

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49470; File No. SR-OCC-2004-03)

March 25, 2004

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Amending OCC's Rules to Provide for Use of a Give-Up Service Provider and Revising OCC's Fee Schedule

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on March 16, 2004, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change described in Items I and II below, which items have been prepared primarily by OCC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposal.

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

The purpose of the proposed rule change is to provide for OCC's use of a "give-up service provider" that will act as an intermediary in reporting certain futures and futures option transactions to OCC and to amend OCC's fee schedule to offset the costs OCC will incur in utilizing a give-up service provider.

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

¹ 15 U.S.C. 78s(b)(1).

below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.²

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

1. Introduction

The proposed rule change responds to a request by CBOE Futures Exchange, LLC (“CFE”) that OCC provide its clearing members with the ability to accept or reject on a trade-by-trade basis trades executed on CFE and given up for the account of a clearing member by another clearing member.

Although the ability to accept or reject give-ups on a trade-by-trade basis is standard in the futures markets, OCC’s clearing system is not currently configured to provide these capabilities. In order to make this function available to clearing members that trade or clear trades executed on CFE, OCC has entered into a Master Processing Services Agreement (“Services Agreement”) with The Clearing Corporation (“TCC”).

As part of the Services Agreement, OCC has agreed to pay TCC certain fees in connection with the services provided by TCC. OCC will pass some of these fees through to CFE pursuant to terms of the Implementation Agreement for Clearing and Settlement Services (“Implementation Agreement”). OCC will pass per-transaction fees charged by TCC through to clearing members in accordance with OCC’s fee schedule. To the extent that the revenues generated from such transaction fees do not cover OCC’s minimum transaction payment obligations to TCC, CFE will compensate OCC for the shortfall pursuant to the Implementation Agreement.

² The Commission has modified the text of the summaries prepared by OCC.

2. Give-Up Services

Transactions given up by one OCC clearing member to another OCC clearing member are currently governed by OCC's Clearing Member Trade Assignment ("CMTA") processing and CMTA agreements that are standard in the options industry. Under a CMTA agreement, an OCC clearing member ("carrying clearing member") authorizes another clearing member ("executing clearing member") to give up the name of the carrying clearing member with respect to any trade executed on a specific exchange. Unless the CMTA agreement has been revoked, the carrying clearing member is responsible for all trades given up to it by the executing clearing member on that exchange. A carrying clearing member may return positions to the executing clearing member only under the very limited circumstances specified in the CMTA agreement. If one of those circumstances arises and the carrying clearing member notifies OCC before a specified cutoff time, OCC will return the position to the executing clearing member. Because CMTA agreements do not require contract-by-contract acceptance of give-up trades but rather presume that the trade is properly given-up to the carrying clearing member, OCC's clearing system accepts as final and accurate trades received in matched trade reports from an exchange unless OCC is notified of a return by the carrying clearing member before the cutoff time.

In contrast to the CMTA processing used by OCC, futures clearinghouses typically allow a carrying clearing member to accept or reject on a trade-by-trade basis trades given up to the carrying clearing member by an executing clearing member. CFE has requested that, in accordance with futures industry custom, OCC carrying clearing members be provided with the opportunity to accept or reject on a trade-by-trade basis trades executed on CFE and given up for their accounts by executing clearing members. Because OCC's clearing system is not currently configured to require a carrying clearing member to review and accept a trade after the trade has

been reported to OCC, OCC has entered into the Services Agreement with TCC. Pursuant to the Services Agreement, TCC will provide certain post trade execution services to OCC in support of certain futures and futures options contracts traded on CFE. The Services Agreement provides a process by which TCC may agree to provide similar services for other futures and futures options contracts traded on CFE and for other futures markets that are affiliated with OCC's current participant exchanges ("affiliated futures markets").

Pursuant to the Services Agreement, TCC will receive all matched trades reported by an affiliated futures market, advise clearing members of those trades on a real-time basis, accept any clearing member changes to noncritical trade data, accept clearing member give-ups and responses to give-ups, permit clearing members to enter average pricing information for their transactions, and permit clearing members to give-up trades as of the trade date on a date after the trade date. TCC will also send real-time trade and give-up data to OCC in a matched trade layout and at the end of each trading day will report final trade data to OCC. OCC will accept for clearance all trades reported by TCC to OCC in accordance with the Services Agreement as if the trades had been reported directly by the exchange to OCC. TCC will not guarantee or otherwise have any financial responsibility for such trades. In essence, TCC functions as a front end service provider to OCC's system, providing certain trade processing services that neither the exchanges' nor OCC's systems currently provide.

