

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52783; File No. SR-OCC-2003-13)

November 16, 2005

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Establish a Comprehensive Standard of Care and Limitation of Liability with Respect to Clearing Members

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ notice is hereby given that on November 5, 2003, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) and on August 18, 2004, amended² the proposed rule change as described in Items I, II, and III below, which items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested parties.

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

OCC is seeking to establish gross negligence as its comprehensive standard of care and limitation of liability with respect to its clearing members.³

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

¹ 15 U.S.C. 78s(b)(1).

² Letter from William H. Navin, Executive Vice President, General Counsel, and Secretary, OCC (August 17, 2005).

³ OCC’s proposed rule change would not affect the regulatory standards (*e.g.*, Section 17A of the Act) that apply to OCC or the way in which OCC conducts its clearing agency operations.

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 these statements.⁴

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

In 1980 in its release setting forth standards for registration of clearing agencies, the Division of Market Regulation stated that it was “of the view that clearing agencies should undertake to perform their obligations with a high degree of care.”⁵ Later, in 1983 in its release registering nine clearing agencies, the Commission stated that it did “not believe sufficient justification exists at this time to require a unique federal standard of care for registered clearing agencies.”⁶ The Commission has left to user-governed clearing agencies the question of how to allocate losses associated with, among other things, clearing agency functions. Along this line, in 1986 in its order approving a proposed rule change of the Midwest Securities Trust Company (“MSTC”) to clarify the rights and liabilities of the MSTC and its participants with respect to certain services, the Commission stated:

The Act does not specify the standard of care that must be exercised by registered clearing agencies and the Commission has determined that imposition of a unique federal standard of care for registered clearing agencies is not appropriate at this time. [citing Securities Exchange Act Release No. 20221, supra note 5] For

⁴ The Commission has modified the text of the summaries prepared by OCC.

⁵ Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 45167 (June 23, 1980).

⁶ Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (October 3, 1983).

those reasons the Commission believes that the clearing agency standard of care and the allocation of rights and responsibilities between a clearing agency and its participants applicable to clearing agency services generally may be set by the clearing agency and its participants. The Commission believes it should review clearing agency proposed rule changes in this area on a case-by-case basis and balance the need for a high degree of clearing agency care with the effect resulting liabilities may have on clearing agency operations, costs, and safeguarding of securities and funds.⁷

Because standards of care represent an allocation of rights and liabilities between a clearing agency and its users, which are generally sophisticated financial entities, the Commission has continued to refrain from establishing a unique federal standard of care and has allowed clearing agencies and other self-regulatory organizations and their users to establish their own standards of care.⁸

With this proposed rule change, OCC is seeking to establish a comprehensive gross negligence standard of care and limitation of liability with respect to its clearing members and makes the following representations. OCC states in the filing that since its founding in 1973, it has performed its clearing services with an exemplary level of care. Its record of fulfilling its commitments to its clearing members for over 30 years reflects OCC's commitment to serving the best interests of its clearing members. It has comprehensive systems and operating

⁷ Securities Exchange Act Release No. 22940 (February 24, 1986), 51 FR 7169 (February 28, 1986).

⁸ See, e.g., Securities Exchange Act Release Nos. 51669 (May 9, 2005), 70 FR 25634 (May 13, 2005) [File No. SR-NSCC-2004-09]; 48201 (July 21, 2003), 68 FR 44128 (July 25, 2003) [File No. SR-GSCC-2002-10]; 37563 (August 14, 1996), 61 FR 43285 (August 21, 1996) [SR-PSE-96-21]; and 37421 (July 11, 1996), 61 FR 37513 (July 18, 1996) [SR-CBOE-96-02].

procedures in place to ensure that its clearing functions are executed with the highest level of accuracy. In addition to its own concern for accuracy, it is subject to extensive regulatory oversight by the Commission. Furthermore, in its amendment to the filing, OCC states that gross negligence is the standard of care generally used by other clearing agencies such as the Fixed Income Clearing Corporation, the decision to apply a gross negligence standard of care to OCC is a conscious allocation of risk between OCC and its members, the filing was unanimously approved by OCC's directors, a majority of whom are officers of clearing members, and the proposed rule change in no way will affect the very high level of care to which OCC has always held itself and to which it is held through the regulatory oversight of the Commission.⁹ As such, OCC believes that a gross negligence standard of care is appropriate for OCC.¹⁰

⁹ Supra, letter from William H. Navin, n. 2.

¹⁰ Specifically, OCC is proposing to amend Article VI of its By-Laws, "Clearance of Exchange Transactions," by adding new Section 25, "Limitation of Liability," which would state:

(a) Notwithstanding any other provision in the By-Laws and Rules, the Corporation will not be liable for any action taken, or any delay or failure to take any action, under the By-Laws and Rules or otherwise, to fulfill the Corporation's obligations to its Clearing Members, other than for losses caused directly by the Corporation's gross negligence, willful misconduct, or violation of federal securities laws for which there is a private right of action. Under no circumstances will the Corporation be liable for the acts, delays, omissions, bankruptcy, or insolvency of any third party, including, without limitation, any bank or other depository, custodian, sub-custodian, clearing or settlement system, data communication service, or other third party, unless the Corporation was grossly negligent, engaged in willful misconduct, or was in violation of

OCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act¹¹ and the rules and regulations thereunder applicable to OCC because it will permit the resources of OCC to be appropriately utilized for promoting the prompt and accurate clearance and settlement of options transactions and for providing for the safeguarding of securities and funds in its custody or control or for which it is responsible.

(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.

(.continued)

federal securities laws for which there is a private right of action, in selecting such third party; and

(b) Under no circumstances will the Corporation be liable for any indirect, consequential, incidental, special, punitive or exemplary loss or damage (including, but not limited to, loss of business, loss of profits, trading losses, loss of opportunity and loss of use) however suffered or incurred, regardless of whether the Corporation has been advised of the possibility of such damages or whether such damages otherwise could have been foreseen or prevented.

¹¹ 15 U.S.C. 78q-1.

(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 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, as amended, 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-2003-13 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-OCC-2003-13. 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.theocc.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-2003-13 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.¹²

Jonathan G. Katz
Secretary

¹² 17 CFR 200.30-3(a)(12).

