

SUBMISSION COVER SHEET

Exchange Identifier Code (optional) SR-OCC-2007-01

Date February 13, 2007

ORGANIZATION | The Options Clearing Corporation

FILING AS A:

DCM

DCO

DTEF

TYPE OF FILING

- **Rule Amendments**

Self-Certification Under Reg. 40.6(a)

Commission Approval Requested Under Reg. 40.5 or 40.4 (a)

Notification of Rule Amendment Under Reg. 40.6(c)

Non-Material Agricultural Rule Change Determination Under Reg. 40.4(b)

- **New Products**

Self-Certification Under Reg. 40.2 or 41.23

Commission Approval Requested Under Reg. 40.3

RULE NUMBERS

New By-Law Article XIV, and Rule Chapter XV; Amendments to By-Law Articles I and VI, and Rule Chapters VI and VIII.

DESCRIPTION (Rule Amendments Only)

The proposed rule change would permit OCC to clear and settle a type of option (a "credit default option") that is related to the creditworthiness of an issuer or guarantor of one or more specified debt securities. Credit default options are proposed to be traded by CBOE.

THE OPTIONS CLEARING CORPORATION

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February 13, 2007

VIA ELECTRONIC SUBMISSION

Ms Eileen Donovan
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Rule Filing SR-OCC-2007-01—Request for Commission Rule Approval

Dear Ms Donovan:

The Options Clearing Corporation (“OCC”) hereby submits the above referenced rule filing for approval by the Commodity Futures Trading Commission (the “Commission”) pursuant to Section 5c(c)(2) of the Commodity Exchange Act (the “CEA”) and Sections 39.4(a) and 40.5 of the Commission’s regulations. This rule filing has been, or is concurrently being, submitted to the Securities and Exchange Commission (the “SEC”) for approval under the Securities Exchange Act of 1934 (the “Exchange Act”). The purpose of this rule filing is to obtain approval for OCC to clear “credit default options” (“CDOs”) proposed to be traded on the Chicago Board Options Exchange, Inc. (“CBOE”) or that might be traded on any other national securities exchange that is an OCC participant exchange.¹

In conformity with the requirements of Regulation 40.5(a), OCC states the following: the proposed effective date of the rule change is the earliest date on which all of the following have occurred: (i) the proposed rule change has been approved by the SEC (or otherwise becomes effective under the Exchange Act); (ii) the SEC has approved, pursuant to the SEC’s Rule 9b-1, a supplemental disclosure document relating to CDOs; and (iii) the proposed rule change has been, or is deemed to have been, approved by the Commission pursuant to regulation Section 40.5. The text of the proposed rule is set forth in Item 1 of the enclosed filing. The proposed rule was duly adopted by the Board of Directors of OCC as described in Item 2 of the enclosed filing, pursuant to the powers granted to the Board by Article III, Section 8 of

¹ CBOE’s proposed rule filing relating to CDOs was filed with the SEC in SR-CBOE-2006-84 and amendments thereto.

OCC's By-Laws. Item 3 of the enclosed filing sets forth the operation, purpose, and effect of the proposed rule. Item 5 of the enclosed filing sets forth a description of any written comments on the rule filing, including any such comments expressing opposing views that were not incorporated into the proposed rule.

As proposed by CBOE, CDOs are binary options that entitle the holder to receive, and require the writer to pay, a fixed exercise settlement amount if and only if a "credit event" is confirmed to have occurred with respect to one or more underlying reference securities of a single issuer. A "credit event" is defined in the rules of CBOE to mean either a failure to pay on the relevant securities, the occurrence of one or more other events of default under the terms of the relevant securities that are specified by CBOE as credit events, or the occurrence of a restructuring of the terms of the relevant securities of a type that CBOE has specified will constitute a credit event. (See CBOE proposed Rule 29.1(c).)

OCC proposes to clear CDOs as securities options subject to the jurisdiction of the SEC, and would therefore not require Clearing Members that carry such options for the accounts of their customers to hold them in accounts that are subject to the segregation requirements of the CEA. OCC believes that this practice would not violate the CEA because such options are within the definition of a "security" under Section 3(a)(10) of the Exchange Act and therefore excluded from the Commission's jurisdiction under Section 2(a)(1)(C)(i) of the CEA.

As a derivatives clearing organization subject to the jurisdiction of the Commission as well as a registered securities clearing agency, OCC is filing this rule change for prior Commission approval in order to confirm that the Commission concurs in OCC's conclusion that OCC would not violate the CEA by treating CDOs as securities rather than commodity options. Should you have any questions regarding this matter, please do not hesitate to contact me.

