Statement of
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before the Commodity Futures Trading Commission (CFTC) and the Securities and Exchange Commission (SEC) Joint Meeting on Regulation Harmonization
Wednesday, September 2, 2009

Thank you Chairman Gensler, Chairman Schapiro, and members of the CFTC and SEC for giving me an opportunity to express the views of The Options Clearing Corporation (OCC) about harmonization of the statutes and regulations that govern the trading and clearing of derivatives in the United States.

I am Wayne Luthringshausen, Chairman and Chief Executive Officer of OCC. I believe that OCC has a unique perspective to share with you on the topic of harmonization of derivatives regulation. OCC is the world's largest derivatives clearinghouse based on contract volume and open interest. OCC operates under the jurisdiction of the SEC as a registered clearing agency and the CFTC as a derivatives clearing organization. OCC currently provides central counterparty (CCP) clearing and settlement services to 13 exchanges and trading platforms for options, financial and commodity futures, security futures, and securities lending transactions.

On the securities side, we clear fungible exchange-traded options contracts for seven options exchanges. As the CCP clearinghouse for these markets, OCC assumes the counterparty risk of members involved in a trade—becoming the buyer to every seller and the seller to every buyer. Through extensive risk management, we reduce risk and ensure that markets work well and efficiently. As we have learned during the recent financial crisis, effective risk management is essential to keeping markets open and functioning well even in times of stress.

OCC is the only clearinghouse for these exchange-traded options products in the U.S. We operate as a market utility providing low cost, high quality services to the markets that we clear and to our 119 clearing members. Our unique corporate structure is the key to our ability to do this. OCC is owned by five of the exchanges that it serves. Each owner is represented on our board. However, the majority of our directors represent clearing members. These clearing members are the broker-dealers and futures commission merchants that are active on the markets that OCC clears. We operate, in effect, as a not for profit corporation rebating to our clearing members any revenues in excess of those needed to operate OCC. Last year, OCC rebated $65 million to its clearing members while charging an effective clearing fee of 1.55 cents (after rebates) per contract. We believe that this is the lowest rate globally for derivative clearing services. However, being a low cost provider does not preclude us from providing high quality, innovative services. Five years ago, we installed a total re-write of our clearing system to provide straight-through processing and enhanced capabilities for our clearing members. Three years ago, we implemented our proprietary state-of-the-art STANS risk margining system. STANS, a true portfolio margining system, uses large-scale Monte Carlo

simulations to forecast price moves and correlations to make margin determinations. In essence, our governance structure ensures that OCC is run for the benefit of the markets it serves, the intermediaries active in those markets, and the ultimate customers of those intermediaries.

OCC's status as the common clearer of fungible exchange-traded options promotes competition at the market level to the benefit of the diverse global participants in these markets. All of the options that OCC clears are fungible. Except for a few proprietary products, all are listed on multiple exchanges. Whether you are a retail customer in the United States or a large hedge fund in London, the seven U.S. options exchanges are competing fiercely to get your order. The fact that a customer can open a position on one of our exchanges and close it not just on that exchange, but on any of the other six, drives the exchanges to try to provide the tightest spreads, the most liquidity, the lowest costs, and the best customer service every day to every customer. Volumes in options have exploded over the past few years with a 25% increase in volume last year on top of a 41% increase in 2007. Through the end of August, 2009 volume is on pace with last year's volume. I believe that this growth is a direct result of the ability of options exchanges to compete and innovate in a drive to draw business to them. OCC is the key reason why these markets are so competitive.

As the only U.S. clearing house for SEC-regulated options, CFTC-regulated futures and SEC/CFTC jointly regulated security futures, OCC is keenly aware of the fact that these products are closely related economically and from a risk management perspective, and are used for similar purposes by customers. We work well with both the SEC and the CFTC and respect their expertise. However, we do not believe that the current regulatory structure for derivatives is the optimal one for our financial markets and their customers. OCC advocates combining the functions of the SEC and CFTC under a new principles-based statute to ensure holistic oversight of all derivatives products. We view the current efforts to harmonize the statutes and regulations of the SEC and CFTC for both exchange-traded and OTC products as an important and necessary first step toward that goal.

Specifically, I would like to comment briefly on several areas where harmonization of the SEC and CFTC statutes and regulations is needed to decrease systemic risk, increase U.S. competitiveness, and benefit customers. These areas are the clearing of OTC derivatives, the introduction of new products, customer portfolio margining, and risk disclosure to customers.

