

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-69642; File No. SR-OCC-2013-05)

May 28, 2013

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change to Provide that OCC, Rather Than an Adjustment Panel of the Securities Committee, Will Determine Adjustments to the Terms of Options Contracts to Account for Certain Events, Such as Certain Dividend Distributions or Other Corporate Actions, That Affect the Underlying Security or Other Underlying Interest

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 15, 2013, The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Clearing Agency’s Statement of the Terms of Substance of the Proposed Rule Change

OCC proposes to provide that OCC, rather than an adjustment panel of the Securities Committee, will determine adjustments to the terms of options contracts to account for certain events, such as certain dividend distributions or other corporate actions, that affect the underlying security or other underlying interest.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

## II. Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.

### (A) Clearing Agency's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The principal purpose of this proposed rule change is to authorize OCC, rather than adjustment panels of the Securities Committee,<sup>3</sup> to determine option contract adjustments and to determine the value of distributed property involved in such adjustments. Other conforming or clarifying changes to the By-Laws relating to adjustments and/or adjustment panels also are being proposed.

#### 1. Background and Purpose of Proposed Rule Change

Certain corporate actions—such as declaration of dividends or distributions, stock splits, rights offerings, reorganizations, or the merger or liquidation of an issuer—affecting an underlying security may require an adjustment to the terms of the overlying options. For example, in a two-for-one stock split, the overlying options might also be split two-for-one, so that each option would continue to cover the same number of shares but with an exercise price equal to half of the pre-split price. The basic procedural rules

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<sup>3</sup> The OCC Securities Committee is authorized under OCC By-Law Article VI Section 11(a) to determine contract adjustments in particular cases and to formulate adjustment policy or interpretations having general applicability. The Securities Committee is comprised of representatives of OCC's participant options exchanges and authorized representatives of OCC.

governing such “adjustments” in the terms of outstanding options are set forth in Section 11 of Article VI of OCC’s By-Laws, and the substantive rules specifically covering adjustment of stock options are set forth in Section 11A of Article VI. Although much less common, it is also possible that events affecting indexes and other underlying interests could also require adjustment of the overlying options. Rules for adjustment of such other options are generally found in the By-Law provisions applicable to such other options.

The procedural rules of Article VI, Section 11 of the By-Laws provide that all adjustments to option contracts be determined on a case-by-case basis by an adjustment panel of the Securities Committee composed of two representatives<sup>4</sup> of each exchange that trades an option on the underlying security and the OCC Chairman (or his representative). All actions are determined by majority vote, with OCC voting only to break a tie. Besides determining particular adjustments in individual cases, Article VI, Section 11 also authorizes the Securities Committee to adopt statements of policy or interpretations governing option adjustments in general. Additionally, the Securities Committee is authorized to determine the value of distributed property involved in stock option adjustments as stated in Article VI, Section 11A(f).

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<sup>4</sup> The Commission has approved an amendment to OCC’s By-Laws under which only one representative of each relevant exchange is required on an adjustment panel. Securities Exchange Act Release No. 34-67333 (July 2, 2012), 77 FR 40394 (July 9, 2012) (SR-OCC-2012-07). However, the amendment will not be implemented until an amendment to the Options Disclosure Document reflecting this change is made. Interpretation and Policy .01 to Article VI, Section 11 clarifies that until such time as the amendment to the Options Disclosure Document is made and only one representative is required, an adjustment panel must have two representatives of each exchange that trades an option on the underlying security.

The options exchanges asked OCC to evaluate possible changes to the structure and procedures which govern option contract adjustments. The request was prompted by a desire to consider ways to lessen investor confusion and enhance consistency in making option contract adjustments. In addition, the exchanges have expressed concern that exchange representatives involved in adjustment decisions may sometimes be subject to undue pressure from investors. Accordingly, the exchanges asked OCC to investigate whether changes to adjustment procedures could insulate the exchanges from undue pressure while concurrently providing greater consistency and efficiency in making adjustment decisions.

