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# OCC news

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## Annual refund announced, clearing fees remain low

OCC announced this past December that it will maintain its discounted clearing fee schedule implemented in July 2005. OCC's Board of Directors also approved a full refund of 2005 earnings because of the record contract volume experienced throughout the year. The refund will take place in two disbursements: \$20 million delivered in December, with an additional \$29,648,466 to be disbursed later in 2006.

Effective July 1, 2005, OCC reduced the base discounted fee from seven cents to five cents per contract. The discount is most notable for trades between one and 500 contracts, which account for approximately 75 percent of the contracts cleared by OCC. Trades between 501 to 1,000 and 1,001 to 2,000 contracts remain at a per contract fee of four cents and three cents, respectively, while trades above 2,000 contracts are charged a flat fee of \$55. The average contract fee remains at an all-time low, with the current average contract fee about half of what it was two years ago.

OCC continues to implement methods and procedures that aggressively control costs, while providing member firms and participant exchanges with the expected high levels of quality, responsiveness, and safe clearing systems.



## Roundtable proposed increased threshold reductions

As a result of increased volume and open positions, as well as great success with the exercise by exception threshold reduction for equity options implemented in September, 2004, OCC's Operations Roundtable proposed to OCC's Board in March to further reduce threshold amounts to five cents for clearing member customer, firm and market maker accounts.

"Reduced thresholds result in reduced operational risk and improved back office processing for our member firms," said Dave Harrison, director of member services.

OCC first reduced thresholds for equity options going from 75 cents to 25 cents in a clearing member's customer account, and from 25 cents to 15 cents for firm and market maker accounts.

OCC automatically exercises options that are in-the-money at expiration by more than the specified threshold amount unless the clearing member carrying the position instructs OCC otherwise. The lower thresholds allow for an increased number of contracts to be automatically exercised, saving time by reducing processing timeframes and staff overtime associated with expiration Saturday.

## Annual survey gauges member satisfaction with OCC

Operations Roundtable participants were recently asked to complete OCC's annual survey to assess systems performance, timeliness and reliability, collateral and ancillary services, communications, Internet services and overall customer service. OCC uses results to establish corporate projects for enhancements and improved services.

Fifteen members were sent and responded to the performance review questionnaire, four of which were new roundtable firms. Together, the 15 respondents represent 80 percent of OCC's cleared contract volume.

Overall, more than half the respondents reported overall satisfaction with OCC as "very satisfied," while the remaining respondents were "satisfied." Forty percent felt that OCC's level of service improved over 2004, while the remaining 60 percent felt OCC maintained the same high level of service. The majority of responses marked OCC higher in every category compared with other clearing corporations.

OCC also asked respondents about their experience with the ENCORE clearing system and related releases. Two thirds of respondents were very satisfied with the system.

## Options in the news

### **Barron's - Jan. 2, 2006**

■ "Options - The Striking Price: Volume Booms in 2005," reviewed the record year in 2005, using data provided by OCC. The article noted that exchange-traded funds (ETFs) were the big standout, with five ETFs making the 2005 list of the 20 most popular options. Also highlighted were 2005's four busiest equity options—Google (GOOG), Altria (MO), Apple Computer (AAPL) and General Motors (GM).

### **Business Week - Nov. 28, 2005**

■ Reporter Adrienne Carter documented her experience taking a two-day introductory course on trading options in the article, "The Agony of Options." Carter was humbled by the course, likening trading options to "learning to speak a foreign language." Before she would feel confident trading options in the real world, Carter said she would need further preparation and education, such as repeating the course, reading materials on the subject, and practicing online using virtual trading programs. The article mentioned The Options Industry Council (OIC).

### **Kiplinger's Personal Finance - October 2005**

■ "How to Win in Any Kind of Market," addressed how to use options in conservative ways to meet individual goals. The article discussed options basics and demonstrated how options allow investors to get "more bang for your buck." A variety of simple, conservative strategies were demonstrated using realistic examples, including the story of how an investor used options to rebuild her retirement after her employer defaulted on its pension. The article cited OIC and the 888options.com Web site as a resource.

