

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67315; File No. SR-NYSEMKT-2012-14)

June 29, 2012

Self-Regulatory Organizations; NYSE MKT LLC; Notice of Filing of Proposed Rule Change Adopting Rules Governing the Listing and Trading of New Products Known as DIVS, OWLS, and RISKS

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”) <sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on June 19, 2012, NYSE MKT LLC (“Exchange” or “NYSE MKT”), on behalf of NYSE Amex Options LLC (“NYSE Amex Options”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to adopt rules governing the listing and trading of a new product known as DORS. The text of the proposed rule change is available on the Exchange’s website at [www.nyse.com](http://www.nyse.com), at the principal office of the Exchange, and at the Commission’s Public Reference Room.

II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization 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 those statements may be examined at the places

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

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

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange proposes to adopt rules governing the listing and trading of a new product known as DORS.<sup>3</sup> The Exchange believes that the product will give investors additional opportunities to manage risk by offering the ability to invest discretely in three instruments that, when taken together, represent the total return of a security over a certain period of time.

a. Generally

DORS are comprised of three components: DIVS, OWLS, and RISKS, each of which is described more fully below. Each component has a different risk/reward profile and will be able to be bought or sold separately to achieve a specific investment goal. The three components, when combined appropriately (i.e., long a DIVS, OWLS, and RISKS on the same underlying security, having the same expiration, where the OWLS and RISKS have identical strike prices), are expected to generate total returns that will attempt to replicate that of a long stock position held for the same duration.

DIVS – The phrase “Dividend Value of Stock” or the term “DIVS” refers to an option contract that returns to the investor a stream of periodic cash flows equivalent to the dividends paid by the underlying stock. An investor that holds a long DIVS contract will receive cash payments equal to the dividend paid by the underlying security. Such payment will occur on the “ex-dividend” date for the underlying security. The investor will continue to have the right to

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<sup>3</sup> In addition, under proposed Rule 900DORS(a), DORS would be included within the definition of “security” or “securities” as those terms are used in the Constitution and Rules of the Exchange.

earn such dividend-equivalent cash payments as long as the investor remains long the DIVS contract up until such time as the DIVS contract expires. DIVS contracts will be European style and cannot be exercised prior to expiration.

OWLS – The phrase “Options With Limited Stock” or the term “OWLS” refers to an option contract that returns to the investor at expiration shares of the underlying security equal in value to the lesser of (1) the current value of the underlying security or (2) the strike price of the option contract. At expiration, regardless of how high the stock closes above the strike price of an OWLS contract, the holders of the contract will never receive more than shares of stock equivalent in value to the strike price of the OWLS contract. The risk/reward of a long OWLS position is similar to a buy/write or covered call position, less the dividends, if any. A long OWLS position offers an investor some limited downside protection in exchange for limiting his or her upside participation to the strike price of the OWLS contract. OWLS contracts will be European style and cannot be exercised prior to expiration.

RISKS – The phrase “Residual Interest in Stock” or the term “RISKS” refers to an option contract that returns to the investor at expiration shares of the underlying security equal in value to the difference between the value of the underlying security at expiration and the strike price of the contract. At expiration, holders of RISKS will receive nothing if the stock closes at or below the strike price of the RISKS contract. A position consisting of a long RISKS contract has a risk/reward similar to that of a long call position. A long RISKS position offers an investor all of the upside price appreciation above the strike price of the RISKS contract while limiting the investor’s capital at risk to the premium paid to acquire the RISKS contract. RISKS contracts will be European style and cannot be exercised prior to expiration.

The Exchange believes that the structure of the product will enable investors to hedge or obtain exposure to discrete portions of the total return of a security. For example, an investor interested in generating more current income while eliminating stock price risk could sell both the RISKS and OWLS against a long position in XYZ stock.<sup>4</sup> This would enable the investor to continue to vote as a shareholder and retain the dividends paid by XYZ for the next five years with no stock price risk. In addition, the investor would receive the premium from selling the RISKS and OWLS, and could earn interest on that premium. At expiration, the investor would deliver 100 shares of XYZ to satisfy settlement of the RISKS and OWLS sold. A slightly less conservative investor could sell just a RISKS contract against the investor's long stock position so that at expiration they will only be obligated to sell some portion of their long stock holdings (stock equal in value to the difference – if any – in price of the stock and the strike price of the RISKS contract). In the interim the investor will continue to vote as a shareholder, earn the dividends paid by the stock and earn interest on the premium received from selling the RISKS contract.

b. Listing Standards

Any security eligible for listed options pursuant to Rule 915 will also be suitable for the listing of DORS. The Exchange will generally seek to list DORS contracts on securities that also trade regular listed options; however, there may be instances where securities eligible for listing and trading options do not have DORS contracts listed and vice versa.

