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occ news

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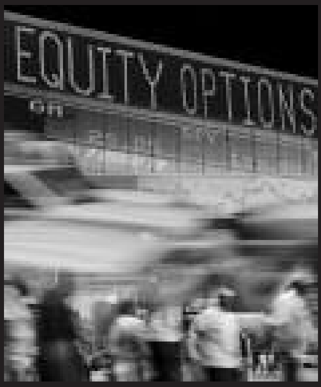
2nd annual new york equity conference a growing success

A new tradition is forming as about 350 people attended this year's FIA/OIC New York Equity Options Conference on September 20. That turnout was a significant increase over the roughly 300 who attended last year's inaugural conference.

Once again, the conference program was loaded with important and insightful panels and guest speakers. In addition to the keynote address by Erik Sirri, Director of the Securities and Exchange Commission's Division of Market Regulation, and the ever-popular exchange leaders panel, there were panels covering timely topics such as portfolio margining and penny quotes versus dollar strikes. In keeping with The Options Industry Council's mission, a couple of panels aimed at investment advisers looked at how top producers grow their options business and how advisors could build their book with options.

The pre-conference industry update session brought an overflow crowd to hear from options exchange representatives and The Options Clearing Corporation's **Mark Baumgardner**, Vice President, Business Operations, who detailed the Options Symbology Initiative. OSI, which is being coordinated by OCC, will bring major changes to the way options transactions are represented, and the conference was a good opportunity to get the word out about what people need to be doing now.



This year's conference also provided a terrific opportunity to celebrate OIC's 15th Anniversary. The anniversary reception was held on one of the spectacular balconies of Grand Central Terminal and featured a special guest. **Paul Stevens**, OIC's founding President —and former OCC President—joined the festivities in New York and intro-

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changes to cash dividend adjustment policies approved by sec

Earlier this year, the SEC approved changes to OCC's By-Laws regarding contract adjustments for cash dividends. OCC described these changes in an Options Disclosure Document supplement published in May 2007. Generally speaking, the policy changes will become effective for cash dividends that are announced on or after February 1, 2009.

Currently, cash dividends that are considered to be "ordinary" do not trigger contract adjustments. However, a cash dividend that is greater than 10 percent can be deemed as "non-ordinary" or "special" and therefore eligible for a contract adjustment – a practice known as the "10% Rule." Under the new policy, a cash dividend or distribution could be eligible for a contract adjustment, regardless of its size or percentage, if the dividend is paid outside the regular dividend paying practice of the company.

In order to provide some limitation to symbol proliferation which can occur as a result of contract adjustments, dividends that are deemed to be non-ordinary will also be subject to a $12.50 per contract size test. This means that in order for a dividend to be considered "special" and therefore eligible for a contract adjustment, it also must result in a per contract value of at least $12.50.

The determination whether any cash dividend is in fact "non-ordinary" or "special" and therefore eligible for option contract adjustment will be made by an Adjustment Panel of the OCC Securities Committee. This panel, comprised of representatives of each exchange that trades the affected option and a representative of OCC, will consider each dividend event on a case by case basis.

To address the concerns of those who felt existing open interest should not be subject to the revised approach, OCC has implemented a "grandfathering" plan that will allow any open interest that existed when the new rules were approved and announced to permanently continue to be subject to the 10% Rule. These equity option positions will never be subject to the new methods. Two separate operational plans are being implemented to grandfather positions under the 10% Rule -- one for standard and LEAPS® equity options and one for equity FLEX options.

For standard and LEAPS equity options, the effective date for the new policy has been set far enough into the future (i.e., February 1, 2009) to allow any open interest that exists when the new policy was approved to expire before the effective date. Equity FLEX options that existed at the time the new policy was announced and which also expire after February 1, 2009 have been designated as permanently subjected to the current 10% Rule. To identify these options, an option symbol change was effected.

Questions about contract adjustments for cash dividends and the 10% Rule can be directed to memberservices@theocc.com.

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duced OIC's 15th Anniversary presentation portion of the conference program.

After Paul provided some historical background, current OIC President **Gina McFadden**, Executive Vice President, Options Industry Services, outlined the many options education efforts now offered by OIC. A video presentation charted the course of OIC's 15 years with clips from different educational materials, advertising campaigns and various incarnations of the web site.

The success of this year's conference has already launched planning for the 2008 FIA/OIC New York Equity Options Conference.

lower clearing fees for the remainder of 2007

OCC announced this past July that temporary discounts will be applied to its 2007 fee schedule for the second time this year. Initial decreases were first implemented in May. Additional reductions were made effective September 1, 2007. The revised schedule, which is outlined to the right, will remain in effect through December 31, 2007.