# industry insight

## Management Vice Chairman George Hender

*OCC News asked Hender about his recent appointments in industry groups and his roles at OCC and OIC.*

### **You are active in a number of industry groups. How has your involvement helped your role at OCC and vice versa?**

I'm involved in two aspects of the industry. The first area is directly related to our exchanges, our clearing members, our customers and other clearing organizations. It's clear to me that although we have a thriving business, the world is changing and business is changing, and it's important to interact with our customers and other clearinghouses to establish personal relationships with them. On the clearing side, if we have some kind of financial issue, such as a member with financial difficulties, it's helpful to have relationships with heads of other clearinghouses. I know I can call them and they'll be honest with me about the type of issues we're facing.

The other area I'm active in pertains to homeland security issues. Shortly after 9/11, the federal government identified OCC as one of the 10 to 15 financial organizations in the U.S. that really can't afford to fail. Because of OCC's important role in the U.S. financial system, the federal government asked me if I'd be willing to help prepare the industry for any kind of terrorist issue, physical attack or cyber attack. And recently, we've added natural disasters, such as hurricanes, to the list. This led to OCC's active participation in the Financial Services Sector Coordinating Council (FSSCC). I will assume the role of FSSCC Chairman this summer. We look at where we are vulnerable as an industry. We encourage connectivity testing. We are working on a set of procedures to assess sector readiness.

OCC has been on the cutting edge in developing business continuity practices. ChicagoFIRST, the financial services regional business continuity organization, really came out of this effort. OCC was instrumental in the creation of ChicagoFIRST. Now, ChicagoFIRST is being used as a model around the country. Something similar has already started in Miami, and soon will in San Francisco and Los Angeles. New York already has a program in place.

I'm also involved in an organization called the Financial Services Information Sharing and Analysis Center (FS-ISAC) that was created as a communications vehicle and provides intelligence information on cyber and physical threats. We've been successful in enlisting key members of the financial community. The goal is that if something were to happen, the Secretary of the Treasury can reach the community within a matter of minutes or seconds, day or night via FS-ISAC.

I do these things to make OCC a safer organization, and to make sure I know what's going on globally and domestically. I make sure we are aware of challenges and how to manage them.

### **Do you think that the FSSCC and FS-ISAC will consolidate?**

At a minimum, I'd like to see these organizations grow much closer. I would like to see the FSSCC recognized as the private sector policy-level body and the FS-ISAC as the communication forum for organizations in the financial services sector. The FS-ISAC has a permanent staff of one; FSSCC has no permanent staff. One of the issues we discuss is that when the existing FSSCC chairman steps down, a lot of institutional knowledge walks out the door. It would be nice to have some permanent staff that would survive the chairman. I would like to expand the FS-ISAC staff to cover FSSCC responsibilities. If this occurs, formal consolidation might not be necessary.

### **You have leadership roles with several international organizations. What are your thoughts on the future of clearing and global consolidation?**

I was prior chairman of the International Organization of Central Counterparties (CCP12). During that time, the International Organization of Securities Commissions (IOSCO) and the Bank for International Settlements (BIS) were establishing standards for clearinghouses. I am also chairman of the International Options Clearing Association (IOCA), and the executive committee of the International Options Markets Association (IOMA). IOCA was started by countries with options exchanges to discuss common issues in clearing. Globally, just about every country is moving toward clearing futures as well as options, so that has changed the organization some.

In Germany, for example, stocks, options and futures are traded and cleared in what I call a vertical silo—a central organization. For competitive reasons, the exchanges like that model. They control clearing, which makes it very difficult for someone to go into Germany and start an exchange. It hinders competition. People who use those exchanges have to belong to many clearinghouses.

In the U.S., you have OCC's model of clearing fungible contracts for a number of exchanges. This model allows the options exchanges to compete for market share and grow the business without maintaining their own clearinghouses. It's a great model for customers because it leads to very tight markets and very low transaction costs. On the futures side, most of the futures exchanges have their own clearinghouses, although the Chicago Board of Trade does clear through the Chicago Mercantile Exchange. I don't see much desire on the part of the U.S. futures exchanges to adopt our OCC model, although their customers might want them to.

In the next five years, I don't see much consolidation among clearinghouses. It's not going to happen for competitive reasons. I've been asked why OCC hasn't gone into other countries and taken over clearinghouses. Governments really don't want an entity like OCC, which they don't control, owning their clearinghouse. If there was a type of central banking system attack, for example, they don't want OCC calling the shots.