2. Description of Proposed Changes

Discussions among OCC and the exchanges concerning potential changes to Securities Committee governance in respect of adjustments yielded a consensus that the exchanges should retain policy-making authority under the adjustment By-Laws through the Securities Committee but that OCC should be the sole determiner of particular adjustment decisions, thereby eliminating adjustment panels convened for the purpose of determining adjustments of particular option contracts. The Securities Committee ratified the following recommendations by unanimous vote:

- (i) The policy making role of the Securities Committee should be unchanged. As members of the Securities Committee, exchanges should retain authority to determine adjustment policy in general.
- (ii) OCC should apply the adjustment By-Laws and Interpretations to determine particular adjustments on a case-by-case basis. An adjustment panel comprised of exchange and OCC representatives should not be

called to determine a particular adjustment, thereby insulating the exchanges from investor pressure to determine a particular outcome.<sup>5</sup>

- (iii) OCC and the exchanges should retain unrestricted ability to mutually discuss considerations pertaining to any adjustment decision or policy.
- (iv) OCC should be given authority to determine the value of distributed property involved in contract adjustments.

These recommendations were reviewed with OCC's Board of Directors, which unanimously approved them by authorizing the filing of this proposed rule change.

Notwithstanding the elimination of exchange representative adjustment panels, panels of exchange representatives would still retain their existing functions and authority under other provisions of OCC's By-Laws. For example, those panels would retain the authority to fix exercise settlement amounts for cash-settled options where a closing price for the underlying is otherwise unavailable.<sup>6</sup>

The types of adjustments for which exchange representative panels may continue to be convened would be limited to very rare situations involving market closures or the unavailability of accurate pricing, and would need to be done on very short notice, unlike dividend adjustments, for which there can be a period of time between the announcement of a dividend and the decision of the panel. Accordingly, it is much less likely that exchange representatives on these panels would be subject to the same risk of undue pressure from investors. These situations are also less likely to fit within a policy or

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<sup>5</sup> There is precedent for this approach in that OCC currently determines all contract adjustments for security futures. *See* Article XII, Sections 3 and 4 of OCC's By-Laws.

<sup>6</sup> *See, e.g.,* Article XIV, Section 5, Article XVII, Section 4, Article XXII, Section 4 and Article XXIV, Section 4.

precedent that could be prescribed in advance by the Securities Committee, and therefore it would be more difficult for the Corporation to make the decisions without the input of the relevant exchanges.

3. Discussion

As a result of the proposed changes described above, adjustment panels for the purpose of determining adjustments of particular options contracts would cease to exist, and exchanges would have no obligation or authority to determine a particular adjustment. OCC would determine the appropriate application of the By-Laws and Interpretations and Policies, but the exchanges would retain policy making authority as members of the Securities Committee. In this policy making capacity, actions of the Securities Committee would continue to require approval by a majority vote.

Occasionally, there may be unique aspects of a corporate event that justify departure from adjustment policy or precedent, or that involve a situation for which there is no existing adjustment policy or precedent. Such events may also highlight a need for a more general reformulation of adjustment policy. Under the proposed changes, if OCC determines such aspects to be present, OCC would determine in its sole discretion any adjustment to be applied in the particular case. The Securities Committee would not initiate policy changes “ad hoc” to address a particular case (which would be a *de facto* determination of a particular adjustment decision). Instead, after OCC determined a particular adjustment, the Securities Committee, in its discretion, would determine the appropriateness of adopting prospective policy changes or clarifications.<sup>7</sup>

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<sup>7</sup> This approach was followed in 2006 in response to a special cash dividend. In that case, adjustment panels determined to depart from precedent and adjust certain ETF options where the ETF distributed pro rata dividends based on the amount of a special

Although OCC and the exchanges believe it is feasible for OCC to independently determine adjustments, both are averse to losing valuable exchange experience and insight that is now brought to bear in adjustment decisions. Accordingly, OCC and the exchanges believe that they should retain unrestricted ability to discuss with each other any considerations pertaining to an adjustment decision or policy – with the understanding that adjustment decisions would be made solely by OCC and the exchanges would be involved solely in an advisory capacity. Accordingly, nothing in the present proposal would prohibit either the exchanges or OCC from initiating conversations concerning adjustment policy or particular adjustment decisions, but neither would such consultation be required.<sup>8</sup> Furthermore, to ensure continued exchange involvement in determining adjustment policy, OCC intends to call periodic meetings of the Securities Committee to discuss policy issues and review recent experience with contract adjustments.<sup>9</sup> Such meetings will be held on a quarterly or more frequent periodic basis.