OCC's Board of Directors also approved further discounting of the Market Maker scratch trade fee which will be temporarily decreased to $0.01 per side. This change also went into effect September 1 and will be applicable through the remainder of 2007.

Contracts/ Trades	Permanent Fee Effective May 1, 2007	Discounted Fee Effective May 1, 2007	Discounted Fee Effective Sept. 1, 2007
1 - 500	$0.05/contract	$0.035/contract	$0.02/contract
501 - 1,000	$0.04/contract	$0.028/contract	$0.016/contract
1,001 - 2,000	$0.03/contract	$0.021/contract	$15.00 (capped)
>2,000	$55.00 (capped)	$35.00 (capped)	$15.00 (capped)

industry insight

dan dewaal

Dan DeWaal is First Vice President and Chief Security Officer at OCC. Prior to assuming his current position, DeWaal managed OCC's Information Systems Security group from 1998 – 2002. Before joining OCC, he served more than twenty-two years in the U.S. Army where he held a variety of positions including Telecommunications Operations Officer and Communications Security Officer. OCC News recently spoke with DeWaal about his role at OCC and the complexities of managing security efforts in the 21st century.

What are some of your core responsibilities?

As CSO, I am responsible for the development, implementation and management of OCC's corporate security program, which includes physical/site, personnel and information systems security. I am also a member of OCC's IT Leadership Team where I oversee information security architecture and operations including infrastructure testing, application security and compliance testing.

How has your past work experience prepared you for your current position?

I think what has been most beneficial is my twenty-two plus years of service in the U.S. Army. There I served in a variety of challenging assignments that provided practical experience in the areas of command operations, planning and support. I guess you could say that my security training began when I entered military boot camp in the '70s. Army basic training introduced me to fundamental security principles that I find still hold true today – having the ability to assess the situation, then design and implement a plan that will detect, protect and respond to the threat. These same principles are applied to our security efforts at OCC.

In today' post-9/11 world, there are several issues that OCC must be prepared to address. What are some of the major challenges we face when it comes to security?

We live in an increasingly complex world where we have to consider threats that were never before imagined. OCC and the industry have acted on many fronts since 9/11 to shore up business continuity and security. We work closely with industry groups to devise a security strategy. We also work in collaboration with our regulators to coordinate security efforts and share threat data.

Still, in light of an increasing reliance on information systems and networks, together with the continuous threat to the Banking and Finance sector, we must maintain a constant security posture. There are difficult decisions to make in terms of weighing the benefits of implementing additional measures to protect facilities against the costs of expanding business continuity capabilities. We work proactively with our public and private partners by examining these sensitive trade-offs and coordinating our business continuity and security plans accordingly.

When speaking about homeland protection, we're not just talking about terrorism, but informational security as well. What are some of the practices in place to help protect the massive amount of information that is transmitted, both internally and externally through OCC?

You're right. We aren't just talking about the threat of terrorism. In order to be effective, a security program needs to address the protection of all critical infrastructure and key resources. Information is essential to our business and, therefore, needs to be protected accordingly. This is especially important as our environment becomes increasingly interconnected. As a result, information is now exposed to a growing and wider variety of threats and vulnerabilities.

We achieve information security at OCC by implementing a suitable set of controls, including policies, processes, procedures, organizational structures and numerous software/hardware functions. Our program is modeled after an international standard for information security (ISO 17799), a code of practice that provides a common framework for information security management.

What are some of the ways that OCC manages to stay 'ahead of the game' on the security forefront?

I have to say we stay ahead of the game by taking a proactive approach to security risk management at all levels. Everyone at OCC is involved in the issue of security. One group in particular is the Security Working Group (SWG), which is comprised of staff from a variety of areas throughout OCC including technology and internal audit. The SWG meets regularly to review new intelligence and assess risk to OCC information systems. They ensure that information security issues are identified and provide recommendations to our security policies and standards. SWG members are the designated security champions for their respective areas.

You work with a number of organizations and participate on committes related to homeland and informational security. One such organization is the Financial Services Sector Coordinating Council (FSSCC). What is your involvement with FSSCC and what issues does this organization address?

OCC's Management Vice Chairman, George Hender currently chairs FSSCC and when he took on that role, several others at OCC signed up to serve in a leadership capacity in support of FSSCC's efforts. As a member of the Leadership team, I participate in managing a number of initiatives including Research and Development (R&D), which helps the Department of Homeland Security (DHS) identify and prioritize which science and technology initiatives will benefit the Banking and Finance sector. I'm also involved with the Homeland Security Information Network (HSIN), which works with the DHS in establishing a HSIN interface for the Financial Services sector.