### **What business areas of OCC are you responsible for?**

As I see it, my job is to make sure that we have good relationships

with a number of different players. First, we need to have good relationships with our members and exchanges as well as other exchanges and clearinghouses, both domestic and international. These relationships are important for business and risk reasons.

I also am involved with the non-options industry forces that influence our business as well—regulatory and legislative. That's why we have a presence in Washington, D.C. Unless you watch carefully what's happening on the legislative side, some new law may pass that can hurt our business. So it's important to pay attention to what's going on in Congress and to have strong relationships with regulators: the Securities and Exchange Commission, Commodity Futures Trading Commission, Federal Reserve and Treasury Department.

I am President of The Options Industry Council (OIC). Options as financial products are not the easiest to understand. We have been successful for years with education. We make sure that we get the right message out there. Education is a powerful tool that helps us grow the business.

I also have a role in the important policy decisions made at OCC. For 18 years I've acted as partner with Wayne [Luthringshausen, OCC Chairman of the Board and Chief Executive Officer]; we rely on each other. We collaborate and I play an active role. We are building a team for the future.

**Explain your involvement in OCC's strategic planning and business development.**

It's always been my philosophy that if a company doesn't change with the times, eventually it's going to die. I try to make sure that we position ourselves for the future.

One way OCC puts this into practice is through technology. Our old clearing system would not carry us into the future. To continue to serve our clearing members, we really had to build a new system. It's one of the most important things we've done. If you look at today's volume, it's clear that the old system would've failed. ENCORE is scaleable, so we are able to actually test for double our highest daily volume. We would've never imagined we'd be clearing a 14 million contract day two years ago, but that's where we are today.

More than 20 percent of our business comes from abroad, so over the years I've also spent time in countries educating and getting the message out about options. I like to turn over new stones. This helps us open our eyes to new opportunities.

Our ownership structure prevents us from doing a lot of things I'd like to do. Nevertheless, the business has grown and we've handled opportunities that have presented themselves. We have to live with the environment. We have to continue to be creative to come up with new ways of getting things done.

You look at the exchanges that have gone public, and they've had very successful IPOs. OCC would be a very successful IPO. But it's not going to happen before I retire. We have tremendous value as a company in servicing customers and in continued dramatic fee reductions, such as reducing cost from nine cents to below four cents per contract. That itself has grown the business.

**What is the current focus of OIC?**

OIC's future is very bright because the options product continues to grow for many reasons. Colleges and business schools now have courses on derivatives. Technology and the Internet are natural assets for options.

What we are doing now is taking a step back and looking at the past, present and future of OIC. Are we using the Internet to its fullest extent? Are we advertising in the right places and forums? What should we do internationally? Historically, Europe is a more institutional market and is growing dramatically. We are just now starting to see retail business there. China and India are huge forces in the world economy—what should our strategy be there? We are considering all of these questions.

OIC is very important. The growth in options is a direct result of OIC's role. There are other factors, certainly, but OIC is an important one. This business almost went away after the '87 crash. If it hadn't been for OIC, this powerful product could've disappeared; OIC helped the market recover more quickly.

**How do you reflect on your career at OCC?**

I feel lucky to have been involved with this business and to be part of OCC. I knew it was a great product early on, but never in my wildest dreams did I imagine it would become what it is today.

I feel fortunate to be part of this quality organization, offering quality services. Today when you see large companies like United Airlines in and out of bankruptcy, struggling to survive, I am proud to work for an organization that is financially and structurally so strong.

This is still an exciting and vibrant place to be. I am learning every day.



## New year, new records

January and February 2006 kicked off the year by setting a number of records, including a new monthly volume record of 178,192,636 contracts traded in January. January volume represented a 51.7 percent increase over the 117,452,308 options contracts traded in January 2005, while volume in February rose 34.5 percent over the same period last year.

Another highlight was back-to-back record trading days on Jan. 19 and 20, with 11,523,913 contracts and 14,888,644 contracts traded, respectively. These two days now hold the top one and three spots of the top 10 highest total options volume days. January holds four of the top 10 spots, overall. February continued the trend of high volume, and concluded the month as the fourth best month ever for trading volume, after January 2006, November 2005 and October 2005.