Sincerely,



William H. Navin

Enclosures

cc: CFTC Central Region (w/ enclosures)
300 South Riverside Plaza, Suite 1600 North
Chicago, IL 60606

Ananda K. Radhakrishnan
Director
Division of Clearing and Intermediary Oversight

John C. Lawton
Deputy Director and Chief Counsel
Division of Clearing and Intermediary Oversight

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

In order to clear and settle “credit default options” proposed to be listed by the Chicago Board Options Exchange, Incorporated (“CBOE”), The Options Clearing Corporation (“OCC” or the “Corporation”) proposes to amend Articles I and VI of its By-Laws and Chapters VI and VIII of its Rules and to add a new Article XIV and Chapter XV to its By-Laws and Rules, respectively, as set forth below. Material proposed to be added is underlined. Material proposed to be deleted is enclosed in bold brackets.

THE OPTIONS CLEARING CORPORATION

BY-LAWS

* * *

ARTICLE I

Definitions

SECTION 1. Unless the context requires otherwise (or except as otherwise specified in the By-Laws), the terms defined herein shall, for all purposes of these By-Laws and the Rules of the Corporation, have the meanings herein specified.

A. [No change.]

B.

Binary Option

(1) The term “binary option” shall have the meaning given to it in Article XIV of the By-Laws.

(1) – (6) [renumbered (2) – (7) and otherwise unchanged]

C. - D. [No change.]

E.

(1) – (19) [No change.]

Expiration Time

(20) Except as otherwise specified in the By-Laws and Rules for particular classes of options, [T]the term “expiration time” in respect of an option contract[, other than an option contract as defined in Section 1.E.(4)(ii) and (iii) of Article XV or Article XX of the By-Laws,] means 10:59 P.M. Central Time (11:59 P.M. Eastern Time).

F. – N. [unchanged]

O.

(1) – (3) [No change.]

Option Contract

(4) The term “option contract” or “option” means a put option, a call option, a binary option or a packaged spread option (as defined in Article XXVI of the By-Laws) issued by the Corporation pursuant to the By-Laws and Rules. The term “stock option contract” means a put or a call, as defined in this Article I for which the underlying security is an equity security, including fund shares. The term “Treasury securities option contract” means a put or a call, as defined in Article XIII of the By-Laws. The term “yield-based Treasury option contract” means a put or a call, as defined in Article XVI of the By-Laws. The term “debt securities option contract” means a Treasury securities option contract, or a credit default option contract as defined in Article XIV of the By-Laws. The term “foreign currency option contract” means a put or a call, as defined in Article XV of the By-Laws. The term “cross-rate foreign currency option contract” means a put or a call, as defined in Article XX of the By-Laws. The term “cash-settled foreign currency option contract” means a put or a call, as defined in Article XXII of the By-Laws. The term “index option contract” means a put or a call, as defined in Article XVII of the By-Laws. The term “cash-settled option contract” means any option contract that is settled upon exercise by payment of cash rather than delivery of, and payment for, the underlying interest. [an index option contract, a packaged spread option contract, a yield-based Treasury option contract or a cash-settled foreign currency option contract.] The term “non-equity securities option contract” means a debt securities option contract, a foreign currency option contract, a cross-rate

foreign currency option contract, a cash-settled option contract, or a futures option. The term “futures option” means any option to buy or sell any commodity futures contract traded on, through the facilities of, or subject to the rules of a futures market. For purposes of Article VIII of the By-Laws, and Chapters VI and X of the Rules, the term “non-equity securities option contract” shall also include such classes of fund options as the Corporation may from time to time designate as non-equity securities option contracts for such purposes.

P. – Z. [No change.]

* * *

ARTICLE VI

Clearance of Exchange Transactions

* * *

Terms of Cleared Contracts

SECTION 10. (a) - (d) [No change.]

(e) Except to the extent provided otherwise in the By-Laws and Rules with respect to transactions in binary options, the expiration date, exercise price (if any), and exercise settlement amount of each series of binary options shall be determined by the Exchange that first introduces such series of options for trading at the time such series is opened for trading. The exercise price and exercise settlement amount of binary options are subject to adjustment in accordance with applicable provisions of Article XIV of the By-Laws.

(e) – [re-lettered as (f) but otherwise unchanged]

* * *
ARTICLE XIV¹

Binary Options

Introduction

By-Laws in this Article are applicable only to binary options. In addition, the By-Laws in Articles I-XI are also applicable to binary options (including credit default 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 binary 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 By-Law in this Article.

Definitions

SECTION 1.

A.

Adjustment Event

(1) The term “adjustment event” when used in respect of a credit default option means either a redemption event or a succession event as defined in the applicable Exchange Rules of the listing Exchange.

B.

Binary Option

(1) The term “binary option” means a style of option having only two possible payoff outcomes: either a fixed amount or nothing at all. Binary options that are cleared by the Corporation are cash-settled options that are subject to automatic exercise. Binary options are also sometimes called digital options, fixed return options or all-or-nothing options.

