

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53053; File No. SR-OCC-2003-13)

January 5, 2006

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

I. Introduction

On November 5, 2003, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) and on August 18, 2004, amended¹ proposed rule change SR-OCC-2003-13 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).² Notice of the proposal was published in the Federal Register on November 23, 2005.³ No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

In its 1980 release setting forth standards for registration of clearing agencies, the Commission’s 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.”⁴ In its 1983 order 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

¹ Letter from William H. Navin, Executive Vice President, General Counsel, and Secretary, OCC (August 17, 2005).

² 15 U.S.C. 78s(b)(1).

³ Securities Exchange Act Release No. 52783 (November 16, 2005), 70 FR 70910.

⁴ Securities Exchange Act Release No. 16900 (June 17, 1980), 45 FR 45167 (June 23, 1980).

agencies.”⁵ 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 its 1986 order approving a proposed rule change of the Midwest Securities Trust Company (“MSTC”) to clarify the rights and liabilities of 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 6] For 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.⁶

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

⁵ Securities Exchange Act Release No. 20221 (September 23, 1983), 48 FR 45167 (October 3, 1983).

⁶ Securities Exchange Act Release No. 22940 (February 24, 1986), 51 FR 7169 (February 28, 1986).

agencies and other self-regulatory organizations and their users to establish their own standards of care.⁷

With this rule change, OCC is establishing a comprehensive gross negligence standard of care and limitation of liability with respect to its clearing members. In connection with this filing, OCC has made the following representations. OCC states in its original 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 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 (1) gross negligence is the standard of care generally used by other clearing agencies such as the Fixed Income Clearing Corporation, (2) the decision to apply a gross negligence standard of care to OCC is a conscious allocation of risk between OCC and its members, (3) the filing was unanimously approved by OCC's directors, a majority of whom are officers of clearing members, and (4) 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

⁷ 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].

of the Commission.⁸ As such, OCC believes that a gross negligence standard of care is appropriate for OCC.⁹

III. Discussion

Section 19(b) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.

⁸ Letter from William H. Navin, supra, n. 1.

⁹ Specifically, OCC is amending Article VI of its By-Laws, “Clearance of Exchange Transactions,” by adding new Section 25, “Limitation of Liability,” which states:

(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 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

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control.¹⁰ The Commission believes that OCC's rule change is consistent with this Section because it will permit the resources of OCC to be appropriately utilized to protect funds and assets.¹¹

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.¹²

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damages or whether such damages otherwise could have been foreseen or prevented.

¹⁰ 15 U.S.C. 78q-1(b)(3)(F).

¹¹ The Commission notes that OCC's adoption of a comprehensive gross negligence standard of care and limitation of liability with respect to its clearing members does not affect the regulatory standards (e.g., those set forth in Section 17A of the Act) that apply to OCC or the way in which OCC conducts its clearing agency operations.

¹² The Commission notes that the rule change does not alleviate OCC from liability for violation of the Federal securities laws where there exists a private right of action and therefore is not designed to adversely affect OCC's compliance with the Federal securities laws and private rights of action that exist for violations of the Federal securities laws.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2003-13) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹³

Nancy M. Morris
Secretary

¹³ 17 CFR 200.30-3(a)(12).

