SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50895; File No. SR-OCC-2004-11)

December 20, 2004

Self-Regulatory Organizations; The Options Clearing Corporation; Order Granting Approval of a Proposed Rule Change Relating to Yield-Based Treasury Options

I. Introduction

On June 8, 2004, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") proposed rule change SR-OCC-2004-11 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").[1] Notice of the proposal was published in the Federal Register on October 5, 2004.[2] No comment letters were received. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

II. Description

The proposed rule change updates two sections of OCC's By-Laws pertaining to yield-based Treasury options in order to conform those sections to the corresponding provisions of OCC's By-Laws governing index options.

Article XVI, Section 3(c) of OCC's By-Laws currently provides OCC with the authority to adjust outstanding options in a class of yield-based Treasury options in the event that an exchange decreases the multiplier. Section 3(c) will now provide for the possibility that an exchange might increase rather than decrease the multiplier and grants OCC the flexibility to adjust any outstanding options accordingly. This rule change is similar to a previously approved OCC rule change pertaining to the adjustment of index option contracts.[3]

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1 15 U.S.C. 78s(b)(1).

2 Securities Exchange Act Release No. 50466, (September 29, 2004), 69 FR 59634.

3 Securities Exchange Act Release No. 44184 (April 16, 2001), 66 FR 20342 (April 20, 2001) [File No. SR-OCC-99-12].

Article XVI, Section 4 of OCC's By-Laws currently provides OCC with the authority to fix the exercise settlement amount for exercised yield-based Treasury option contracts "in accordance with the best information available as to the correct settlement value of the underlying yield" if OCC determines that the settlement value of the underlying yield is unreported or otherwise unavailable for purposes of calculating the settlement amount for exercised contracts. Until recently, the Chicago Board Options Exchange ("CBOE"), on which yield-based Treasury options are traded, had a rule setting forth a specific method for determining the settlement value of the yield in the event the reporting authority failed to supply a settlement value. The CBOE rule setting forth that method, a random poll of a minimum of ten primary government bond dealers, was eliminated on December 2, 2003, when the Commission accepted for immediate effectiveness a CBOE rule filing deleting it. In that filing, CBOE adopted a provision stating that the settlement value would be determined in accordance with OCC's By-Laws and Rules.[4]

The repeal of the CBOE rule prompted OCC to review its own rules governing the setting of exercise settlement values for yield-based Treasury options. OCC is now amending Article XVI, Section 4 to give OCC substantially the same discretion in fixing exercise settlement values for yield-based Treasury options as it has under Article XVII, Section 4 governing index options.[5] As noted in the order approving OCC's rule change for index options, OCC's authority

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[4] Securities Exchange Act Release No. 48865 (December 2, 2003), 68 FR 68676 (December 9, 2003) [File No. SR-CBOE-2003-48].

[5] A draft supplement to the Options Disclosure Document ("ODD") that describes the substance of the By-Laws changes proposed herein will be filed with the Commission pursuant to Rule 9b-1 under the Act. Implementation of this rule change will be coordinated with the distribution of the related ODD supplement.

to fix exercise settlement values in unusual market conditions should be sufficiently broad to ensure that such values are consistent with the settlement values established for related products in other markets whenever that result is deemed to be in the best interest of investors.[6] While Article VI, Section 4(a)(2) as currently drafted is also broad, OCC believes that its authority should be expressed in language parallel to other By-Laws provisions that expressly acknowledge that a settlement price may be fixed based either on the last reported price before a market disruption or the next reported price following the disruption or by some other method.

As with index options, under revised Article XVI, Section 4(a)(2) the settlement value of yield-based Treasury options will be fixed by an adjustment panel consisting of representatives of the exchange or exchanges on which the affected series of options is traded. Also, under revised Section 4(a)(3), in the event the adjustment panel delays fixing a settlement value beyond the expiration date of the affected series, the normal exercise by exception procedures will not apply. Instead, options that are in the money by one dollar or more would be deemed to have been irrevocably exercised prior to the expiration time.

OCC believes that the proposed rule change is consistent with the purposes and requirements of Section 17A of the Act, as amended, because it is designed to promote the prompt and accurate clearance and settlement of securities transactions, foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, remove impediments to the mechanisms of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the

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6 Securities Exchange Act Release No. 46561 (September 26, 2002), 67 FR 61943 (October 2, 2002) [File No. SR-OCC-2002-09].

public interest. The proposed changes promote these objectives by providing OCC with flexibility in responding to unanticipated events.

III. Discussion

Section 17A(b)(3)(F) of the Act requires, among other things, that the rules of a clearing agency be designed to promote prompt and accurate clearance and settlement of securities transactions.[7] The proposed rule change will allow OCC to make an adjustment to the multiplier of yield-based Treasury options in coordination with such an adjustment by an exchange and more clearly defines the method OCC will use to make a settlement adjustment for yield-based Treasury options in the event the settlement value is not available. By aligning OCC's rules for yield-based Treasury option rules with OCC's rules for index options, which have been previously approved by the Commission, the proposed rule change is designed to add uniformity and certainty to OCC's rules and therefore should help to promote prompt and accurate clearance and settlement of securities transactions.

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular Section 17A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2004-11) be and hereby is approved.

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[7] 15 U.S.C. 78q-1(b)(3)(F).

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[8]

Margaret H. McFarland
Deputy Secretary

[8] 17 CFR 200.30-3(a)(12).