Additionally, average daily volume in January was 8,909,632 contracts, and open interest reached an all-time high on Jan. 20 of 220,641,740 contracts.

"OCC's ability to efficiently process more than 300 million contracts over the course of the two months, with a huge surge over expiration week in January, is a testament to our core processing system, ENCORE, and the diligence of our employees," said Mike Cahill, OCC president and chief operating officer. "Our commitment to ongoing tuning efforts has allowed OCC to meet the demands of a near doubling of our daily volume record in the past two years."

These impressive accomplishments come after a record 2005 when year-end total options volume surpassed 1.5 billion contracts.

## Annual objectives include enhanced services for futures clearing

Due to recent growth within the futures markets, part of OCC's 2006 corporate objectives includes enhancing services to support futures clearing. This is a direct response to input from futures commission merchants to bring ease and connectivity to clearing. OCC is seeking to enhance its futures clearing infrastructure by addressing delivery allocations, futures-style adjustments, trade management services and the GAINS system (give-up transaction billing).

Phase I of the initiative is complete, with OCC implementing allocations and futures-style give-up functionality on ENCORE, our web-based online system. Processing via FIXML is expected to be available mid-year. The trade management portion of the initiative will add customer type indicator (CTI) and origin codes to records that identify what account the order and/or trade is for, and allow members to update non-critical information on a futures trade. Futures-style position adjustments will allow firms to give ending position amounts consistent with the practice of other futures clearing organizations. Additionally, OCC will strive to deliver GAINS-style commission billing via an existing application interface.

## Symbology project initiative moves forward

OCC's Board of Directors initiated a symbology project last July to eliminate OPRA codes in the listed options market. Since then, a committee of industry operations professionals has reached consensus on standard data elements to be used to identify listed options. OPRA decided to continue to use a single alphabetical character to denote the expiration month and call/put indicator on inbound and outbound quote traffic. However, all vendors, options exchanges, exchange members, OCC, OCC members and related parties will be asked to eliminate the use of OPRA codes for exchange-listed options in all other aspects of the trading and clearance cycle. Strike prices will be represented in decimal formats once the symbology plan is implemented.

Planning for implementation is underway. The Securities Industry Association's (SIA) options conference in May is being targeted as a venue to introduce the initiative to industry participants. The exchanges are developing detailed tools for analysis.

Benefits of the initiative include elimination of confusion over the LEAPS® rollover process and wrap symbols, reduced corporate action symbol(s) conversions, reduced frequency of coordination with the New York Stock Exchange for symbol elections, and decreased back office errors and trading errors.

## Save the date for annual Options Industry Conference



Planning for the 2006 annual Options Industry Conference is underway with the Philadelphia Stock Exchange serving as this year's host exchange. The event will take place May 3 - 6 at Loews Miami Beach in Miami Beach, Fla. For details or registration, visit [www.optionsindustryconference.com](http://www.optionsindustryconference.com).

## Employee program encourages leadership development

OCC's Mentor Program is in its ninth year, matching employees with management mentors to promote leadership development within the organization.

Human Resources Vice President Carol Letofsky developed the program, modeling it after programs she'd seen in other organizations. Senior management recognized the program's potential to increase retention and spur leadership development.

Human Resources matches pairs based on the mentee's career goals, often trying to mix business and technical individuals within the organization. "It's a great opportunity to learn about the other side of the business and their challenges," said Letofsky. "For those with a technical background, it's an opportunity to practice skills not common to their everyday role. For the business side, it gives a better understanding and appreciation of critical needs and what comprises OCC's IT systems."

Eleven to fifteen mentor-mentee pairs participate each year, with the program taking place from January to November. Each pair gives a presentation on topics such as teamwork, leadership, communication skills, industry and business topics and work-life balance. The program allows mentors to develop newer employees on speaking skills, organization and impromptu teamwork.

OCC employees interested in being a mentee complete applications based on their needs and career goals. More than 80 percent of OCC's officers and directors have served as mentors, many serving repeatedly. Many executives have served as well.

Another benefit of the program is networking for employees who wouldn't normally have an opportunity to interact. "We've seen a lot of lasting friendships and relationships develop," said Letofsky.

# occ news

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