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# OCC news

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## occ takes on more prominent role at fia expo

As clearing has become a hot topic, particularly when it comes to OTC derivatives, OCC raised its profile during the Futures Industry Association Expo last November in Chicago.

OCC President Mike Cahill participated on the panel "Balancing Act: OTC vs. Traditional Clearing Demands" with clearing house leaders from CME Group, Eurex, LCH.Clearnet and ICE Clear U.S. Right from the start of the panel Cahill was able to differentiate OCC from the pack on questions of membership standards, capital requirements and access to clearing. Cahill said that broader access to clearing services is most desirable for the market. To that end, he said membership standards and capital requirements should not be used as a barrier to access, though they do factor into decisions about the extent of business a firm can do through the clearing house.



The panel discussion also touched on the issue of competition in clearing where Cahill provided the unequivocal response that "clearing houses should never be allowed to compete on risk management standards, and that includes capital requirements."

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The issue of regulatory reform and clearing house governance structures was also a key panel topic for OCC. Cahill noted that OCC is monitoring the rule-making process closely because the dual oversight jurisdiction of both the SEC and CFTC means OCC needs regulatory harmonization. He also questioned whether some of the governance changes being discussed, such as increasing the minimum number of independent members of boards and risk committees, would really be beneficial to the marketplace. OCC's board structure of exchange owner representation countered by a majority of clearing members has provided a balance that has served well for decades, Cahill said. He added that potential requirements of independent members on risk committees could rob clearing houses of necessary expertise during a time of crisis.

Michael McClain, OCC Executive Vice President, Business Operations Group, appeared on the panel "Impact of Regulatory Reform on the Equity Options Markets" that focused largely on the global move of OTC products onto exchanges or into clearing houses. McClain spoke of OCC's

announced license to clear S&P OTC index option products and working with market participants to build the system that best suits their needs. Along with firm representatives on the panel, McClain talked about how the OTC and listed options markets are complementary and that capital efficiencies could be achieved by bringing OTC options into OCC.

One of the regulatory reform topics discussed was the ongoing effort to define a Swaps Execution Facility, or SEF, called for in the legislation. McClain said that when it comes to equity options, some of the SEFs are beginning to look a lot like an exchange. He cautioned that allowing a SEF to operate as an exchange but with lighter regulatory oversight and standards could be detrimental to the overall options marketplace.

OCC was also more visible because of a new sponsorship, Expo Today Live!, that provided video news and promotional spots throughout the conference. The videos, including an interview with Mike Cahill, can be seen on the FIA website.



## update from the hill

By Ted Dahlstrom

Now that it is 2011, the newly elected freshmen class that includes 96 Congressmen and 13 Senators are working to accomplish the promises they made to their constituents while on the campaign trail. In addition to helping freshmen learn the ropes, the establishment has been hard at work doling out committee assignments and electing chairmen to head those committees.

Appointments in the new year include Spencer Bachus (R-Alabama) who will chair the House Financial Services Committee (HFSC) and in a newly-created position, Jeb Hensarling (R-Texas) will serve as Vice-Chairman of the HFSC. It is unclear what role he will play in his new position. Barney Frank (D-Massachusetts) was reelected as top Democrat on the Committee.

In addition, Scott Garrett (R-New Jersey) continues his role as the leading Republican on the Capital Markets and Government Sponsored Enterprises Subcommittee, but this time he will serve in the role of Chairman. This subcommittee has jurisdiction over the Securities and Exchange Commission (SEC) which will in turn impact participant options exchanges and clearing houses. Mr. Garrett's role

will prove to be very important to OCC and others in the exchange world. Maxine Waters (D-Calif.) will be the top Democrat on this important subcommittee.

In regulatory news, the Commodity Futures Trading Commission (CFTC) published on December 13 proposed regulations in the Federal Register that would establish compliance standards for Derivative Clearing Organizations (DCO). These regulations include the creation of a chief compliance officer for DCOs and the establishment of a portfolio margining program for customer accounts that were included in the Dodd-Frank Act. In addition, the SEC voted unanimously on December 15 to seek comments on an end-user exemption measure that matches the one approved by the CFTC earlier that month.

On a more personal note, OCC's Bradley Edgell who has co-authored with me all of the Update from the Hill articles has left to become Managing Director with the Security Industries and Financial Market Association in Washington, D.C. "I want to express my deep appreciation and thanks for all the work that we have done together," Bradley states. "It has been an honor for me to represent the options industry." OCC's Washington, D.C. office wishes Bradley all the best in her new endeavors.

# industry insight

## bats vice president jeromee johnson

*BATS Exchange, Inc. began listing standard series of equity options with OCC in February 2010. OCC News sat down with Jeromee Johnson, Vice President, Marketing Development at BATS to discuss the company's transition into the options market as well as his views on the industry's market structure.*



### **What prompted BATS to make its foray into the options business?**

Much like BATS who led the way in the U.S. equities marketplace with innovative and aggressive pricing, BATS Options wants to be a leader in providing platform performance technology and to be a low-cost provider that drives innovation and competition in the marketplace.

