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occ launches STANS

new risk management methodology

The Options Clearing Corporation (OCC) successfully launched its new risk management methodology, STANS (ENCORE Release 4.8), August 4 - 6. STANS, an acronym for System for Theoretical Analysis and Numerical Simulations, is used to measure the risk exposure of portfolios of options, futures and cash instruments cleared and carried by OCC on behalf of its clearing members.

Last April, OCC commemorated the 20th anniversary of the installation of its Theoretical Intermarket Margin System (TIMS) methodology, the first portfolio margin approach used at a clearinghouse. STANS replaces TIMS and distinguishes OCC as the first clearinghouse to implement a Monte Carlo simulation approach to margining. The STANS model provides more precise margin calculations which should improve the financial stability of the derivatives markets, and produce clearing and settlement efficiencies beneficial to investors.

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Using Monte Carlo-based simulation techniques, STANS generates a set of 10,000 hypothetical market scenarios intended to provide a realistic evaluation of risk at the portfolio level. These simulated scenarios incorporate information extracted from the historical behavior of each individual security as well as its relationship to the behavior of other securities. Scenarios are generated for more than 7,000 risk factors, including a broad range of individual equities, exchange-traded funds, stock indices, currencies and commodity products.

In addition to the base simulation, STANS generates complementary sets of scenarios intended to measure increased portfolio risk given atypical market conditions.

OCC received approval from the Securities and Exchange Commission (SEC) to employ STANS in March 2006, however the successful installation of this dramatically advanced risk management approach at OCC was a result of nearly four years of diligent hard work by many individuals across the company.

Nearly 30 employees working in shifts implemented the new system over one weekend. More than 50 OCC staff members across the entire organization were directly involved in the development, testing and implementation of STANS. Departments that contributed to the effort included Risk Management, Application Development, Testing and Deployment, Technical Services, Database Administration, Enterprise Operations, Configuration Management, National Control, Treasury Operations and Member Services.

"The cooperation and team work among these groups over the past months leading to a successful install of this very complex system were exceptional," said Michael E. Cahill, OCC President and Chief Operating Officer. "We are convinced that the STANS methodology will be the gold standard for risk management at clearinghouses globally for many years."

oic surveys european market participants

The Options Industry Council (OIC) announced in September the results of its European Market Survey, which show that 15-20 percent of U.S. exchange-traded options volume originates from Europe.

The survey also found that while trading volume from Europe should continue to grow, the industry needs to address the technological, regulatory and information/educational barriers that exist between U.S. and European brokers and banks in order to reach its full potential. The industry also needs to develop a better understanding of the different needs of the various client groups in Europe.

Capco, one of the leading global providers of consulting services for the financial services industry, administered the survey in June 2006 which consisted of interviews with twenty broker-dealers, banks and asset managers of various sizes in key European financial centers.

Responses from these interviews indicate that most of the European order flow into U.S. options markets today originates from the larger global firms that have the resources to deal with a complex and sophisticated trading environment. Survey participants also indicated that encouraging greater volume from smaller European participants will require better access to technology, harmonization of processes, and enhanced educational activities.

As a result of the survey, OIC will form a European User Group in order to better gauge the input of European market participants and ensure there is open communication on topics of interest in the marketplace.

industry insight

occ's cfo and treasurer, frank larocca



Frank Larocca joined OCC in 1975 and is now Senior Vice President, Chief Financial Officer and Treasurer. In his current role, Larocca maintains management responsibilities for Accounting, Cash Management, Project Office, Human Resources and Office Services, as well as OCC's budget processes, banking relationships and the procurement process. He is a member of the American Institute of Certified Public Accountants and the Illinois Certified Public Accountant Society.

When you joined OCC more than 30 years ago, what was your first job here and how has your career progressed?

My first job was staff accountant and I was the fourth person in the department. We had a controller, department assistant and another staff accountant. I then became an accounting manager and was in that role for a few years. I started the internal auditing department and was the lone auditor for a couple of years, then I moved back to accounting as assistant controller. I was promoted to Vice President/Controller and then I became First Vice President/Controller in which I was responsible for Accounting, Human Resources, Office Services and Project Office. I've been in Accounting/Administration for 28 of my 31 years at OCC.

You are Chief Financial Officer, but also head up Human Resources. Why is this?

Human Resources is an administrative department which includes maintaining employee policies, benefit plans and recruiting. This is typically under the purview of the CFO.

In the past 30 years, how has OCC changed in terms of financial management?