The Services Agreement is essentially an agreement for TCC to provide computer services to OCC on a contract basis. It contains provisions typical of a computer services outsourcing agreement. Of note with respect to the parties' roles in the clearing process are Section 3(b) which states that OCC and its clearing members will have financial responsibility for the clearance and settlement of all trades processed by TCC and Section 3(c) which states

that OCC will require the affiliated futures exchanges to report matched trade information to TCC. Sections 5(b) and (c) require that TCC have and maintain a disaster recovery plan and audit TCC's system of receiving trades from the affiliated futures markets to ensure that the system is functioning properly. Section 9 describes the fees payable by OCC for TCC's services including: (a) start-up fees; (b) fees of 6 cents per matched contract with minimum guaranteed transaction fees of \$150,000 per year per market for the first two markets for which TCC provides services and of \$50,000 per year for each additional market; and (c) fees for additional work requested by OCC. Under Section 10, the term of the Services Agreement is three years with annual renewal terms of one year.

OCC has the right to terminate the Services Agreement without cause before the end of the three-year term. The Services Agreement will terminate automatically on May 1, 2005, if trading in contracts as to which TCC provides services under the Services Agreement has not yet begun. Under either of those termination scenarios, OCC would be required to make certain payments to TCC as provided in Section 10 of the Services Agreement, but under the Implementation Agreement, the affiliated futures market would be required to reimburse OCC for those payments. Section 15 mandates that OCC include certain language in its rules limiting the liability of TCC.

OCC will be responsible for payment to TCC of all fees required under the Services Agreement. OCC will also accept responsibility to perform or to require performance of those tasks required of OCC or an affiliated futures market. In order to ensure that affiliated futures markets accept ultimate responsibility for fees and other requirements set forth in the Services Agreement that are appropriately attributable to those markets, OCC will enter into an Implementation Agreement with each affiliated futures market that requests that OCC use TCC's

services. OCC has already entered into an Implementation Agreement with CFE.

The Implementation Agreement establishes the financial and other obligations of OCC and passes through to the affiliated futures market certain costs and other obligations that are the responsibility of OCC under the Services Agreement. The Implementation Agreement provides that each affiliated futures market will be required to guarantee payment to OCC of any deficiency that might result between the amount paid by OCC to TCC and the yearly transaction fee minimum. For example, assume the yearly applicable minimum is \$150,000 (which at 6 cents/contract represents 2.5 million contracts). If only 2 million contracts are processed by TCC during the applicable year, the affiliated futures market will be obligated to pay OCC \$30,000 (500,000 contracts at 6 cents/contract). OCC will pay TCC on a monthly basis throughout the year and will receive any payments due from an affiliated futures market at the end of the calendar year. An affiliated futures market will also be obligated to reimburse OCC for any money OCC pays to TCC to expand the scope of TCC's give-up services, provided the request for such work was initiated by the affiliated futures market and for any fees payable by OCC to TCC in connection with the early termination of the Services Agreement.

In order to implement the give-up process outlined above under OCC's By-Laws and Rules, OCC is adding the terms "affiliated futures market" and "give-up service provider" as defined terms in Article I, Section 1 of OCC's By-Laws. A futures market or security futures market is an "affiliated futures market" if it is at least 50% owned by a participant exchange or is under the ownership of an entity which also owns, directly or indirectly, at least 50% of a participant exchange. Changes are also being made to Article XII, Section 1 to incorporate the new "affiliated futures market" term.

"Give-up service provider" refers generically to TCC and any other entity that has agreed

with OCC to provide post trade execution services to OCC in support of futures and futures options trading on one or more affiliated futures markets. New language is added to Rule 401 to indicate that if a give-up service provider is reporting to OCC transactions executed on an affiliated futures market, matched trade information from the give-up service provider shall be deemed to be submitted to OCC by such affiliated futures market for all purposes of OCC's By-Laws and Rules. OCC will not be obligated with respect to any transaction until it receives matched trade information from the give-up service provider as required in OCC's By-Laws and Rules. Proposed Rule 404(a) is added to describe a give-up service provider and its functions. Proposed Rules 404(b)-(d) set forth specific services that will be provided to clearing members as well as the rights and obligations of clearing members who take advantage of those services. Proposed Rules 404(e)-(g) add provisions limiting the liability of TCC as provided in Section 15 of the Services Agreement with TCC.