The decision for BATS to get into the options business was really based on all the transformation that is going on in the industry. The market has shifted from being more quote driven to one that is highly fragmented, works at a higher speed and is more order driven. We believe there is phenomenal opportunity to drive cost savings for the entire industry. BATS' tagline of 'Making Markets Better' is something that we are wholeheartedly committed to do.

### **How would you categorize BATS' market structure and what makes you stand out from your competition?**

What I believe sets us aside from a positioning standpoint is the transparency of our market structure and our approach to that structure. Phrases like 'price-time' and 'maker-taker' are absolutely accurate. However I think it also masks the message that we are providing a flat market structure. A perfect example is our risk mitigation tools — something we provide to all members, regardless of capacity, at no cost.

We have also been very innovative around pricing, which I think sets us apart. At the beginning of January 2011, we rolled out new pricing for all members, which includes a new \$.50 rebate for members that set the NBBO on BATS. We want to reward members willing to take risks and drive the NBBO and we think the NBBO Setter Rebates will create some exciting opportunities for members.

We want to continue to look at breaking down barriers and providing that flat market structure — something that drives down cost and at the same time, levels the playing field.

### **Have there been any unexpected challenges in the listed options space? Do you feel that the exchange is where you anticipated it would be at this point in time?**

Yes and no. Obviously, there are always challenges to any new venture. Although we were optimistic that all the other exchanges would just slice off a quarter of their market share and hand it to us on a silver platter, we knew that wasn't a realistic expectation.

If you look at how things have progressed, we put up our first trade at the end of February 2010 and the roll out ran through May. We lifted our market maker restriction on June 1. Looking at the metrics through July, we were clicking on all cylinders and felt very much that things were on track, maybe even a little ahead of schedule.

Going into August, we had some hiccups with some routing and administrative issues and took a pretty big step back with regards to market share and volume. We put ourselves in the penalty box in a pretty significant way.

We had to get our act together very quickly and be very clear with our clients as to what went wrong and how we addressed the issues. But we've learned a great deal through this entire process, improved our systems and platform, and have come out stronger as a result. We're looking forward to the year ahead.

### **What have been some of your key observations about the industry's market structure thus far? What works and what may need to change?**

If you look at the trends over the past five years, things like the penny pilot were contributing to more fragmentation. You also have changing regulation, whether it is the elimination of step-ups that is currently being proposed or the new locked and cross market plan that we got just over a year ago. Good, bad, right or wrong, from a regulatory perspective, trading in the derivatives markets is progressively working more like cash markets. You also have more participants, particularly automated liquidity providers on the derivatives side that are migrating their strategies from the cash side to options.

On the institutional side, you are seeing more use of algorithms and other tools that are driving more options in the business. All of these big, long-term macro trends are driving volume growth and transformation in the industry.

In terms of what needs to change and what has worked, you look at the efforts the exchanges have put forth, especially in conjunction with The Options Industry Council (OIC) and we have done a very good job of educating the populous about the capabilities of options — how they fit in to your portfolio and what strategies are available.

It hasn't been quite as successful on the institutional side. How many \$150 billion plus asset managers are out there that have barely dipped their toes in the water with regards to a strategy as plain vanilla as writing a covered call? I do think what OIC has done to start talking to portfolio managers is a good move that has created a nice niche. However, there's a huge audience out there that the industry has barely tapped in terms of serving the institutional community.

One of the big changes we've currently proposed is to apply a new "directed order" model to BATS Options. The proposal, which is currently being reviewed by the SEC, would give customers the ability to direct their orders to market makers of their choosing within our price-time market. It would allow market makers to control who is allowed to preference them and the structure under which that would take place. This is something very different for the options industry, but we think it is putting a better structure in place.

**BATS is located in Kansas City, slightly off the beaten path relative to other exchanges. Does BATS' home base lend itself to a different type of culture when compared to a typical Wall Street environment?**

We see ourselves as a Wall Street firm that just happens to be headquartered in the Midwest, but we do have a physical office on Wall Street in New York and in the City in London. We have very tight connections to the financial centers in which we operate.

BATS has a very down-to-earth culture in Kansas City, London and New York. Our employees work hard, have fun at what they do, and maintain a good work-life balance so they can enjoy the things that are important in life.

BATS has been recognized as one of the premiere places to be employed at in Kansas City. We are very proud of that fact and continue to aggressively cultivate that culture.

## symbology initiative concludes, opra codes eliminated

Last Spring, the industry-wide conversion to a simpler, more standardized method of identifying exchange-listed options was completed. Prior to the implementation of new and current options symbology, there had long been the need to express strike prices in decimal values (dollars and cents), and to standardize the manner in which LEAPS® contracts are identified. The old method, used since 1973 when exchange-listed options were first introduced, had resulted in a proliferation of illogical option identifiers that became confusing to both investors and option professionals. This confusion commonly led to bookkeeping and order entry errors, and thus the need for Symbology arose.

