

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53455; File No. SR-OCC-2005-22)

March 8, 2006

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Allocations Processing

I. Introduction

On December 13, 2005, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) proposed rule change SR-OCC-2005-22 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 30, 2006.² No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The proposed rule change relates to new Rule 405, “Allocations,” which governs the processing of post-trade allocation instructions by clearing members. OCC installed a new system to process post-trade allocation instructions in January 2006, and in order to accommodate the immediate use of the allocation system for commodity contracts cleared by OCC that are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission (“CFTC”), OCC adopted Rule 405 by submitting File No. SR-OCC-2005-21 for immediate effectiveness pursuant to Section 19(b)(3)(A) of the Act.³ OCC included Interpretation and Policy .02 to Rule 405 to provide that the new system could not be used for

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 53150 (January 19, 2006), 71 FR 4953.

³ Securities Exchange Act Release No. 53151 (January 19, 2006), 71 FR 4951 (January 30, 2006).

positions in contracts which are subject to the Commission's jurisdiction (i.e., securities options or security futures) until the Commission issued an order approving the use of Rule 405 and the new system for processing post-trade allocations with respect to such positions. The purpose of the proposed rule change is to obtain such Commission approval and to delete Interpretation and Policy .02 to Rule 405.

The new allocation system and Rule 405 provide clearing members with a centralized system for processing allocation or "give-up" instructions across all exchanges for which OCC provides clearing services. Allocations are post-trade instructions entered by one clearing member (i.e., an authorized "executing" or "giving-up" clearing member) that direct OCC to move a transaction or position to the account of another clearing member (i.e., the "carrying" or "given-up" clearing member).

Post-trade allocations of securities options have been processed through OCC's Clearing Member Trade Assignment ("CMTA") functionality, which normally causes a transaction to automatically be moved into an account of the carrying clearing member so long as the executing and carrying clearing members have an effective CMTA arrangement registered with OCC for the exchange submitting the matching trade information for that transaction.⁴ Under the new allocation system, clearing members will be able to elect either to continue to use the existing CMTA system or to use the new allocation system for securities options.

Most post-trade allocations of commodity futures cleared through OCC have been processed through The Clearing Corporation's ("CCorp") "give-up" system, which requires the given-up clearing member to affirmatively accept a transaction.⁵ OCC's new allocation system

⁴ OCC Rule 403.

⁵ OCC Rule 404.

has enabled clearing members to process commodity futures “give-ups” without going through the CCorp system.

New Rule 405 currently governs the processing of allocation instructions for contracts subject to the exclusive jurisdiction of the CFTC. As amended by this proposed rule change, Rule 405 will operate in the same fashion for contracts subject to the Commission’s jurisdiction. Transactions will first clear in the designated account of the giving-up clearing member. Instructions to allocate positions may be submitted either through an exchange’s system for providing matching trade information to OCC or through OCC’s clearing system, ENCORE. In either case, if the given-up and giving-up clearing members are parties to an allocation agreement that has been registered with OCC, OCC will automatically allocate the positions resulting from an allocation instruction to a designated account of the given-up clearing member without further action by the clearing members.⁶ If the clearing members are not parties to a registered allocation agreement, OCC will not effect the allocation instruction until the given-up clearing member gives OCC notice of its affirmative acceptance of the allocated positions. (In contrast, the CMTA system does not allow for acceptance of allocated positions without a registered CMTA agreement.) If the given-up clearing member does not give OCC notice of such acceptance by an OCC-specified deadline, the allocation instruction will not be processed, and the positions will remain in the account of the giving-up clearing member, which will remain responsible for the positions.

⁶ Unlike CMTAs, clearing members will not be required to register their allocation arrangement by exchange.

A given-up clearing member will be responsible for appropriately allocated positions. Given-up positions are moved to the given-up clearing member's account at the premium price in the case of options or at the contract price in the case of futures at which the positions were established by the executing clearing member. Positions that are allocated on an intraday basis will not be reflected in position reports until the following business day. However, OCC will take those positions into account in processing any intraday settlements authorized by its By-laws and Rules, including intraday margin settlements. A given-up clearing member may enter an instruction to reverse an allocation that was accepted in error. If the given-up and giving-up clearing members are parties to a registered allocation agreement, the reversing instruction will be automatically processed. If the clearing members are not parties to a registered allocation agreement, the reversing instruction must be affirmatively accepted by the original giving-up clearing member.

Allocation instructions may be for a single position (i.e., a position in a given series established at a single price) or for a group of positions (i.e., positions in the same series established at different prices). Allocation instructions for grouped positions must be submitted through ENCORE. For single positions, the instruction must identify the contract quantity, series, and price as specified in the matching trade information. For grouped positions, the allocation instruction must provide the same information, but the price may be an average price if not prohibited under exchange rules and applicable law.⁷ For the convenience of clearing

⁷ Average pricing is permitted under the Commodity Exchange Act in certain circumstances. In those circumstances, a clearing member may instruct OCC to use the average price in clearing and settling the trades. Clearing members have requested that OCC provide functionality that would also permit positions in securities options and security futures to be allocated at an average price. Accordingly, OCC has developed its allocation system to accommodate the use of such prices for security options and security futures, provided that such use does not violate exchange rules or applicable law.

members, OCC's system will produce a suggested average price for grouped allocations that clearing members may adopt for purposes of processing the instruction.

Registration of allocation agreements may be terminated either by mutual agreement or unilaterally. Mutually terminated registrations will be effected immediately in OCC's system. Unilaterally terminated registrations will be terminated in OCC's system effective as of 8:00 AM CST the business day after the termination notice is received by OCC and the other clearing member. These are the same standards currently applied to terminating CMTA arrangements under OCC Rule 403. Following termination of registration of an allocation agreement, an allocated position may be allocated to a given-up clearing member only upon its affirmative acceptance.

III. Discussion

Section 17A(b)(3)(F) of the Act provides that the rules of a clearing agency should be designed to promote the prompt and accurate clearance and settlement of securities transactions. OCC's rules permitting allocation of clearing member positions are designed to ensure that positions are carried in the appropriate clearing member account at OCC. The new allocation service offered under Rule 405 is designed to improve upon and add efficiencies to OCC's existing CMTA functionality for allocating post-trade instructions by centralizing and further automating post-trade allocations. Although OCC designed the new allocation system to be an improvement upon its current system, clearing members may choose to continue using the

CMTA functionality. Accordingly, because the proposed rule change is designed to enhance OCC's service offerings and to provide efficiencies to clearing members, the Commission finds that the proposed rule change is designed to promote the prompt and accurate clearance and settlement of securities transactions.

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 with the requirements of Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2005-22) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

Nancy M. Morris
Secretary

⁸ 17 CFR 200.30-3(a)(12).