Occasionally option adjustments involve the substitution of cash value in lieu of delivery of property. For example, this is the case when a security does not trade in the United States or cash in lieu of property is involved. Currently, the Securities Committee

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dividend paid by the issuer of one of the component stocks in the ETF. Following these adjustments, the Securities Committee recommended to the OCC Board a policy reformulation. *See* Interpretation .08 to Article VI, Section 11A.

<sup>8</sup> Confidentiality of the communications between OCC and the Exchanges would continue to be observed – as it is today.

<sup>9</sup> As a practical matter, even if adjustments are determined solely by OCC it would still be necessary for OCC and the exchanges to coordinate the operational execution of all option adjustments. This coordination includes, but is not limited to, the determination of an effective date, option symbols and strike prices and the publication of notices.

has authority to determine such cash value. OCC is proposing that it would instead be authorized to determine cash value in these cases since it would have sole discretion to determine contract adjustments.

The proposed changes would apply only to the functions of OCC and the Securities Committee in the determination of option contract adjustments as described in Article VI, Sections 11 and other By-Law provisions.<sup>10</sup> The Securities Committee – or panels comprised of representatives of the Securities Committee – in respect of actions that do not involve option contract adjustments would retain all other functions and authority granted under the By-Laws, including, for example, the ability to fix index option settlement values in cases of market disruption<sup>11</sup> and similar actions.

Adjustment provisions of the By-Laws pertaining to classes of options other than stock options sometimes provide for adjustment panels by referring to Article VI, Section 11. Insofar as Article VI, Section 11 would be modified to eliminate the need for adjustment panels, the requirement for adjustment panels to determine contract adjustments for these other types of option contracts would also be eliminated, with case by case adjustment decisions determined solely by OCC.

#### 4. Other changes

In addition to the principal purpose underlying this rule change as described above, certain other conforming and/or clarifying changes are being proposed. These changes are intended to update the By-Laws to eliminate stale rule provisions, to conform

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<sup>10</sup> See, e.g., [sic] Article XII, Sections 3 and 4; Article XIV, Section 3A; Article XV, Section 4; Article XVI, Section 3; Article XVII, Section 3; Article XX, Section 4; Article XXII, Section 3; Article XXIII, Section 4; and Article XXIV, Section 6.

<sup>11</sup> See, e.g., By-Law Article XVII, Section 4.

cross-references contained in other By-Laws to changes being proposed herein and to clarify certain interpretations adopted under the By-Laws to reflect a recent policy determination made by the Securities Committee in accordance with its authority granted under Article VI, Section 11 of OCC's By-Laws. These changes generally are described below.

OCC is proposing to modify or eliminate certain adjustment related By-Law provisions because, due to industry or other changes, there is no longer any open interest in options covered by such provisions. For example, equity options previously had traded with exercise prices expressed in either fractions or decimals. All exercise prices for equity options now are expressed in decimals, and all open interest in options series for which exercise prices were expressed in fractions has expired. Several By-Law provisions are being modified or eliminated to reflect this circumstance.<sup>12</sup>

OCC also is proposing to eliminate other stale provisions, including those found within Interpretation and Policy .01 under the Article VI, Section 11, which relates to the determination of "ordinary cash dividends or distributions" for which no adjustment is ordinarily made. These provisions preserved the "10% rule" (*i.e.*, the former method used to determine whether a cash dividend or distribution was ordinary) for application to certain series that had open interest prior to rescission of the 10% rule. Open interest in all such "grandfathered" series has expired, and therefore these provisions are no longer necessary. Changes would also be made to Article XIV, Section 3A(a)(3) in relation to binary options for which the underlying is an equity interest.