Rule 915 specifies the criteria for underlying securities to be eligible for listed options. Generally, underlying securities in respect of which put or call option contracts are approved for listing and trading on the Exchange must meet the following criteria:

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<sup>4</sup> For every 100 shares of stock held long, the investor could sell one RISKS, one OWLS and one DIVS contract and be fully hedged.

- the security must be duly registered and be an "NMS stock" as defined in Rule 600 of Regulation NMS under the Securities Exchange Act of 1934; and
- the security shall be characterized by a substantial number of outstanding shares which are widely held and actively traded.

Rule 915 also provides that the Board of Directors of the Exchange shall from time to time establish guidelines to be considered by the Exchange in evaluating potential underlying securities for Exchange option transactions. In addition, Rule 915 states that there are many relevant factors which must be considered in arriving at such a determination. Under Rule 915, the fact that a particular security may meet the guidelines established by the Board does not necessarily mean that it will be approved as an underlying security. Further, in exceptional circumstances an underlying security may be approved by the Exchange even though it does not meet all of the guidelines. The Exchange may also give consideration to maintaining diversity among various industries and issuers in selecting underlying securities. With respect to DORS, as a practical matter the Exchange shall generally avoid listing DORS on securities that meet the criteria in Rule 915 but in fact do not have regular put and call options listed for trading. The Exchange believes that DORS are complementary products to regular listed put and call options and that price discovery, and hedging should be enhanced when both product types are available for trading.

The Exchange also notes that Rule 916 will apply to DORS. Rule 916 considers the circumstances in which the Exchange will contemplate the withdrawal of approval for underlying securities. Specifically, whenever the Exchange determines that an underlying security previously approved for Exchange option transactions does not meet the then current requirements for continuance of such approval or for any other reason should no longer be approved, the Exchange shall not open for trading any additional series of options of the class

covering that underlying security and may thereafter prohibit any opening purchase transactions in series of options of that class previously opened, to the extent it shall deem such action necessary or appropriate; provided, however, that where exceptional circumstances have caused an underlying security not to comply with the Exchange's current approval maintenance requirements, regarding number of publicly held shares or publicly held principal amount, number of shareholders, trading volume or market price the Exchange may, in the interest of maintaining a fair and orderly market or for the protection of investors, determine to continue to open additional series of option contracts of the class covering that underlying security. When all option contracts in respect of an underlying security that is no longer approved have expired, the Exchange may make application to the Securities and Exchange Commission to strike from trading and listing all such option contracts. With respect to DORS, should regular put and call options on the same underlying security cease trading for any reason other than a failure to satisfy Rule 916, DORS shall continue to be listed for trading but new series shall not be added unless the Exchange determines that in the interest of maintaining a fair and orderly market the addition of such series is warranted.

c. Rights and Obligations of Holders and Sellers of DORS

Proposed Rule 902DORS(a) would provide that, subject to the provisions of Rules 907 and 909, the rights and obligations of holders and sellers of DORS dealt in on the Exchange shall be as set forth in the By-Laws and Rules of the OCC. Rule 907 applies to the liquidation of positions and provides that, whenever the Exchange shall determine that a person or group of persons acting in concert holds or controls, or is obligated in respect of, an aggregate position (whether long or short) in all option contracts of one or more classes or series dealt in on the Exchange in excess of the applicable position limit established pursuant to Rule 904, it may

direct all members and member organizations carrying a position in option contracts of such classes or series for such person or persons to liquidate such position as expeditiously as possible consistent with the maintenance of an orderly market. Whenever such a direction is issued by the Exchange, no member organization receiving notice thereof shall accept any order to purchase, sell or exercise any option contract for the account of the person or persons named in such directive, unless in each instance express approval therefore is given by the Exchange, or until such directive is rescinded.

Rule 909 addresses other restrictions on exchange traded options transactions and exercises and specifies that the Exchange shall have the power to impose, from time to time in its discretion, such restrictions on Exchange option transactions or the exercise of option contracts in one or more series of options of any class dealt in on the Exchange as it deems advisable in the interests of maintaining a fair and orderly market in option contracts or in the underlying securities covered by such option contracts, or otherwise deems advisable in the public interest or for the protection of investors. During the effectiveness of any such restriction, no member or member organization shall effect any Exchange option transaction or exercise any option contract in contravention of such restriction. Notwithstanding the foregoing, during the ten (10) business days prior to the expiration date of a given series of options, no restriction on the exercise of option contracts shall remain in effect with respect to that series of options.<sup>5</sup>

In addition, proposed Rule 902DORS(b) would provide that the provisions of Rule 905NY are applicable to DORS. 905NY provides generally that neither the Exchange nor its Directors, officers, committee members, employees or agents shall be liable to the ATP Holders of the Exchange or to persons associated therewith for any loss, expense, damages or claims that

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<sup>5</sup> In addition, Rule 909 would be explicitly applied to DORS through proposed Rule 909DORS.