C.

Class

¹ This entire Article is proposed to be added. For ease of review, it is not underlined.

(1) The term “class” when applied to credit default options means all credit default options having the same reference entity, reference obligation(s), credit event(s), and reporting authority.

Credit Default Option

(2) The term “credit default option” means an option that is automatically exercised upon receipt by the Corporation of a credit event confirmation with respect to the reference obligation(s) of a reference entity.

Credit Event

(3) The term “credit event” when used in respect of a credit default option means a credit event, as defined in the rules of the Exchange on which the options are listed, with respect to a reference obligation for such option.

Credit Event Confirmation

(4) The term “credit event confirmation” when used in respect of a credit default option means a notice received by the Corporation from the reporting authority that the reporting authority has confirmed that a credit event occurred within the “credit event confirmation period” specified in the Exchange Rules of the listing Exchange.

Credit Event Confirmation Deadline

(5) The term “credit event confirmation deadline” when used in respect of a credit default option means the deadline specified by the Corporation by which a credit event confirmation must be received by the Corporation on any business day other than the expiration date in order to be treated as having been received on the business day on which it was submitted. Credit event confirmations received by the Corporation after the credit event confirmation deadline on the expiration date shall be treated as provided in the By-Laws and Rules.

D.

Reserved

E.

Exercise Price

(1) The term “exercise price” when used in respect of a binary option other than a credit default option means the specified value or range of values that is compared to the underlying interest value to determine whether the option will be automatically exercised. A credit default option has no exercise price.

Exercise Settlement Amount

(3) The term “exercise settlement amount” when used in respect of a series of binary options means the fixed amount of cash to be paid upon exercise to a holder of an option that is automatically exercised. The exercise settlement amount shall be specified by the listing Exchange at or before the time when a series of binary options is first opened for trading.

Expiration Date

(4) The term “expiration date” when used in respect of a binary option means the last day on which the option may be automatically exercised. In the case of a series of credit default options, the expiration date is the fourth business day after the last trading day for such series of options as such trading day is specified by the Exchange on which the series of options is listed; provided, however, that when a credit event confirmation is deemed to have been received by the Corporation with respect to a series of credit default options prior to the last trading day for such series, the expiration date for options of that series will be accelerated to the second business day following the day on which such credit event confirmation is deemed to have been received by the Corporation. For any other binary option for which no different expiration date has been specified, the expiration date is the Saturday following the last trading day for the option.

F. – L.

Reserved

M.

Multiplier

(1) The term “multiplier” when used in respect of an Exchange transaction in binary options means the fixed number by which the price agreed upon by the purchaser and seller is multiplied in order to calculate the total purchase price per contract.

N. – O.

Reserved

P.

Premium

(1) The term “premium” when used in respect of an Exchange transaction in binary options means the price, in dollars and cents, agreed upon by the purchaser and seller in the transaction times the multiplier and the number of contracts subject to the Exchange transaction.

Q.

Reserved

R.

Reference Entity; Reference Obligation(s)

(1) The term “reference entity” as used in respect of a class of credit default options means the issuer or guarantor of the reference obligation(s); and the term “reference obligation(s)” means one or more debt securities the terms of which define a credit event for a class of credit default options, as provided under the Exchange Rules of the listing Exchange.

Reporting Authority

(2) The term “reporting authority” when used in respect of a binary option other than a credit default option shall have the meaning given to that term in Article I of the By-Laws,

and, when used in respect of a class of credit default options, means the person or entity responsible for confirming the occurrence of the relevant event. Unless another reporting authority is identified by the listing Exchange for a class of credit default options, the listing Exchange will be the reporting authority.

S.– T.

Reserved

U.

Underlying Interest

(1) The term “underlying interest” when used in respect of a binary option other than a credit default option means the underlying security, index, or measure whose underlying interest value is compared to the option’s exercise price to determine whether the option will be automatically exercised. When used in respect of a credit default option, such term means the reference obligation(s).

Underlying Interest Value

(2) The term “underlying interest value” when used in respect of a binary option other than a credit default option means the value or level of the underlying interest at any point in time as reported by the reporting authority. Where the underlying interest is a security or an index, the underlying interest value is the current price or level of the underlying interest. The term “underlying interest value” is not applicable to credit default options.

V.

Variable Terms

(1) The term “variable terms” when used in respect of a series of binary options means the identity of the underlying interest, the exercise price (in the case of an option other than a credit default option), the event the occurrence of which will trigger automatic exercise (in the case of a credit default option), the expiration date and the exercise settlement amount of such option contract.

