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File No. SR-OCC-2004-04

**SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

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**Form 19b-4**

**Proposed Rule Change  
by**

**THE OPTIONS CLEARING CORPORATION**

**Pursuant to Rule 19b-4 under the  
Securities Exchange Act of 1934**

**Item 1. Text of the Proposed Rule Change**

The Options Clearing Corporation (“OCC”) proposes to amend Rule 805, which describes expiration date exercise procedures, including exercise by exception processing. Specifically, OCC proposes to reduce the threshold amounts used to determine equity options that are in the money for purposes of exercise by exception processing.

Underlining indicates material proposed to be added and brackets indicate material proposed to be deleted.

**THE OPTIONS CLEARING CORPORATION**

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**RULES**

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**CHAPTER VIII**

**Exercise and Assignment**

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**Expiration Date Exercise Procedure**

**RULE 805.** (a) –(c) [unchanged]

(d) Each Clearing Member shall be deemed to have properly and irrevocably tendered to the Corporation, immediately prior to the expiration time for such option contracts on each expiration date, an exercise notice with respect to:

(1) [unchanged]

(2) every option contract of each series listed in the Clearing Member's Expiration Exercise Report that has an exercise price below (in the case of a call) or above (in the case of a put) the closing price of the underlying security by (i)

[3/4 of a point] \$0.25 or more, if the option contract is carried in a customers' account, or (ii) [1/4 of a point] \$0.15 or more, if the option contract is carried in any other account, unless the Clearing Member shall have duly instructed the Corporation, in accordance with subparagraph (b), to exercise none, or fewer than all, of the option contracts of such series carried in such account. If a Clearing Member desires that any such option contract not be exercised, it shall be the responsibility of the Clearing Member to give appropriate instructions to the Corporation in accordance with subparagraph (b).

(e) – end [unchanged]

**Item 2. Procedures of the Self-Regulatory Organization**

The proposed rule change was approved by the Board of Directors of OCC at a meeting held on March 5, 2004.

Questions regarding the proposed rule change should be addressed to Jean M. Cawley, First Vice President and Deputy General Counsel, at (312) 322-6269.

**Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

The Options Clearing Corporation (“OCC”) is proposing to amend Rule 805, which describes expiration date exercise procedures, including exercise by exception processing. Specifically, OCC proposes to reduce the threshold amounts used to determine equity options that are in the money for purposes of exercise by exception processing.

**Background**

OCC has for years maintained an “exercise by exception” procedure. Under that procedure, options that are in the money at expiration by more than a specified threshold amount are exercised automatically unless the clearing member carrying the position instructs otherwise.

Equity options are determined to be in the money or not based on the difference between the exercise price and the closing price of the underlying equity interest on the last trading day before expiration. The current threshold for equity options is \$.75 in a clearing member's customers' account and \$.25 in any other account (i.e., firm and market makers' accounts).

### Discussion

OCC's Roundtable<sup>1</sup> has proposed that the threshold amounts for equity options be reduced to \$.25 in a customers' account and \$.15 in any other account. The Roundtable believes that reducing these thresholds will streamline expiration processing.

In response to the Roundtable's proposal, OCC analyzed equity options exercise information from the November 2003, December 2003, and January 2004 expirations. OCC's analysis determined that clearing members exercised 93% to 97% of equity option contracts carried in their customers' accounts that were in the money by \$.25 to \$.74 (i.e., the change in the "in the money" amount represented by the proposed threshold). OCC's analysis also determined that exercise activity in other account ranges supported the proposed threshold change.

OCC also surveyed all clearing members to obtain their views and comments on the proposed change. Survey results demonstrated strong support across the membership for the change. 105 out of 116 clearing members<sup>2</sup> responded to the survey, with 96 clearing members in favor of the threshold change. Clearing members supporting the change confirmed the

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<sup>1</sup> OCC's Roundtable is an OCC sponsored advisory group comprised of representatives from OCC's participant exchanges, OCC, a cross-section of OCC clearing members, and industry service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and lower costs in the options industry.

