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MEMORANDUM

April 7, 1988

TO: Files

FROM: Alden Adkins

RE: April 6, 1988 Meeting with OCC

On April 6, 1988, Chairman Ruder, Rick Ketchum and Alden Adkins met with Wayne Luthringhausen of OCC and OCC's outside counsel Burt Rissman and Neil Cross of Schiff, Hardin & Waite. Mr. Luthringhausen said that the principal purpose of their visit was to discuss OCC's concerns with the Chicago Board of Trade's announced intention to register an options clearing agency with the SEC. Rick Ketchum provided the Chairman on the spot background on this issue, including the Commission's 1974 decision to require unified standardized options clearing in OCC, the 1975 Act amendments establishing competition for clearing services as a goal of the federal securities laws, and the Commission's decisions in the NSCC registration proceedings to require one account processing through interfaces. Burt Rissman added to this summary that part of the significant background of the 1975 Act amendments regarding clearing was Congress' concern with the New York Stock Exchange using its monopoly power in trading markets to create monopoly power in clearing markets.

Mr. Luthringhausen then said that the Commission in 1974 required unified clearing for options because of the late 1960's paperwork crisis in the stock market and the consensus in the industry that unified clearing would avoid operational problems. He said that the 1975 Act amendments did not contemplate that in 1988 there would be connections between stock markets and futures markets; that futures would be instrumental in hedging options; that stock firms increasingly participated in the futures markets but not vice versa; and that CBT's monopoly in the clearing of its products through its captive Clearing Corporation would thus be a significant competitive factor for options clearing. He said that the CBT has not come forward with constructive responses on cross-margining because of its fear of the SEC effectively requiring the CBT to share its index futures product base through clearing interfaces. He suggested that there is a problem in that OCC can't go to the CFTC and get its subsidiary registered as a futures clearing house but the CBT apparently could come to the SEC and register an options

clearing subsidiary. The result could be that CBT could have both a futures and an options clearing business, while OCC would be limited to options. He argued that if CBT gets both options and futures clearing capacity it gets cross-margining, which would give it a tremendous competitive advantage. He said that the CBT, in its discussions with CBOE on their joint venture, had already in effect demanded that CBOE withdraw the OEX from OCC and move it to CBT's proposed options clearing subsidiary. Rick Ketchum suggested that, if the Commission were to defer approval of registration of CBT's options clearing subsidiary until CBT had reached a cross-margining agreement with OCC, then the competitive concern OCC was raising would be mitigated. OCC agreed, although Burt Rissman also suggested that even with a cross-margining agreement with OCC CBT might have a competitive advantage because it has such great market power and influence in Chicago.

Wayne Luthringhausen indicated that OCC had presented CBT with cross-margining proposals under which the OCC and CBT clearing would share position information and create in effect cross liens. CBT has said no, and he believes that two reasons why CBT may have said no are (1) it has no incentive to negotiate on cross-margining as long as it thinks it has a chance to get its options clearing agency registered with the Commission; and (2) it is concerned that cross-margining would bring the SEC into the picture with the possibility for dual trading and fungibility requirements that would undercut CBT's monopoly market position with regard to its index futures products. He suggested that CBT has indicated a willingness to move to cross- margining without cross-liens, i.e. based just upon OCC showing CBT that OCC members have certain options position. Burt Rissman suggested that in fact CBT prior to October had been giving cross-margining credit for options positions without a rule, without procedures and without liens. He said this was known to the CFTC but the CFTC has done nothing about it, despite the credit exposure this created to the clearing house, because of the politics of the situation.

Chairman Ruder asked whether it wouldn't be a great advantage to have everything in one entity, whether it was a futures related options/futures clearing subsidiary or OCC. He suggested that maybe the ideal solution would be to require the clearing subsidiary be split off from CBT just as the 1975 Act amendments effected the separation of stock clearing from the trading markets. We could then move to a unified clearing system without all these concerns with trading market monopolies. Burt Rissman agreed that prohibiting captive clearing corporations on the futures side would make unified clearing easier to accomplish. He closed by repeating that competition is a goal of the 1975 Act amendments regarding clearing, but that these goals are to be balanced against other

goals of the Act and that unified options clearing, as the Commission expressed in 1974, is an exceptionally important goal, particularly in light of the events of October 1987.

cc: Chairman Ruder
Linda Fienberg
Brent Taylor
Martha Peterson