W. – Z.

Reserved

[Section 1 of this Article adds certain new definitions relevant to binary options and replaces the definitions of class, exercise price, expiration date, multiplier, premium, reporting authority, underlying interest, and variable terms in Article I, Section 1 of the By-Laws.]

General Rights and Obligations of Holders and Writers of Binary Options

SECTION 2. (a) Subject to the provisions of the By-Laws and Rules, the holder of a single binary option has the right to receive from the Corporation the exercise settlement amount for such option if (i) in the case of an option other than a credit default option, the underlying interest value as of the time specified in the Exchange Rules of the listing Exchange is determined to meet the criteria for automatic exercise of the option, or (ii) in the case of a credit default option, the relevant event is determined to have occurred within the time specified therefor in the Exchange Rules of the listing Exchange, in each case in accordance with Exchange Rules and the By-Laws and Rules.

(b) The writer of a single binary option is obligated, upon assignment to such writer of an exercise in respect of such option, to pay to the Corporation the exercise settlement amount for such option, in accordance with Exchange Rules and the By-Laws and Rules.

[Section 2 of this Article replaces paragraphs (a) and (b) of Section 9 of Article VI of the By-Laws.]

Adjustments of Credit Default Options

SECTION 3. (a) Sections 11 and 11A of Article VI of the By-Laws shall not apply to binary option contracts, except in respect of credit default options as provided in paragraph (b) of this Section 3.

(b) The listing Exchange is vested with complete discretionary authority to confirm adjustment events and make adjustments to credit default options in accordance with Exchange Rules, as they are interpreted by the Exchange. Adjustment determinations shall be reported to the Corporation by the Exchange. Every adjustment determination by the Exchange will be within its sole discretion and shall be conclusive and binding on all holders and writers and not subject to review. The Corporation shall not be responsible for any adjustment determination by the Exchange.

[Section 3 of this Article supplements Section 11 and 11A of Article VI of the By-Laws.]

Determination of Occurrence of Credit Event

SECTION 4. A class of credit default options will be exercised automatically, without any action on the part of the holders, if a credit event confirmation is received by the Corporation at any time prior to the expiration time on the expiration date for the class. The reporting authority will confirm credit events in accordance with Exchange Rules, as they are interpreted by the reporting authority and reported to the Corporation by the reporting authority. Every credit event confirmation will be within the sole discretion of the reporting authority and shall be conclusive and binding on all holders and writers and not subject to review. The Corporation will not be responsible for any credit event determination made by the reporting authority.

Determination of Underlying Interest Value

SECTION 5. The method for determining the underlying interest value at expiration of a series of binary options, other than credit default options, shall be as specified in the Exchange Rules of the Exchange on which the series of options is traded; provided, however, that in the event of any conflict between such Exchange rules and the By-Laws and Rules of the Corporation, the By-Laws and Rules of the Corporation shall control. The underlying interest value may be based upon the price or level of the underlying interest at the open or close of trading on the last trading day prior to the expiration date of the series, or it may be based upon an average, including a volume weighted average, of prices or levels during a specified period of time on such last trading day. Subject to the authority of the Corporation to adjust or fix such values as provided under the By-Laws and Rules, the underlying interest value for a series of binary options shall be the value reported to the Corporation by the reporting authority. If a series of binary options is listed on more than one Exchange, the Corporation, in its sole discretion, may (i) designate one of them as the principal market for the series and obtain the underlying interest value for the series solely from such principal market or (ii) calculate the underlying interest value from values obtained from some or all of such Exchanges in accordance with procedures specified by the Corporation from time to time. Unless the Corporation directs otherwise, the underlying interest value as initially reported by the listing Exchange(s) shall be conclusively presumed to be accurate and shall be deemed final for the purpose of determining whether a binary option will be automatically exercised and in calculating exercise settlement amounts, even if such value is subsequently revised or determined to have been inaccurate.

. . . Interpretations and Policies:

.01 The Corporation will not adjust an underlying interest value reported by the listing Exchange(s), even if the value is subsequently found to have been erroneous, except in

extraordinary circumstances. Such circumstances might be found to exist where, for example, the value as initially reported is clearly erroneous and a corrected value is promptly announced by the listing Exchange. In no event will a completed settlement be adjusted due to errors in reported underlying interest values.

* * *

RULES

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CHAPTER VI

Margin

* * *

Margin Requirements

Rule 601. (a) –(e) [No change.]

... Interpretations and Policies:

.01 - .02 [No change.]

.03 Notwithstanding the provisions of Rule 601, the Corporation may exclude positions in credit default options in any account of a Clearing Member from the margin requirement calculations under paragraphs (c) and (d) of Rule 601. The margin requirement for excluded short positions in any series of credit default options shall be a fixed amount determined by the Corporation based upon the maximum potential exercise settlement amount for such options as determined by the Corporation. Except to the extent that the Corporation determines otherwise, long positions in credit default options shall be given no value for margin purposes and shall not offset margin requirements on short positions except to the extent that a Clearing Member carries unsegregated long positions and short positions in the same class of options in the same account.