Interpretation and Policy .01 following Rule 404 makes provision for clearing members to submit "as-of give-up" trades to the extent not inconsistent with exchange rules or applicable law. An as-of give-up is typically used where a trade was given-up or intended to be given up on the trade date but either the "Give-Up Clearing Member" inadvertently failed to do so or the "Given-Up Clearing Member" neglected to accept the give-up.

Interpretation and Policy .02 provides that clearing members may give average pricing information to TCC to the extent not prohibited by exchange rules or applicable law. Average pricing is permitted under the Commodity Exchange Act in certain circumstances. In those circumstances, a clearing member may submit instructions to TCC to report the average price for two or more transactions in the same series of futures or options that were executed at different prices. OCC will use the average price in clearing and settling the trades.

3. Revised Fee Schedule

Futures clearing transaction fees are based on a fee election made by each futures market. OCC currently permits futures markets to elect between a 7 cent fixed rate schedule (7 cents/side with a sliding scale discount for large transactions) and the fee schedule applicable to securities options (9 cents “floating”). OneChicago and Nasdaq Liffe Markets, LLC (“NQLX”), the futures markets currently cleared by OCC, have both elected the 7 cent fixed rate schedule.

Affiliated futures markets that request that OCC utilize TCC’s services will also be able to elect between the two fee schedules. However, in order to help offset the additional costs that OCC will incur to make TCC’s services available, a “give-up charge” of 7 cents per give-up will be implemented by OCC. This fee is effectively one-half the fee charged by other futures clearinghouses, including TCC, because OCC will only charge the executing side of the give-up rather than both sides as do other futures clearinghouses.

OCC is also making two changes to the 7 cent fixed rate futures clearing fee schedule when TCC’s services are being used. First, OCC is removing the cap applicable to large futures block transactions. The current cap provides that a trade totaling greater than two thousand contracts is assessed a flat \$85 clearing fee. However, under Section 9(a) of the Services Agreement, TCC charges OCC a 6 cent per contract clearing fee with no fee break for block size transactions. If OCC does not modify its fee schedule, it will be required to pay out to TCC more than it receives for large trades that generate fees for TCC in excess of \$85. To avoid this result, OCC is amending its fee schedule so that trades greater than two thousand contracts will be charged 3 cents per side (6 cents total). Second, OCC is removing the fee break it gives to new futures contracts. OCC currently does not charge a fee for the first month a contract trades and implements a graduated phase-in of fees for the second and third months of trading in such

contracts. However, Section 9(a) of the Services Agreement does not provide a similar fee waiver, and OCC will therefore not waive fees with respect to new contracts for which TCC's services are used.

The proposed rule change is consistent with the requirements of Section 17A of the Act³ and the rules and regulations thereunder applicable to OCC because it is designed to promote the prompt and accurate clearance and settlement of derivative transactions, assure the safeguarding of securities and funds which are in the custody or control of OCC, and, in general, to protect investors and the public interest by allowing OCC to provide its clearing members with the ability to accept or reject on a trade-by-trade basis trades executed on CFE and given-up for their account by another clearing member.

(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

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of Section 17A(b)(3)(F).⁴ Section 17A(b)(3)(F) requires that the rules of a clearing agency be

³ 15 U.S.C. 78q-1.

⁴ 15 U.S.C. 78q-1(b)(3)(F).

designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and, in general, to protect investors and the public interest. The Commission finds that the approval of OCC's rule change is consistent with this section because it will allow OCC to protect itself, its clearing members, and ultimately investors, by providing its clearing members with the ability to accept or reject on a trade-by-trade basis trades in certain futures and futures options executed on CFE and given-up for their accounts by other clearing members.

OCC has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of the notice of the filing. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the publication of notice because such approval will allow OCC to implement the proposed rule change before March 26, 2004, when CFE commences trading certain futures and futures options to be cleared and settled by OCC.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Comments may also be submitted electronically at the following e-mail address: rule-comments@sec.gov. All comment letters should refer to File No. SR-OCC-2004-03. 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, comments should be sent either in hardcopy or by e-mail but not by both methods. 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, 450 Fifth Street, NW, 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 website at www.optionsclearing.com. All submissions should refer to File No. SR-OCC-2004-03 and should be submitted by [insert date 21 days from the date of publication in the Federal Register].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁵ that the proposed rule change (File No. SR-OCC-2004-03) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland
Deputy Secretary

⁵ 15 U.S.C. 78s(b)(2).

⁶ 17 CFR 200.30-3(a)(12).

