



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5100
Facsimile: (202) 418-5521
www.cftc.gov

Office of the Secretariat

June 14, 2010

Mr. William H. Navin
Executive Vice President, General Counsel, and Secretary
The Options Clearing Corporation
One N. Wacker Drive, Suite 500
Chicago, Illinois 60606

Re: Options Clearing Corporation Approval Request for Rule Filing SR-OCC-2010-05

Dear Mr. Navin:

By a submission received March 16, 2010, the Options Clearing Corporation (“OCC”), a registered derivatives clearing organization, requested that the Commission approve a rule amendment in the form of a sentence to be added to the Introduction of Article XXII of OCC’s By-Laws pursuant to Section 5c(c)(2) of the Commodity Exchange Act (“CEA” or “Act”) and Commission regulations 39.4(a) and 40.5.

As described by the submission, the proposal is intended to clarify the status of foreign exchange currency contracts denominated as “options” with a nominal exercise price (such as \$0.01). Such contracts would be deep-in-the-money at the commencement of trading and remain so until expiration. OCC seeks to confirm that these contracts could be traded on national securities exchanges, and treated and cleared as securities options, notwithstanding such nominal exercise price.

Specifically, the text of the proposed amendment provides:

“By-Laws in this Article are applicable only to cash-settled options where either the trading currency or the underlying interest is a foreign currency. In addition, the By-Laws in Articles I-XI are also applicable to such options, in some cases supplemented by one or more By-Laws in this Article, except for By-Laws that have been replaced in respect of such options by one or more By-Laws in this Article and except where the context otherwise requires. Whenever a By-Law in this Article supplements or, for purposes of this Article, replaces one or more By-Laws in Articles I-XI, that fact is indicated in brackets following the provisions of Article XII of the By-Laws and Chapter XIII of the Rules. Options subject to the provisions of this Chapter will be treated as securities options subject to the jurisdiction of the Securities and Exchange Commission even if the exercise price is fixed at a nominal amount, such as one cent, resulting in options that are deep in the money when they are opened for trading, provided that the Commodity Futures Trading Commission has taken the position, through issuance of exemptive orders or otherwise, that such options may be traded on the listing Exchange and cleared by the Corporation as securities without violating the Commodity Exchange Act.” [underlined in original submission].

In the submission, OCC states that:

“The purpose of the proposed rule change is to remove any potential cloud on the jurisdictional status of cash-settled foreign currency options with an exercise price of one cent...In

order to foreclose any potential argument that the clearing by OCC of such options as securities options constitutes a violation of the CEA.”

OCC’s submission also provides that “[t]he products for which approval is requested are essentially the same as cash-settled, foreign currency options that OCC currently clears except for the low strike price.” Accordingly, the submission, at least in part, would require the Commission to recognize the described contracts as foreign exchange options.

As noted above, the foreign currency contracts described in the proposed rule amendment have a strike price that is nominal, and thus would be economically equivalent to contracts with identical terms and an exercise price of \$0. Under this specification, the contracts would function in a materially different manner than the standard foreign exchange option contracts that are currently traded on national securities exchanges and cleared by OCC.¹ This would appear to be somewhat inconsistent with the statement in the submission providing that “[t]he products for which approval is requested are essentially the same as cash-settled, foreign currency options that OCC currently clears except for the low strike price.” The attributes of the covered contracts are discussed below.

We understand that the ownership of a typical OCC-cleared and securities exchange traded foreign currency call option contract, for example, gives the holder the right, but not the obligation, to buy the underlying asset; in this case, a cash payout at a specified exercise price. The cash payout is representative of the prevailing exchange rate between two currencies modified by a multiplier (in many cases 100).²

If the exercise price on a call option is a nominal amount (*i.e.*, an amount that in no way reflects the value of the underlying asset)³, the option premium will be economically indistinguishable from the value of a futures contract on the underlying asset. From the commencement of trading, the value of the premium on the proposed contracts would move essentially in unity, *i.e.*, in a 1-to-1 ratio, with the price of a futures contract on the underlying asset.

The covered contracts are not *bona fide* options. These contracts would be deeply in-the-money at the start of trading and at expiration. This would ensure that all outstanding contracts would be exercised at expiration. Therefore, the foreign currency contracts described in the submission would be the economic and functional equivalents of foreign currency futures contracts that currently trade on futures exchanges, both domestically and abroad.

Section 5c(c)(3) of the CEA provides that the Commission shall approve any new rule or rule amendment unless the Commission finds that such new rule or rule amendment would violate the CEA. Section 4(a) of the Act provides that “[u]nless exempted by the Commission pursuant to subsection (c), it shall be unlawful for any person to...conduct any office or business anywhere in the United States, its territories or possessions, for the purpose of soliciting or accepting any order for, or otherwise dealing

¹ OCC clears foreign exchange option contracts for the International Securities Exchange and NASDAQ OMX PHLX.

² *Cf. Understanding Equity Options* at 10 (Options Industry Council 2007): “The strike price for an option is initially set at a price which is reasonably close to the current share price of the underlying security.... New strike prices are introduced when the price of the underlying security rises to the highest, or falls to the lowest, strike price currently available.”

³ Based on approximate values of the underlying rate-modified foreign currency pairs currently disseminated by the International Stock Exchange as of June 9, 2010, a nominal strike price of one cent represents significantly less than one-tenth of 1% (*i.e.*, 1/1000) of the value of the underlying assets.

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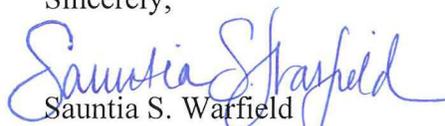
in, any transaction in, or in connection with, a contract for the purchase or sale of a commodity for future delivery...unless...such transaction is conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market or derivatives transaction execution facility for such commodity.”

Approving the proposed submission would require the Commission to treat the covered contracts as cash-settled foreign currency “options,” and to permit OCC to clear them as such. The Commission has concluded that the covered contracts are not *bona fide* options, but, rather, are “contract[s] for the purchase or sale of a commodity for future delivery.” Thus, such approval would permit OCC to violate Section 4(a) of the Act.

The Commission recognizes that the effectiveness of the proposed rule amendment is conditioned on the Commission taking the position, through the issuance of exemptive orders or otherwise, that such covered contracts may be traded on a listing securities exchange and cleared by OCC as securities without violating the CEA. The Commission notes that it has not issued such an exemptive order and has not otherwise taken the position that these contracts may be traded and cleared as securities without violating the CEA. Furthermore, the Commission does not intend to issue any such order or to otherwise take such a position.

For the reasons stated, the OCC’s rule amendment and submission are inconsistent with the Act and not approved.

Sincerely,



Sauntia S. Warfield
Assistant Secretary of the Commission