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<sup>12</sup> See, *e.g.*, the proposed changes to the definition of the term "adjustment increment," Article I, Section 1.A (2); Article VI, Section 11A(d); Interpretation & Policy .09 under Article VI, Section 11A; and Article XII, Section 3(d).

OCC's Securities Committee is empowered under the By-Laws to adopt statements of policy or interpretations having general application to specified types of events or specific kinds of cleared contracts. Recently, the Securities Committee issued a clarifying interpretation with respect to determinations of corporate issuers to accelerate or defer payments of otherwise ordinary dividends. More specifically, the Securities Committee determined that such events would not, as a general rule, affect the ordinary nature of such dividends subject to the evaluation of these events on a case-by-case basis.<sup>13</sup> Comparable changes, as applicable, would be made to Article XIV, Section 3A. Other changes being proposed are conforming in nature in that they update cross-references to By-Laws and Rules proposed to be amended.

OCC believes the proposed rule change is consistent with the purposes and requirements of Section 17A(b)(3)(F) of the Securities Exchange Act of 1934, as amended, (the "Act")<sup>14</sup> and the rules and regulations thereunder because the proposed changes would help promote the prompt and accurate clearance and settlement of securities transactions and foster cooperation and coordination with persons engaged in the settlement of securities transactions<sup>15</sup> by providing OCC with sole discretion for particular adjustment decisions to help ensure that decisions are consistent, efficient and free from undue influence and by providing conforming and clarifying changes to OCC's By-Laws and Rules to help ensure that OCC maintains a well-founded, transparent and

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<sup>13</sup> Securities Exchange Act Release No. 34-68531 (December 21, 2012), 77 FR 77157 (December 31, 2012) (SR-OCC-2012-26).

<sup>14</sup> 15 U.S.C. 78q-1.

<sup>15</sup> 15 U.S.C. 78q-1(b)(3)(F).

enforceable legal framework as required by Rule 17Ad-22(d)(1).<sup>16</sup> The proposed rule change is not inconsistent with any rules of OCC, including any rules proposed to be amended.

OCC will not implement these proposed rule changes until the effectiveness of an amendment to the Options Disclosure Document relating to the proposed changes.

(B) Clearing Agency's Statement on Burden on Competition

OCC does not believe that the proposed rule change will impact, or impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change primarily affects OCC's clearing members and their customers, but it would not impose any additional burden on them because options are already subject to adjustment and the revised procedures apply equally to all clearing members. OCC does not believe that providing OCC with sole discretion for particular adjustment decisions, rather than continuing to rely on adjustment panels consisting of exchange representatives, would inhibit access to any of OCC's services or disadvantage or favor any user of OCC's services in relationship to any other such user. In fact, OCC believes that the proposed rule change would promote competition among participants in the options markets because it would help ensure that adjustment decisions are consistent, efficient and free from undue influence and therefore it would promote certainty, fairness and a level playing field in the options markets with respect to when and how participants are affected by adjustments.

For the foregoing reasons, OCC believes that the proposed rule change is in the public interest and consistent with the requirements of the Act applicable to clearing

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<sup>16</sup> 17 CFR 240.17Ad-22(d)(1).

agencies because it would promote competition in the options markets that OCC serves and not impose a burden on competition that is unnecessary or inappropriate in furtherance of the purposes of the Act.

(C) Clearing Agency's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments on the proposed rule change were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act. Comments may be submitted by any of the following methods:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-OCC-2013-05 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549.

All submissions should refer to File Number SR-OCC-2013-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of OCC and on OCC's website: [http://www.theocc.com/components/docs/legal/rules\\_and\\_bylaws/sr\\_occ\\_13\\_05.pdf](http://www.theocc.com/components/docs/legal/rules_and_bylaws/sr_occ_13_05.pdf)).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-OCC-2013-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>17</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>17</sup> 17 CFR 200.30-3(a)(12).