The bulk of my FSSCC activity involves working with its designated operational arm, the Financial Services Informational Sharing and Analysis Center (FS-ISAC). OCC was a founding member of this organization, which was established in 1998. FS-ISAC, in collaboration with the Treasury and FSSCC, works to enhance the ability of the financial services sector to prepare for and respond to cyber and physical threats, vulnerabilities and incidents. I currently serve on its Board of Directors and I also chair the Product and Services Committee.

Security is a concern that tends to be both constant and looming. How does Dan DeWaal decompress from dealing with such a high priority issue day in and day out?

Similar to many other high stress level jobs, it's important to recognize the need for self-maintenance. You have to make time to decompress and do other things outside of work. I find that it helps me to be more productive in the office or when an emergency situation does occur. It's something that I not only stress with myself, but with the whole security team.

When my sons were younger, it was a lot easier to decompress because I was involved in school activities and scouting. Now that my wife and I are "empty nesters," I have had to adapt and find other ways to decompress. I really enjoy home repair and remodeling. My wife is an avid walleye fisher, so she and I do a lot of fishing. It's actually become my new relief value.

osi implementation schedule announced

The industry-wide Options Symbology Initiative (OSI) continues to make progress with the announcement of the implementation schedule, incorporating three primary phases for the process. To start the implementation, OCC and the exchanges have each published strategies for their respective market participants.

The first phase begins with the exchanges and OCC developing record layouts that support both the new and old data formats. Tentatively scheduled for completion by June 2008, OCC and the exchanges will be responsible for supplying and accepting both existing and OSI-compliant data values in new record layouts. This comes at the request of market participants for a mechanism to determine the quality of new inbound data elements to initiate early feedback prior to moving on to further steps in the implementation process.

The second phase will commence in January 2009 with industry-wide scripted testing. Tests will be conducted in an environment where both pre- and post-data conversion events are validated and the symbol conversion plan is executed.

Finally, on July 31, 2009, all market participants must be prepared to process in an environment absent OPRA codes and utilizing decimal strikes in the existing symbology method. The symbol consolidation will commence according to the plan which is due to be published on December 1, 2008. The overall goal for this implementation strategy is for all applications to be put into operation and tested by August 2009, and at that time OPRA codes will become obsolete from all data interfaces.

OSI was developed in response to limitations in current methods, which have been magnified as options volume continues to increase. Representatives from various organizations participate in the Symbology Committee and feedback from these organizations has assisted in shaping the Committee's direction for the project.

For more information, visit OCC's Web site at www.optionsclearing.com/initiatives/symbology/default.jsp, or contact Mark Baumgardner, Vice President, Business Operations at mbaumgardner@theocc.com.

updates from the hill

By Bradley Edgell

With Democrats taking control of Congress, 2007 has been busy for OCC in Washington, D.C. With many new faces, our focus has been to conduct outreach to Members of Congress and their staffs to educate them about critical issues concerning the options industry.

We are aiming to meet with 31 House Financial Services Committee (HFSC) offices and all 21 Senate Banking Committee member offices. These meetings provide an excellent opportunity to introduce our industry to decision-makers and to learn more about their interests related to capital markets. As global markets and our industry grow, these relationships should help inform Washington policy-makers about key securities issues such as the options penny pilot program, the new product approval process, the options market-maker exception to Reg. SHO, the process for approving exchange and OCC rule changes, recognition of non-U.S. regulatory systems and products by the SEC, and SEC/CFTC merger.

The HFSC, chaired by Rep. Barney Frank (D-MA), has approved 21 bills and held 56 hearings already this year. Several hearings focused on capital market issues, such as those impacting hedge funds and private equity. For the first time in more than a decade, all five SEC Commissioners testified before the HFSC on June 26 and members of the President's Working Group on Financial Markets appeared before the committee on July 11. At both hearings, OCC worked with Members of Congress to ensure that questions were offered related to our industry. We are closely monitoring actions by this Committee to ensure that our concerns are shared with Committee staff and Members of Congress.

The House may also consider tax legislation (H.R. 1284), which would tax carried interests of partnership as ordinary income, instead of capital gains treatment. Rep. Sander Levin (D-MI) and Rep. Charlie Rangel (D-NY), Chairman of the House Ways and Means Committee, are supporting this effort to change tax policy. The Levin-Rangel bill could have an adverse impact on some options market-makers organized as partnerships, and we are closely following this bill. Senator Max Baucus (D-MT) and Senator Chuck Grassley (R-IA) have introduced similar legislation, which would impose higher tax rates on publicly-traded partnerships.