A team of industry professionals from exchanges, clearing members and OCC started working on the Options Symbology Initiative (OSI) in 2005. Last year, Symbology was officially implemented along with the industry's elimination of OPRA codes. While there are still some users who are adjusting to this transition, the overall response has been very positive.

Dave Harrison, Vice President, Member Services, stated that feedback from the industry since implementation has been very positive with clearing members expressing appreciation about the predictable nature of the overall plan. Harrison credits the significant feedback received during the testing phases as one of the principle reasons for a successful conversion.

### coming soon. . .

After this issue, OCC News will become a web page publication available exclusively online. Don't miss your opportunity to receive the latest clearing news and information from OCC.

Sign up today to receive OCC News via email. To be added to the list, send a blank email message to: [join-occ\\_online\\_news@list.theocc.com](mailto:join-occ_online_news@list.theocc.com).

## oic develops outreach programs for advisors, students

Last fall, The Options Industry Council (OIC) strengthened its reach through two new programs — a partnership with Rutgers University for continuing education courses, and The Road to Wall Street: Analyze Your Options, a seminar geared towards students.

In September, Rutgers University launched new online courses on options trading designed for financial advisors. The three-part series was accredited for continuing education by three elite authorities, (CFA, CFP and IMCA). These courses cover the basics of options trading, strategies such as covered calls, and options pricing. They are designed to help financial advisors better protect clients' investments, spark new ideas for high-net worth clients and build their practice through the use of options. To date, more than 400 advisors have taken the courses. The on-demand format allows advisors to access the courses at their convenience. For more information about Rutgers' offerings or to register for a course, visit [options.rutgers.edu](http://options.rutgers.edu).

In October, OIC co-sponsored a university outreach program, The Road to Wall Street: Analyze Your Options, with Baruch College in New York and Illinois Institute of Technology's Stuart School of Business in Chicago. These half-day seminars were offered to graduate and undergraduate students. The events brought options traders, exchange leaders and industry professionals directly to students to give them perspective on the options industry. Key speakers included David Krell, Co-founder and Chairman of the International Securities Exchange (ISE), William Brodsky, Chairman and CEO of the Chicago Board Options Exchange (CBOE), Jon Najarian, CNBC Contributor and Co-founder of [optionMONSTER.com](http://optionMONSTER.com) and [tradeMONSTER.com](http://tradeMONSTER.com) and Guy Adami, Managing Director of Drakon Capital and Lead Analyst at [optionMONSTER](http://optionMONSTER.com). The new program was well received with over 350 students attending the events. OIC plans to expand the seminar series this year.

## occ launches online clearing member application

This past October, OCC launched a Pre-Qualification Online Application for potential clearing members.

This web-based application is not a submission for membership; rather, it is intended to provide OCC with information to determine if prospective firms are valid applicants for membership. Candidates must submit basic information such as; name, company overview, why they want to become a member, type of financial institution, products they would like to clear, etc. Once OCC deems a prospective member to be a valid applicant, it provides the firm links to all of the necessary documents that need to be completed for the formal membership application process. Upon receipt of the

applicant's official documentation and preliminary information submitted via the online application, OCC's Member Services will schedule an exploratory conference call. If an applicant is deemed invalid, they will receive a message and follow-up email explaining why they did not meet the necessary pre-qualification standards.

The online application was created in an effort to streamline the clearing member application process and provide information to interested members in a timely, efficient manner. The Pre-Qualification Online Application can be found at the Membership portal of OCC's web site under Becoming a Member.

## record year for occ options, futures, and stock loan clearing

OCC cleared more contracts last year than any other in its 37 year history. At nearly 4 billion contracts total in 2010, options volume reached record highs while futures volume more than doubled the 2009 annual total. Additionally, OCC's stock loan program continued to grow dramatically as securities lending activity increased 64% from 2009.

Total options trading volume for 2010 came in at 3,899,068,670 contracts. This surpassed 2009's record year by 8% and marks the eighth consecutive year a new annual trading volume record has been set. Six of the top ten highest volume record days were set in 2010, including four of the top five.

Options markets have held up remarkably well in 2010, especially when compared to equity volume, which declined about

11%. When equity markets plunged in the wake of the Flash Crash on May 6, the options industry set a new daily volume record with 30,818,984 contracts traded. While the marketplace has not experienced the volume growth rates that were seen in 2007 and 2008, the options industry as a whole is still moving higher at a steady pace.

Cleared futures volume and stock loan activity also experienced significant growth. 2010 brought OCC futures clearing to its highest level with an annual total of 26,618,135 contracts, up 115% over the previous year. Transactions in OCC's stock loan program, including OTC and AQS, increased to more than 650,000 with an average daily notional value of \$13.2 billion.



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