<sup>2</sup> OCC also contacted clearing members that did not respond to its survey. These firms expressed no opinion on the matter.

Roundtable's view that it would significantly reduce the number of instructions they are required to input on expiration, thereby shortening the timeframe for completing instructions to OCC.

OCC contacted each firm that opposed the threshold change. These firms expressed a concern about having to input more "do not exercise" instructions. All of these firms agreed that they could adapt to the change if supported by the majority of clearing members. OCC reviewed the positions carried by these firms and determined that, on average, they carry positions in fewer than 10 expiring series that are below the current threshold of \$.75. This review led OCC to conclude that the threshold change would result in only a slight increase in processing time for these firms and that they would not be unduly burdened by its implementation.

The clearing member survey also asked firms to provide an estimate of the time needed to accommodate the threshold change based upon supplied timeframes (i.e., 0-3 months or 4-6 months). The majority of firms indicated that they could complete the necessary systems development and customer notifications within 6 months. OCC contacted any firm that commented on the proposed timeframes, and all expressed the view that their efforts would be completed in the 6 month time period.

The Roundtable has asked that this change be implemented for the September 2004 expiration. OCC therefore requests the Commission to approve this rule filing effective September 1, 2004, and authorize OCC to implement the threshold change thereafter based upon its assessment of clearing member readiness. If OCC determines clearing members need additional time to complete preparations for the threshold change, it will be implemented for the October 2004 expiration. OCC will provide at least 10 days advance notice to clearing members

of the effective date for the new threshold amounts. Such notice will be provided via information memoranda and other forms of electronic notice such as email.

\* \* \*

The proposed rule change is consistent with Section 17A of the Securities Exchange Act of 1934, as amended (the "Exchange Act") because it facilitates the prompt and accurate processing of exercise information on expiration.

**Item 4. Self-Regulatory Organization's Statement on Burden on Competition**

OCC does not believe that the proposed rule change would impose any burden on competition.

**Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others**

As referenced in Item 3, written comments were received on the proposed rule change in connection with the clearing member survey conducted by OCC. No other written comments were received and none other are intended to be solicited with respect to the proposed rule change and none have been received.

**Item 6. Extension of Time Period for Commission Action**

Not applicable.

**Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)**

Not applicable.

**Item 8. Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission**

The proposed rule change is not based on a rule of another self-regulatory organization or of the Commission.

**Item 9. Exhibits**

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the Federal Register.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

**THE OPTIONS CLEARING CORPORATION**

By: \_\_\_\_\_  
**William H. Navin**  
**Executive Vice President and**  
**General Counsel**



**EXHIBIT 1**

**SECURITIES AND EXCHANGE COMMISSION**

(Release No. 34-\_\_\_\_\_ ; File No. SR-OCC-2004-04

**SELF-REGULATORY ORGANIZATION**

Proposed Rule Change By  
The Options Clearing Corporation

Relating to Equity Options Thresholds  
For Expiration Processing

Comments requested within days  
after the date of this publication.

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Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C.

'78s(b)(1), notice is hereby given that on \_\_\_\_\_, 2004, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would amend Rule 805 to reduce the thresholds applied to equity options for purposes of exercise by exception processing on expiration.

**II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change**

In its filing with the Commission, the self-regulatory organization 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 below. The self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

The Options Clearing Corporation (“OCC”) is proposing to amend Rule 805, which describes expiration date exercise procedures, including exercise by exception processing. Specifically, OCC proposes to reduce the threshold amounts used to determine equity options that are in the money for purposes of exercise by exception processing.

**Background**

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## **Discussion**

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The proposed rule change is consistent with Section 17A of the Securities Exchange Act of 1934, as amended (the "Exchange Act") because it facilitates the prompt and accurate processing of exercise information on expiration.

**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**

As referenced in Item II A., written comments were received on the proposed rule change in connection with the clearing member survey conducted by OCC. No other written comments were received and none other are 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 35 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 90 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 the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted by \_\_\_\_\_.

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

Secretary

Dated: \_\_\_\_\_

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