OCC thinks that many, but not all, existing OTC derivatives can and should be cleared. However, some OTC derivatives are just too customized or complex to risk manage within a clearinghouse effectively and efficiently. OCC is currently exploring whether to provide clearing services for OTC equity derivatives. While no decisions have been made, OTC equity derivatives may be a natural extension of our current business. For this reason, we are following legislative developments on the regulation of OTC derivatives very closely. We are still analyzing the draft legislation on OTC derivatives released by the Treasury Department last month and do not yet have many

specific comments. However, as an initial matter, I would observe that the complexity of the draft legislation buttresses our view that having a single U.S. regulator for all derivatives under a new principles-based statute is the optimal approach We are looking forward to working with the SEC and CFTC as well as the Treasury Department, Federal Reserve Board and members of Congress throughout the legislative process on this important piece of financial regulatory reform.

OCC has, on occasion, found it necessary to decline to take the legal risk of clearing a product whose legal status is unclear. This is not an issue when one of our exchanges wants us to clear a product that is clearly a future or clearly a security. As both a DCO and a registered clearing agency, we are authorized to clear both products. However, when an exchange approaches us with a product whose status is unclear under the futures and securities laws, delays in launching the product invariably ensue. Last year, a dispute between the CFTC and SEC over the regulatory status of credit default options delayed the introduction of this product for months. Similar jurisdictional disputes delayed the introduction of options on gold and silver ETFs for years. We urge the SEC and CFTC to develop a method of resolving these types of disputes that is transparent and expeditious. Litigation is not an option. The agencies should not hesitate to suggest that the Treasury Department or the proposed Financial Services Oversight Council act as a mediator, and, if necessary, a tiebreaker in difficult cases. Lengthy jurisdictional disputes that deprive markets of the ability to list new products and customers of the choice to trade them do not serve the interests of anyone and are, appropriately, a source of embarrasment to the SEC and CFTC.

Portfolio margining is another area that cries out for harmonization between the agencies. OCC has been working with the U.S. options exchanges for a number of years to gain regulatory approval for broker-dealers to offer qualified customers portfolio margining of all securities-related positions for appropriate customers in a single account. Today, the SEC permits many customers to have their securities accounts margined on a portfolio basis as occurs on the futures side However, these customers cannot fully enjoy the risk-reducing and capital efficiency benefits of portfolio margining because they cannot carry their broad-based stock index futures positions in securities portfolio margining accounts. Two important changes must occur before this can occur. First, Congress needs to amend the Securities Investor Protection Act (SIPA) to allow broad-based index futures products to be treated as securities for SIPA purposes when included in an SEC-regulated portfolio margining account. After this is done, the CFTC must provide exemptive relief from the Commodity Exchange Act's requirements regarding segregation of customer funds to permit those futures products to be carried in securities accounts. We urge the CFTC and SEC to support the targeted changes to SIPA that passed the House of Representatives last year as part of H.R. 6513 as an important step toward full customer portfolio margining. The ongoing impasse between the agencies on how to permit customer portfolio margining essentially punishes customers who choose to use a full range of securities and securities-related futures in a responsible and risk-reducing fashion by imposing substantially higher margins on them than is justified by the risk of their portfolio. It encourages these customers, which tend to be larger

institutions, to take their business offshore, where there is no artificial distinction between securities and futures products and true portfolio margining has been offered for years.

On customer risk disclosure, we would like to see the SEC move towards the effective model used by the CFTC. Currently, a customer is required to receive a copy of "Characteristics and Risks of Standardized Options," known as the Options Disclosure Document (ODD), prior to opening an options account. We fully support providing adequate disclosure about options to customers and we understand the important role that disclosure plays in the U.S. securities laws. However, the current ODD is very long at over 158 pages and difficult to understand. We believe that customers would be better served if the ODD was simplified and streamlined. On the futures sides, customers receive a generic risk disclosure document that is short and easy to understand. Following this model for options disclosure would likely promote a better understanding of the risks that exchange-traded options pose than the current dense, lengthy ODD. Detailed information regarding particular options products is much more effectively presented on exchange web sites and through other modern means that can provide interactive, targeted information responsive to investors' needs.

OCC applauds your efforts to harmonize the existing U.S. regulatory regimen so that it is more efficient and effective in the future. We encourage you to work together to resolve the issues that we have identified. From its unique perspective, OCC stands ready to assist both of its regulators in this difficult but important endeavor.

Thank you for giving me this opportunity to express OCC's views. I would be glad to answer any questions that you may have.