

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53425; File No. SR-OCC-2005-19)

March 6, 2006

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving Proposed Rule Change Relating to Submission of Exercise Notices for American Option Contracts other Than at Expiration

I. Introduction

On December 12, 2005, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-OCC-2005-19 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”).¹ Notice of the proposal was published in the Federal Register on January 18, 2006.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

II. Description

The purpose of the proposed rule change is to modify OCC Rule 801, which applies to the submission of exercise notices for American-style option contracts other than at expiration, to delete specific references to the times when such exercise notices may be submitted and to instead provide OCC with the authority to prescribe the time frames for their submission. Implementing this change requires additional conforming changes to Rule 801 as described herein.

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 53090 (January 10, 2006), 71 FR 2973.

Rule 801

Rule 801(a) permits a clearing member desiring to exercise an American-style equity or non-equity option on a business day other than the business day prior to its expiration to submit an exercise notice to OCC between 9:00 a.m. and 7:00 p.m. provided that an exercise notice for an American-style currency option must be submitted by 2:30 p.m.³ (All times are at Central Time.) Exercise instructions submitted with respect to equity and non-equity options become irrevocable at 7:00 p.m. and 2:30 p.m. in the case of currency options unless the exercise instruction has been modified or revoked by a clearing member because of a bona fide error by the clearing member or its customer in accordance with the procedures prescribed by OCC.

Rule 801(b) allows the OCC Board of Directors to designate with not less than seven days' prior written notice to non-equity securities clearing members a cut-off time earlier than that specified in Rule 801(a) as the deadline for submitting exercise notices with respect to American-style non-equity option contracts and the time when such exercise notices become irrevocable.

Subject to specified exceptions and conditions, Rule 801(e) grants certain OCC employees⁴ the discretion to permit a clearing member to file, revoke, or modify any exercise notice submitted in accordance with Rule 801(a) after the 7:00 p.m. deadline for the purpose of correcting a bona fide error. One condition is that the requesting clearing member is liable to OCC for a late filing fee in escalating increments and time segments. The late filing fee is as follows:

³ Except for short dated options, an American-style option may not be exercised on the business day prior to its expiration date.

⁴ Those employees are OCC's Chairman, Management Vice Chairman, President, or a designee of such officer.

- \$2,000 for any request accepted between 7:00 p.m. and 8:00 p.m.;
- \$5,000 for any request accepted between 8:01 p.m. and the start of critical processing provided that the request does not materially affect the start of critical processing; and
- \$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 clearing members on a pro rata basis if more than one clearing member is assigned.

Changes to Rule 801

The operational and processing efficiencies gained from real-time trade submission have prompted the OCC Roundtable⁵ to propose that OCC advance the 7:00 p.m. cut-off time for submission of post-trade instructions, including exercise notices, by clearing members on regular business days. The Roundtable believes that an earlier deadline for filing such instructions would further straight-through processing goals by permitting OCC to move forward the times when it initiates nightly processing and distributes data to members.

Although current discussions have centered on a post-trade submission cut-off time of 6:30 p.m., the Roundtable has not yet reached a consensus on a recommended time.⁶ Notwithstanding that additional discussions are required to determine a new deadline, the Roundtable has asked OCC to amend Rule 801 to eliminate the requirement that exercise notices

⁵ The OCC Roundtable is an OCC-sponsored advisory group comprised of representatives from OCC, a cross-section of clearing members, participant exchanges, and industry service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and to lower costs in the options industry.

⁶ An analysis by OCC staff determined that submission of files containing exercise instructions after 6:30 p.m. occurred seven times during the period April 1 - December 31, 2005. E-mail from Jean M. Cawley, First Vice President and Deputy General Counsel, dated January 11, 2006.

with respect to most American-style options be submitted between 9:00 a.m. and 7:00 p.m. on a business day. In response to the Roundtable's request and consistent with other OCC rules, OCC will amend Rule 801 to permit OCC to specify the times when such exercise notices may be submitted.⁷ (Such times will be specified in OCC's operations manual.) The amendment will allow OCC to promptly implement the new deadline for post-trade instructions once it is determined and will give OCC greater flexibility in responding to future operational and technology developments. OCC will also make the following conforming changes to Rule 801.

- Amend Rule 801(a) to eliminate the mandated 2:30 p.m. deadline for filing exercise notices with respect to currency options. The deadline will instead be a time specified by OCC (in its operations manual). While there are no current plans to advance this deadline, the language of the rule will be changed for consistency and future flexibility.
- Amend Rule 801(a) to provide that the prescribed deadlines for submitting exercise notices may be changed with not less than 30 days' prior written notice to affected clearing members. This will ensure that clearing members have sufficient time to adjust their procedures for submitting exercise notices.
- Delete Rule 801(b) which authorizes the Board to advance the deadline for submitting exercise notices for American-style non-equity options. The subject matter of Rule 801(b) will be covered by the changes to Rule 801(a).
- Amend Rule 801(e) to restructure portions of the fee schedule for submitting late requests to file, revoke, or modify exercise notices. The \$2,000 filing fee will be eliminated. The \$5,000 filing fee will be applied to all requests accepted after the deadline specified pursuant to Rule 801(a) but before the start of critical processing.

⁷ Under Rule 805, OCC already has the authority to prescribe deadlines for the submission of exercise instructions for purposes of expiration date processing.

No change will be made to the filing fee for requests accepted after the start of critical processing. These proposed changes will align the filing fee schedule under Rule 801 with the filing fee schedule for supplementary exercise notices filed under Rule 805 (which applies to expiration date processing).

III. Discussion

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions.⁸ The Commission finds that OCC's proposed rule change is consistent with this requirement because it enables OCC to take advantage of operational and processing efficiencies gained from real-time trade submission to move forward the times for accepting submissions of exercise notices. Earlier submission of exercise notices permits OCC to move forward the times when it initiates nightly processing and distributes data to its members. Moreover, by OCC having more flexibility with respect to designating time frames and deadlines OCC will be able to keep such time frames and deadlines in step with future operational and technical advances.

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.

⁸ 15 U.S.C. 78q-1(b)(3)(F).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁹ that the proposed rule change (File No. SR-OCC-2005-19) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Nancy M. Morris
Secretary

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 17 CFR 200.30-3(a)(12).