* * *

CHAPTER VIII

Exercise and Assignment

Exercise of Options

RULE 801. Issued and unexpired option contracts may, subject to Exchange Rules and the By-Laws, be exercised as follows:

(a) [No change.]

(b) Any expiring American option contract may be exercised on its expiration date in accordance with Rule 805. Any capped or European option contract may be exercised [(other than automatically exercised in the case of a capped option)] only on its expiration date in accordance with Rule 805 except that a capped option may be automatically exercised in accordance with the By-Laws and Rules applicable to capped options. Any binary option that meets the exercise parameters set forth in Rule 1501 will be automatically exercised in accordance with that rule. Notwithstanding the foregoing, any expiring flexibly structured index option contract, quarterly index option contract, or short term index option contract that meets the exercise parameters set forth in Rule 1804(c) will be automatically exercised on its expiration date in accordance with that rule. No expiring option contract other than an American style flexibly structured option contract, a foreign currency option contract, a short term option contract, a quarterly option contract, or a cross-rate foreign currency option contract may be exercised on the business day immediately preceding its expiration date.

(c) – end [unchanged]

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CHAPTER XV²

* * *

Binary Options

Introduction

² This entire Chapter is proposed to be added. For ease of review, it is not underlined.

Rules in this Chapter are applicable only to binary options (as defined in the By-Laws). In addition, the Rules in Chapters I through XII are also applicable to binary options, in some cases supplemented by one or more Rules in this Chapter, except for Rules that have been replaced in respect of binary options by one or more Rules in this Chapter and except where the context otherwise requires. Whenever a Rule in this Chapter supplements or, for purposes of this Chapter, replaces one or more of the By-Laws or Rules in Chapters I through XII, that fact is indicated in brackets following the Rule in this Chapter.

Automatic Exercise of Binary Options

RULE 1501. (a) In the case of a binary option other than a credit default option, a Clearing Member shall automatically be deemed to have exercised, immediately prior to the expiration time on each expiration date, every expiring binary option contract whose underlying interest value, when measured against its exercise price, has satisfied the criterion for exercise specified in the Exchange Rules of the listing Exchange.

(b) In the case of a credit default option, a Clearing Member shall automatically be deemed to have exercised such option on any business day on which a credit event confirmation is received by the Corporation before the credit event confirmation deadline. A credit event confirmation received after such deadline shall be deemed to have been received by the Corporation on the following business day; provided, however, that a credit event confirmation received after the credit event confirmation deadline on the business day before the last scheduled trading day and before the expiration time on the expiration date will be deemed to have been received on the expiration date. If a credit event confirmation is received after the credit event confirmation deadline on the expiration date and before the expiration time, the Corporation may extend the exercise settlement date pursuant to Rule 1503(c).

[Rule 1501 supplements Rule 805 and replaces Rule 802.]

Assignment and Allocation of Binary Option Exercises

RULE 1502. Following the automatic exercise of binary option contracts in any series, the exercises shall be assigned and allocated to all open short positions in such series of options. The Corporation shall make available to each Clearing Member on the business day following the date of exercise a report or reports reflecting all automatic exercises of binary options in the accounts of such Clearing Member effected on such date, and all assignments of exercises to short positions in the accounts of such Clearing Member.

[Rule 1502 replaces Rules 803 and 804.]

Exercise Settlement Date for Binary Options

RULE 1503. (a) The exercise settlement date for an exercised binary option, other than a credit default option, shall be the business day following the expiration date.

(b) The exercise settlement date for a credit default option shall be the third business day following the date on which the option is deemed to have been exercised; provided, however, that in the case of an option that is deemed to have been exercised on the expiration date, the exercise settlement date shall be the business day following the expiration date.

(c) The Corporation may extend or postpone any exercise settlement date for binary options whenever, in its opinion, such action is required in the public interest or to meet unusual conditions.

[Rule 1503, together with Rule 1504, replaces Rule 902.]

Settlement of Binary Option Exercises

RULE 1504. (a) Exercised binary options and short positions in binary options to which exercises have been assigned shall be settled through the payment of the exercise settlement amount by the Corporation to the holder of the binary option and by the writer of the binary option to the Corporation.

(b) On each exercise settlement date for binary options, at or before such time as the Corporation may specify, the Corporation shall:

(1) Determine, as to each account of each Clearing Member, the number of exercised and assigned option contracts of each series of binary options for which the current business day is the exercise settlement date.

(2) Net the exercise settlement amounts to be paid by the Clearing Member against the exercise settlement amounts to be paid to the Clearing Member to obtain a single net settlement amount for binary option exercises with respect to each account of each Clearing Member.