The Senate Banking Committee, chaired by Senator Chris Dodd (D-CT), has also examined industry issues by holding hearings on cross-border exchange mergers and the state of the securities markets.

In addition to congressional action, there have been significant regulatory actions that impact OCC clearing members. SEC Commissioners voted in June to eliminate the options market-maker exception to the regulation governing short selling (Reg. SHO) while also proposing two alternative approaches. Once these proposals are published in the Federal Register, OCC plans to coordinate a comment letter from the options exchanges in support of the exception. Additionally, the SEC held a roundtable on June 11 about mutual recognition, and Chairman Christopher Cox stated he expects the SEC to take action on the issue later this year.

operations roundtable updates

This summer, OCC's Operations Roundtable welcomed five new members to the committee: Kelly Bell of Southwest Securities; Bill Metzger of J.P. Morgan Securities; Bryan Johnson of Penson Financial Services; George Swindasz of National Financial Services; and Jose Varughese of RBC Capital Markets. These new members, along with the rest of the Roundtable, will focus on processing improvements on behalf of OCC from 2007 – 2009.

The Roundtable established several goals and objectives for the new term including:

- The creation and execution of a road map to expiration Friday night processing
- The development of a real-time bookkeeping system for clearing members
- The application of customer and branch sequence identifiers on trade records

In addition, the options industry is currently in the process of changing the equity expiration threshold from $.05 to $.01 for all account types. OCC has surveyed clearing members regarding this change and 83 percent of respondents agreed with the move to $.01. This initiative, which has been approved by OCC's Board of Directors, will go into effect in 2008.

cross-margining affected by ice and russell index partnership

This past June, Russell Investment Group reached an agreement with Intercontinental Exchange Inc. (ICE) giving it exclusive rights to list stock index futures contracts based on the full range of Russell's indexes. This move means that futures and options on futures tied to Russell indexes will no longer be listed on the Chicago Mercantile Exchange (CME), but will instead be solely listed with ICE.

This arrangement will have an impact on OCC's Cross-Margin program operations as OCC recognizes the offsetting of hedged positions maintained by firms across multiple products cleared at CME's clearinghouse. The dynamics of this relationship will change as open interest flows from CME to ICE, who has a different clearinghouse than CME. The concern for clearing members is how cross-margin accounts will be impacted once this transition goes into effect.

OCC has been working diligently to create an operational solution that will have minimal impact on its participating members. Currently, OCC and ICE Clearing US are in discussions regarding a separate cross-margin relationship and work is in progress to bring this solution to market in an expedited manner. There are two phases under this approach. The first is to disseminate both risk-based haircut and SPAN arrays to the market, which will provide for offsets between the products (ICE futures and OCC options) for market makers. The second phase would provide for a full cross-margin clearing solution between OCC and ICE.

Plans to implement these solutions are currently in progress.

oic and occ host european roundtable discussions

OIC and OCC hosted two European Roundtable discussions this past spring in London. Building upon the momentum first established after a Capco survey showed that 15 to 20 percent of volume originates in Europe, the European Roundtable was developed to help facilitate an open dialogue between the U.S. options industry and Europe's financial communities. The Capco study, conducted on behalf of OIC, further revealed some misconceptions about the U.S. options market begging the need for a forum to candidly discuss these issues.

Otto Näegeli, a consultant for OIC's international outreach efforts who spearheaded the development of the European Roundtable, views these discussions as a massive opportunity for OIC and OCC to educate and inform while at the same time dispel widely-held misperceptions that European market participants may have about the U.S. options industry. "A substantial amount of business is handled in Europe," said Näegeli. "Consequently, the U.S. markets should care about this customer segment and listen to the concerns and comments of this group."

Roundtable participants from OCC included **Susan Milligan**, Senior Vice President, Government Relations and Communications, and **Gina McFadden**, Executive Vice President, Options Industry Services. McFadden provided an explanation of the U.S. Operations Roundtable process as well as an overview of the Options Symbology Initiative, the Expiration Threshold Reduction and the Adoption of Real-Time Clearing Data. The second Roundtable discussion, which took place eight weeks later, focused on issues related to market trading. Representatives from all six options exchanges were in attendance.

Participants came away from both meetings with a better understanding of the concerns that European financial intermediaries have about the U.S. options market and how OIC and OCC can better address these issues. "We were successful in explaining certain U.S. processes," Näegeli said. "We also got a number of suggestions and recommendations from the European constituency, which will be discussed with the Operations Roundtable."

Plans for additional European Roundtable discussions are currently underway.

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