the June 2007 Roundtable meeting. The Roundtable determined that OCC's management should decide whether to recommend the proposal to OCC's Board of Directors.

greater compensation to clearing members receiving “late assignments” while at the same time preserving the ability of firms to correct bona fide operational errors. To reflect current operating procedures, OCC proposes to eliminate the \$5,000 filing fee for late exercise requests filed prior to the start of critical processing. For consistency, OCC also proposes to modify the fees applicable to the submission of supplementary exercise notices at expiration as set forth in Rule 805.¹⁰ Accordingly, OCC will amend Rule 805’s filing fees to conform them to the changes being made in Rule 801.

OCC states that the proposed change is consistent with Section 17A of the Act¹¹ because it promotes the prompt and accurate clearance and settlement of securities transactions by providing an incentive for clearing members to improve back office processing with respect to determining positions for which an exercise notice is to be submitted, while preserving their ability to correct bona fide operational errors. In addition, 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 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

OCC has not solicited or received written comments with respect to the proposed rule change.

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

¹⁰ It has been at least five years since a supplementary exercise notice has been submitted for processing.

¹¹ 15 U.S.C. 78q-1.

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-2007-16 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 Number SR-OCC-2007-16. 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 Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such filing also will be available for inspection and copying at OCC's principal office and on OCC's web site (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 submissions should refer to File No. SR-OCC-2007-16 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Trading and Markets pursuant to delegated authority.¹²

Florence E. Harmon
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).