(3) Make available to each Clearing Member a report showing the results of the netting described herein.

(c) At or before 9:00 A.M. Central Time (10:00 A.M. Eastern Time) on each exercise settlement date for binary options, each Clearing Member shall be obligated to pay to

the Corporation any net settlement amount in any account of such Clearing Member shown to be due to the Corporation on the report referred to in paragraph (b) of this Rule for such day, and the Corporation shall be authorized to withdraw from the Clearing Member's bank account established in respect of such account an amount equal to such net settlement amount, provided that the Corporation may, but is not required to, offset against any such net settlement amount any credit balance which may be due from the Corporation to the Clearing Member in the same or any other account.

(d) At or before 10:00 A.M. Central Time (11:00 A.M. Eastern Time) on each exercise settlement date for binary options, the Corporation shall be obligated to pay to the Clearing Member (provided the Clearing Member has deposited all margin required to be deposited pursuant to Chapter VI of the Rules and has deposited the full amount of any net daily premium due to the Corporation under Rule 502) the net settlement amount in any account shown to be due from the Corporation to such Clearing Member on the report referred to in paragraph (b) of this Rule for such day.

(e) Solely for purposes of Rule 601, exercised and assigned binary option contracts shall be deemed settled as of the opening of business on the exercise settlement date. No margin shall be required and no margin credit shall be given in respect of such contracts on such date.

[Rule 1504 replaces Chapter IX of the Rules and supplements Rules 502 and 607.]

Suspension of Clearing Members - Exercised Contracts

RULE 1505. Exercised binary option contracts to which a suspended Clearing Member is a party (either as the Exercising Clearing Member or as the Assigned Clearing Member) shall be settled in accordance with Rule 1504 provided that the net settlement amount in respect of such contracts shall be paid from or, subject to the rights of any Pledgees under Rule 614, credited to the Liquidating Settlement Account of such Clearing Member established pursuant to Rule 1104. The Corporation shall effect settlement pursuant to Rule 1504 with all Clearing Members that have been assigned an exercise of a suspended Exercising Clearing Member or that have exercised binary option contracts that were assigned to a suspended Assigned Clearing Member without regard to such suspension.

[Rule 1505 supplements Rule 1104 and Rule 1107(b) and replaces Rule 1107(a) and (c).]

Deposits in Lieu of Margin Prohibited

RULE 1506. Rule 610 shall not apply to binary options.

[Rule 1506 replaces Rule 610.]

Acceleration of Expiration Date

RULE 1507. If the Corporation determines in its discretion that the underlying interest value for a binary option (other than a credit default option) has become fixed prior to the expiration of the option, such value will be treated as the closing underlying interest value and the expiration date of the option contract will ordinarily be accelerated to fall on or shortly after the date determined by the Corporation to be the date on which such value became fixed. If a credit default option is deemed to have been exercised on any day prior to the expiration date, the expiration date will be accelerated to fall on the date of exercise.

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 December 5, 2006.

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 purpose of this rule change is to permit OCC to clear and settle a type of option that is related to the creditworthiness of an issuer or guarantor ("reference entity") of one

or more specified debt securities (“reference obligation(s)”).³ Credit default options (“CDOs”) are binary options that pay a fixed amount to the holder of the option upon the occurrence of a “credit event” affecting the reference obligations. Characteristics of CDOs are described below, followed by an explanation of the specific rule changes being proposed to clear them.

Description of Credit Default Options. CDOs are structured as binary options⁴ with an automatic exercise feature. A CDO will be automatically exercised and the exercise settlement amount will be payable if a “credit event” occurs at any time prior to the last day of trading. A “credit event” is defined, generally speaking, as any failure to pay on any of the reference obligations or any other occurrence that would constitute an “event of default” or “restructuring” under the terms of any of the reference obligations and that the listing exchange has determined would be a credit event for purposes of the CDO. Under CBOE’s current proposal, the payout or “settlement amount” for a single exercised option would be \$100,000. CDOs represent a type of binary option that is automatically exercised immediately upon confirmation of the occurrence of a defined event.

³ The options are proposed to be traded on the CBOE. CBOE’s proposed rules for CDOs were filed for approval by the Commission in SR-CBOE-2006-84 and Amendment No. 1, 2, 3 and 4 thereto. *See* Securities Exchange Act Release 55251 (February 7, 2007).

⁴ “Binary” options (also sometimes referred to as “digital” options) are all-or-nothing options that pay a fixed amount if automatically exercised and otherwise nothing.

