

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54306; File No. SR-OCC-2006-05)

August 11, 2006

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Expiration Date Exercise Procedures

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on April 26, 2006, 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 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 Substance of the Proposed Rule Change

The proposed rule change would amend Rule 805, which describes expiration date exercise procedures including exercise by exception 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.<sup>2</sup>

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> The Commission has modified parts of these statements.

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

The proposed rule change would amend Rule 805, Expiration Date Exercise Procedure, to reduce the threshold amounts used to determine the equity options that are in the money for purposes of exercise by exception processing. A conforming change would also be made to Rule 1106, Open Positions, which concerns the treatment of open positions following the suspension of a clearing member.

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. In September 2004, in order to streamline expiration processing, OCC reduced the threshold amounts for equity options from \$.75 to \$.25 in a clearing member’s customers’ account and from \$.25 to \$.15 in any other account (i.e., firm and market makers’ accounts).<sup>3</sup> This change, which was implemented at the request of the OCC Roundtable,<sup>4</sup> immediately yielded significant benefits to both OCC and clearing members as the time for submitting exercise instructions was reduced by one to three hours on an average expiration weekend.

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<sup>3</sup> Securities Exchange Act Release No. 50178 (August 10, 2004), 69 FR 51343 (August 18, 2004) [File No. SR-OCC-2004-04].

<sup>4</sup> The OCC 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.

Increasing options volumes in 2004 and 2005 prompted the OCC Roundtable to review the thresholds applied to equity options in an effort to further reduce operational risks and improve expiration processing. Initially, the Roundtable proposed that the threshold for all account types be set at \$.01, but an OCC survey of clearing members found that while 65% of responding clearing members supported this change, 35% were against it. A second OCC survey determined that 75% of responding clearing members were in favor of a threshold change to \$.05 for all account types and 25% were opposed to it. The Roundtable then requested that OCC establish \$.05 as the threshold applicable to equity options exercises for all account types.

In response to this request, OCC analyzed equity options exercise information from the June 2004 through December 2005 expirations. OCC's analysis determined that 70% of equity option contracts carried in clearing members' customers' accounts that were in the money by the amount of \$.05 to \$.24 (i.e., the change in the "in-the-money" amount represented by the proposed threshold) were exercised. OCC's analysis also determined that exercise activity in other account ranges supported the proposed threshold change.

OCC surveyed all clearing members to obtain their views and comments on the proposed change to \$.05 as the threshold amount for equity options for all account types. Survey results demonstrated strong support across the membership for the change. Eighty-seven clearing members<sup>5</sup> responded to the survey with sixty-five clearing members (75 percent) in favor of the threshold change and 22 clearing members (25 percent) opposed. 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 are generally mid-size to small retail clearing members. Their opposition to the change reflected their principal concern about having to input more “do not exercise” instructions. Some indicated concerns about the need to educate customers and the possibility that commission costs could make an exercise unprofitable.<sup>6</sup> However, all of these firms agreed that they could adapt to the change if supported by the majority of clearing members. OCC further reviewed the positions carried by these firms and determined that, on average, they carry positions in fewer than 10 expiring series per expiration that are below the current threshold of \$.25. 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.

OCC’s survey of clearing members also asked firms to provide an estimate of the time needed to accommodate the threshold change based upon supplied time frames (e.g., 0-3 months or 4-6 months). The majority of firms indicated that they could complete the necessary systems development and customer notifications within six months. OCC contacted every firm that commented on the proposed time frames, and all expressed the view that their efforts would be completed in the six month time period.

The Roundtable has recommended that this change be implemented for the October 2006 expiration. OCC therefore requests that the Commission approve the proposed rule change with an effective date of October 1, 2006, and that the Commission authorize OCC to implement the

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<sup>5</sup> OCC contacted clearing members that did not respond to its survey. These firms expressed no opinion on the matter.

<sup>6</sup> As noted, clearing members are able to instruct OCC not to exercise an expiring equity option.

threshold change thereafter based upon its assessment of clearing member readiness. OCC would provide at least ten days advance notice to clearing members of the effective date for the new threshold amounts by information memoranda and other forms of electronic notice such as email. Additionally, OCC would allow clearing members additional time to complete preparations for the threshold change if necessary.

OCC believes that the proposed rule change is consistent with Section 17A of the Act because it facilitates the prompt and accurate processing of exercise information on expiration.

(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

Written comments were not and are not 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 35 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 90 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 the 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](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2006-05 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-2006-05. 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 the principal office of OCC and on OCC's Web site at [www.optionsclearing.com](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-2006-05 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.<sup>7</sup>

Nancy M. Morris  
Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).