The most significant change is the involvement of the financial management group in the negotiations with our vendors. This came about in the last few years with the development of the Procurement Team. It has had a major impact on cost containment.

How does OCC manage to keep up with best practices in Project Office?

Project management has changed dramatically. We send our staff to monthly Project Management Institution meetings where they network and learn the latest in best practices. We try to incorporate the best practices that are suited for OCC.

How has the Accounting department developed from the early days of OCC?

We have changed from typing checks and doing budgets and financial reports in pencil to having everything automated. What we used to do with dozens upon dozens of ledger pads, pencils and a lot of erasers is now all done with computers. There is always some manual work involved in reviewing invoices and such, but even that now is easier as all of our invoices are electronically scanned. In the early 1980s, the first computer we purchased was called the Leading Edge. We used it to create budgets and the PC explosion grew from there. Management was impressed with how easy it was to use and how much time it would save.

A lot of the work that we had asked department managers to help us with is now done only in the Accounting department. We still consult with department managers every year to discuss budgets by reviewing what's been done in the last year and what we expect our base budget to be for the coming year. We ask departments what new items they are proposing and their justification for those budget items.

We used to have a homegrown accounting system that was difficult to maintain. With advances in technology, we purchased a general ledger package that we have been running for about 15-18 years with upgrades. It is much easier to maintain and freed our internal resources for work on our clearing system.

What are the challenges, from a personnel and budget standpoint, when managing multiple locations?

From a budget standpoint, there are not many challenges. On the personnel side, each state has its own requirements for medical programs so we have to make sure that we are compliant and up-to-date with those. Other issues involve the payroll and state taxes, local taxes and what we have to file with the state and local governments - both for payroll and corporate tax purposes.

How has the evolution of the industry over the years impacted your role at OCC?

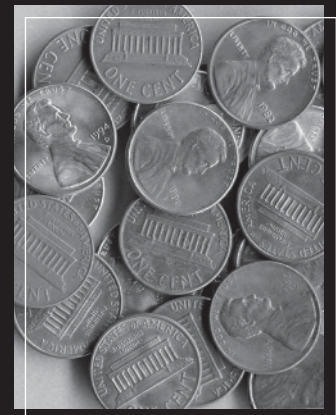
Probably one of the biggest challenges is how we constantly try to maintain being the low cost provider for the industry. The way the options industry has grown, our costs have dramatically been reduced on a per contract basis — obviously, the tremendous increase in volume impacts our per contract cost, but also we are cognizant of our budgets and control our costs.

When I was hired in 1975, the entire company consisted of approximately 35 people and we all shared in what needed to be done. Everyone had to work expirations. With automation and more defined department procedures, fewer people had to be around for expiration weekend. But everyone still pitched in when needed. The company matured with the industry.

It's been a great experience for me — the people, the environment, the challenges — and I'm excited to be a part of an industry that's flourishing and growing. I've learned a lot at OCC and I hope to learn even more over the years.

industry news

- o More than 1.6 billion contracts have traded as of the end of October, 37 percent more than at the same point last year. This volume is equal to all of the options contracts traded on the U.S. exchanges in 2005, making 2006 the fourth consecutive year a new annual volume record has been achieved.
- o Options trading is growing faster than stock trading in the U.S. Through August, the number of shares traded on the NYSE, Nasdaq and Amex was up 15 percent over the first eight months of 2005. Options volume during the same period has increased more than 42 percent.
- o In January 2007, exchanges will start to quote options prices in one-cent increments on a trial basis. The SEC has asked the exchanges to move from its five- to ten-cent increments to a one-cent increment, which is seen to increase the number of price points at which transactions occur. "The new increment price should not affect the way OCC clears trades," says Geri Love, First Vice President, Business Operations Group - Member Services.



chicagoFIRST celebrates third anniversary, participates in chicago business district evacuation

On June 28, the eve of ChicagoFIRST's three-year anniversary, the organization came together to recognize its achievements, receiving praise from Mayor Richard M. Daley at a reception attended by members, strategic partners and local dignitaries.

Mayor Daley joined federal and local officials to acknowledge the collective successes of ChicagoFIRST and the City of Chicago, and their efforts to ensure Chicago's economic resilience in the face of a disaster.

"ChicagoFIRST is a groundbreaking organization, the first to partner with government entities to make a commitment to protect our vital financial sector," said Mr. Daley. "I salute ChicagoFIRST. This organization shows that Chicago business leaders are always leading the way."