OCC does not currently clear any binary options, although OCC has filed a rule change⁵ seeking to clear binary options on securities and securities indexes that have been proposed for trading by Amex and CBOE.⁶ The rule filings of OCC, Amex and CBOE are still pending approval by the Commission, and OCC expects to amend its binary options rule filing in the near future in order to conform it to the changes made in this filing and to make any additional changes necessary to accommodate the Amex and CBOE products. Under these rule filings, binary options are proposed to be traded on the price of single securities or on indexes of securities where the option is exercised if the closing value of the underlying interest meets the specified criterion for automatic exercise, which could be defined as “at or above” a certain value, “below” a certain value, or in other ways. In other words, the underlying interest is a continuous measure that could have a wide range of positive values. CDOs, on the other hand, are options for which the payout is determined by the occurrence or non-occurrence of a discrete credit event affecting underlying securities. The rules proposed in the current rule filing for CDOs are intended to be sufficiently generic to be the basis for clearing CDOs as well as other binary options, although certain provisions specific to other binary options proposals will be filed separately.

By-Law and Rule Amendments Applicable to CDOs. In order to accommodate trading in CDOs and to provide a framework of rules that can accommodate other

⁵ See SR-OCC-2004-21.

binary option products as well, OCC proposes to add a new By-Law Article and a new Chapter to its Rules, incorporating several new defined terms and procedures for clearing and settling binary options generally and CDOs specifically.

1. *Terminology—Article I, Section 1 and Article XIV, Section 1*

“Binary Option” is defined in Article XIV, Section 1 of the By-Laws, and that definition is cross-referenced in Article I of the By-Laws. The definition of “expiration time” in Article I is modified to be a default provision, permitting the expiration time to be defined differently for different classes of options. The definition of “option contract” in Article I of the By-Laws is amended to include a binary option, and to provide a more generic definition of “cash-settled option.”

“Adjustment event” is defined in Article XIV by reference to the rules of the listing exchange. Similarly, “credit event” is defined by reference to exchange rules. The terms “credit event confirmation” and “credit event confirmation deadline” are used, respectively, to refer to the notice that must be provided by the listing exchange or other reporting authority to OCC that a credit event has occurred (and that a CDO will therefore automatically be exercised) and to the deadline for receipt of such notice if it is to be treated as having been received on the business day on which it is submitted. Credit event confirmations received after the deadline on the expiration date but before the expiration time will be given

⁶ See SR-AMEX-2004-27 and SR-CBOE-2006-105.

effect but may result in delayed exercise settlement.

The definition of “exercise price” in Article I would be replaced in respect of CDOs with a revised definition in Article XIV, Section 1 which recognizes that binary options will be settled by a fixed cash payment. The “exercise price” of a binary option is not, as defined in Article I, an amount that is paid in exchange for an underlying interest nor is it used to determine the exercise settlement amount as in the case of other cash-settled options. In the case of a binary option other than a CDO, the exercise price is simply a defined value or range of values for the underlying interest. If the underlying interest falls within the defined range at expiration of the option, the option will be automatically exercised. Otherwise, it will expire unexercised. A CDO is said to have no exercise price.

OCC also proposes to redefine the term “exercise settlement amount” in Article XIV for purposes of binary options. The exercise settlement amount of a binary option is the amount specified by the Exchange on which the option is traded that will be paid in settlement of an automatically exercised option. CBOE has specified the exercise settlement amount for a single CDO as \$100,000. OCC’s proposed definition would permit an exchange to specify a different exercise settlement amount. The exercise settlement amount will be determined by the Exchange at the time of listing, when the Exchange fixes the other variable terms for the options of a particular class or series.

OCC proposes to replace the definitions of “variable terms,” “premium”

and “multiplier” in Article I of the By-Laws with revised definitions in Article XIV, Section 1, that are applicable to binary options generally. The term “class” is also redefined in Article XIV, Section 1. This new definition of “class” does not apply to binary options other than CDOs, and will need to be supplemented for other binary options. To be within the same class, CDOs must have the same reporting authority, which OCC anticipates will ordinarily be the listing exchange. This is necessary because of the degree of discretion that the reporting authority will have in determining whether a credit event has occurred.

CDOs will be a subcategory of binary options where exercise is triggered by a discrete event such as a “credit event” affecting the “reference obligations” issued by a “reference entity,” which terms are defined to have the meanings given to them in the rules of the listing exchange. The term “underlying interest” is defined, in the case of CDOs, to be the reference obligation(s) in respect of which the credit event will or will not occur. In the case of other binary options, “underlying interest” is defined as the underlying security, index or measure whose underlying interest value is compared to the option’s exercise price to determine whether the option will be automatically exercised. “Underlying interest value” is defined to mean the value or level of the underlying interest used to determine whether a binary option will be automatically exercised. The term “underlying interest value” is not applicable to CDOs.

2. *Terms of Cleared Contracts—Article VI, Section 10(e)*

A new paragraph (e) is added to Article VI, Section 10, so that an

Exchange is required to designate the exercise settlement amount, expiration date, and exercise price for a series of binary options at the time the series is opened for trading. Section 10(e) also reminds the reader that binary options are subject to adjustment under Article XIV.

3. *Rights and Obligations—Article XIV, Section 2*

Article XIV, Section 2 defines the general rights and obligations of holders and writers of binary options. As noted above, the holder of a binary option that is automatically exercised has the right to receive the fixed exercise settlement amount from OCC, and the assigned writer has the obligation to pay that amount to OCC.

4. *Adjustments of Credit Default Options—Article XIV, Section 3;
Determination of Occurrence of Credit Event—Article XIV, Section 4*

Article XIV, Section 3 provides for adjustment of CDOs in accordance with the rules of the listing exchange. CBOE's proposed rules provide for adjustment of CDOs in the case of certain corporate events affecting the reference obligations, and OCC proposes simply to defer to those rules and to the determinations of CBOE pursuant to those rules. Accordingly, OCC will have no responsibility for adjustment determinations with respect to CDOs. Adjustment rules for other binary options will be supplied as necessary for other products.

Similarly, Section 4 provides that the listing exchange for a class of credit default options will have responsibility for determining the occurrence of a credit event that will result in automatic exercise of the options of that class. The listing exchange has the obligation

to provide a credit event confirmation to OCC in order to trigger the automatic exercise.

New Article XIV, Section 5 provides, in essence, that the underlying interest value of a series of binary options other than CDOs will be determined by the Exchange or Exchanges on which such series is traded. OCC reserves the right to override that determination in certain circumstances. If a series of binary options is traded on more than one Exchange, OCC may use the underlying interest value received from the Exchange deemed by OCC to be the principal Exchange, or OCC may employ a procedure to derive a single value based on some or all of the values received.

5. *Exercise and Settlement—Chapter XV of the Rules and Rule 801*

Binary options would not be subject to the exercise-by-exception procedures applicable to most other options under OCC's Rules, but would instead be automatically exercised at expiration if the specified criterion for exercise is met. The procedures for the automatic exercise of binary options, as well as their assignment and settlement (including during periods when a Clearing Member is suspended), are set forth in Rules 1501 through 1505 of new Chapter XV and in revised Rule 801(b).

6. *Special Margin Requirements—Rule 601; Deposits in Lieu of Margin—Rule 1506*

OCC will not initially margin CDOs through its usual "STANS" system. Because of CDOs' fixed payout feature, further systems development is needed to accommodate these options in STANS. Until such development is completed, OCC has initially determined to

require that writers of such options post margin in a fixed amount that will be set at 100% of the fixed exercise settlement amount applicable to each series of CDOs. OCC would have discretion to reduce the requirement to something less than 100% if research, analysis and experience suggest that a lower percentage is sufficient. Initially, long positions in CDOs will be valued at zero and will provide no offset against margin requirements on the shorts. Again, based on research, analysis and experience, OCC may determine to give some value to the longs. Ultimately, CDOs will be incorporated into the STANS system and valued and margined on a risk basis.

OCC does not propose to accept escrow deposits in lieu of clearing margin for binary options. Therefore, Rule 1506 states that Rule 610, which otherwise would permit such deposits, does not apply to binary options.

7. *Acceleration of Expiration Date—Rule 1507*

This provision would permit OCC to accelerate the expiration date of a binary option when the value of the underlying interest has become fixed (e.g., where a stock underlying a binary option has been converted by a merger into the right to receive a fixed amount of cash). If the value of the underlying interest does not meet the specified criterion for automatic exercise, it would expire unexercised. Otherwise, it would be automatically exercised.

* * *

The proposed changes to OCC's By-Laws and Rules are consistent with the purposes and requirements of Section 17A of the Securities Exchange Act of 1934, as amended, because they are designed to promote the prompt and accurate clearance and settlement of transactions in, including exercises of, credit default options and other binary options, and to foster cooperation and coordination with persons engaged in the clearance and settlement of such transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of such transactions, and, in general, to protect investors and the public interest. They accomplish this purpose by applying substantially the same rules and procedures to these transactions as OCC applies to similar transactions in other cash-settled options. Other than as described in Item 3 above, the proposed rule change is not inconsistent with the existing rules of OCC, including rules proposed to be amended.

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

Written comments were not and are not 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

OCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934.

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

OCC does not seek summary effectiveness or accelerated effectiveness. Additionally, OCC will delay implementation of this rule change until distribution of a supplement to the options disclosure document, Characteristics and Risks of Standardized Options, addressing credit default options.

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

Not applicable.

Item 9. Exhibits

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

SIGNATURE

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 Navin /mp
William H. Navin
Executive Vice President and
General Counsel