OCC played a major role in the formation of ChicagoFIRST in July 2003, when leading members of the financial services industry recognized the interdependence of the Chicago financial services industry and its economic importance to city, state and federal governments. A non-profit organization, ChicagoFIRST works with all levels of government to address homeland security and emergency management issues affecting financial institutions to enhance the resiliency of the local financial community in the event of a crisis.

The City of Chicago has provided critical support to ChicagoFIRST throughout its existence, with Chief Emergency Officer Cortez Trotter acting as a key advocate. While serving in a previous role as Executive Director of the Office of Emergency Management and Communications (OEMC), he helped the coalition meet its initial primary objective of securing a seat at the City's Joint Operations Center.

"The communication and collaboration with which ChicagoFIRST has been established is commendable," said Mr. Trotter. "ChicagoFIRST will be used as a template for various disciplines, such as hotels, hospitals, universities, infrastructure agencies and media outlets, whose partnerships with the City in preparedness are critical. For many years, the Mayor has talked of [the importance of] public/private partnerships and you [ChicagoFIRST members and strategic partners] have made it a reality."

As part of its ongoing business continuity initiatives, ChicagoFIRST participated in an evacuation drill of Chicago's Central Business District on September 7. The City of Chicago and the OEMC evacuated four buildings at the intersection of Monroe Street and Wacker Drive, at which four ChicagoFIRST members – NYSE Arca, Chicago Mercantile Exchange (CME), ABN AMRO/LaSalle and JP Morgan Chase – are located or have facilities. The exercise was the first large-scale evacuation drill ever con-

ducted in a major city and was designed both to refine Chicago's existing emergency plans and to encourage people to develop their own disaster plans.

CME encouraged all ChicagoFIRST members who were participating in the drill to use the Exchange's facilities. This allowed members that are not located in the evacuation area to experience and benefit from the exercise. These members included PrivateBank & Trust Co., Northern Trust and Mesirow Financial. Aon Corporation also volunteered assistance to the City in the drill. In all, eight ChicagoFIRST members participated in the drill in some capacity.

"It was wonderful to have a wide range of member participation," said ChicagoFIRST Executive Director Brian Tishuk. "The drill was a massive and crucial endeavor, one that speaks volumes about the City of Chicago and its dedication to creating a culture of preparedness."



innovation team

Earlier this year, OCC rolled out a new initiative to increase creative thinking and measured risk taking among employees by forming the Innovation Team.

The Innovation Team's goal is to promote an innovative culture or mindset that is adapted throughout all aspects of daily processes and tasks among employees.

"Our belief is that, as an organization, we can document and put a framework around innovation that will help us in the long-term measure our success in achieving this type of creative-thinking environment," said Michael E. Cahill, President and Chief Operating Officer. "Innovation is a fundamental human mental process – we're looking to focus on it, document it and repeat it in order to ensure it."

Heading up the initiative is John Von Stein, Chief Information Officer. Von Stein has worked with innovation initiatives at prior employers and shared several experiences and

ideas with the team regarding how to initiate the process.

"Innovation should not be something that we do in addition to what we already are doing. It should be how we do what we do," said Von Stein. "If we can enhance and improve upon the innovativeness that already exists in OCC, then we can add that much more value to our clearing members and exchanges."

OCC's Innovation Team organizes workshops to enhance creative thinking among participants in their daily job functions. "The idea is to encourage creative thinking so that employees can progressively incorporate it into their activities," said Wendy Diez, Manager, Training and Compensation and member of the Innovation Team.

To date, the Innovation Team has worked with several internal OCC groups to achieve more innate creative-thinking approaches.

oic news

o OIC recently launched an institutional web site for options professionals. The site, www.OICOptions.com, features original research, quotes and options chains, most active series and other historical data. Visitors can link to Barron's The Striking Price and exchange content including VIX and ISEE graphs.

o OIC developed its first podcast series, "Options Strategies for Stock Investors" to complement its live seminar program. The podcasts have been downloaded more than 83,000 times and the podcast page on OIC's site has received more than 25,000 unique visits. As of the end of October, iTunes has ranked the series 24th in the top 100 Business Podcasts. OIC plans to launch its next podcast series, "Covered Calls" in early 2007.

o In October, OIC released a new educational DVD, "It's Good to Have Options." This free DVD is targeted to stock investors who have never traded options. It aims to reduce the intimidation factor and stimulate options trading. Moderated by personal finance expert, Terry Savage, as host to a panel of options professionals, the DVD also includes a quiz, a tour of the OIC web site, a tutorial of the Options Investigator educational software and links to the U.S. options exchanges.

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