arise out of the use or enjoyment of the facilities or services afforded by the Exchange, any interruption in or failure or unavailability of any such facilities or services, or any action taken or omitted to be taken in respect to the business of the Exchange except to the extent such loss, expense, damages or claims are attributable to the willful misconduct, gross negligence, bad faith or fraudulent or criminal acts of the Exchange or its officers, employees or agents acting within the scope of their authority.

d. Role of the Options Clearing Corporation (“OCC”)

The OCC has indicated a willingness to work with the Exchange to issue, clear and settle DORS. The Exchange notes that prior to trading of DORS, the OCC will need to amend its rules with respect to DORS and amend the existing Options Disclosure Document required pursuant to Rule 9b-1 under the Exchange Act<sup>6</sup> to incorporate disclosure about DORS.

e. Series of DORS Open for Trading

DORS will be listed with expirations of up to six years from the listing date. The Exchange intends to list five consecutive-year expiration series at any one time, with the expiration date set to coincide with regular options expiration on the third Friday of January in each expiration year. For example, as of April 1, 2012, the Exchange would expect to list and trade DORS contracts expiring on January 18, 2013, January 17, 2014, and January 16, 2015, January 15, 2016, and January 20, 2017. On the Monday following the expiration of the January 18, 2013 series, the Exchange would list the series expiring on January 19, 2018.

At the initial time of listing, the Exchange will seek to list both OWLS and RISKS with strike prices that are slightly in or out of the money. Periodically the Exchange will introduce new strikes as necessary to ensure that both OWLS and RISKS that are slightly in or out of the

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<sup>6</sup> 17 CFR 240.9b-1.

money will be available for trading. The listing of a new OWLS series will result in the listing of a RISKS contract with the same terms and vice versa. Standard strike price intervals will apply to series of both OWLS and RISKS.

DIVS, however, will always have one strike available for trading for a given expiration series. DIVS will always be listed with a strike price of \$.01 (with no value attached) since they are intended to give investors exposure to a stream of cash flows representing the dividends paid by the underlying security during the time the investor owns the DIVS contract. For example, DIVS on XYZ stock are listed having a strike price of \$.01 and an expiration date of January 16, 2017. Assume that, as April 1, 2012, XYZ is expected to continue to pay a \$.20 dividend in each of the calendar quarters remaining until the DIVS contract expires on January 20, 2017. Given this information, it is reasonable to expect that the DIVS contract will be quoted in the market place at a price reflective of the net present value of the expected future dividends. In this example, assuming a discount rate of .78%,<sup>7</sup> those future dividends that total \$3.80 would have a net present value of \$3.73. Consequently, it is reasonable to expect that the market price for this DIVS contract would be centered around this value such that the bid may be \$3.70 with an ask price of \$3.75. An investor, having purchased the DIVS contract for \$3.75, would receive periodic cash payments that will equal dividends paid by the underlying security. Therefore, each dividend declared and paid by the underlying security will result in a cash payment to the DIVS holder and, concurrent with that payment, the market value of the DIVS contract will be reduced by the amount of the dividend paid. At expiration, it is expected that the DIVS contract, having paid out cash payments over its life equal to dividends declared by the underlying security, will

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<sup>7</sup> Assume .78% is the current yield on five-year Treasury notes, which is a good approximation for the discount rate that would be commonly used in calculating the net present value of a future stream of cash flows.

expire with no value. DIVS are essentially a call option on the future dividend stream of the underlying security. As such, there is no need for multiple strike prices; rather, the market will price each DIVS based on the net present value of the expected future stream of dividends.

After DORS options have been approved for listing and trading on the Exchange, the Exchange shall from time to time open for trading series of options therein. Within each approved class of DORS options, the Exchange may open for trading series of options expiring in consecutive calendar years ("consecutive year series"), as provided in proposed Rule 903DORS(a)(1). Prior to the opening of trading in any series of DORS options, the Exchange shall fix the expiration day, expiration month, expiration year and strike price of DORS option contracts included in each such series. Consecutive year series will result in the various DORS components, DIVS, OWLS, and RISKS, all being listed such that no more than 5 consecutive year series exists at any one time with the most distant expiration not to exceed 6 years. Generally, DIVS, OWLS and RISKS consecutive year series shall expire on the third Friday of January. Expiration series with greater than 9 months until expiration are not subject to rules regarding strike price intervals, bid/ask differentials and continuity.

In addition, proposed Rule 903DORS(b) would provide that the provisions of Rule 903A shall apply to DORS, except as provided for in Commentary .01 to the rule. Rule 903A provides generally that the exercise price of each options series listed by the Exchange shall be fixed at a price per share which is reasonably close to the price of the underlying at or about the time the Exchange determines to list the series. Commentary .01 to proposed Rule 903DORS(b) would provide that OWLS and RISKS shall initially be listed with strike prices that are slightly out of or in the money. For example, if the underlying security is trading at \$72.50, the expectation is that OWLS and RISKS would be listed with strike prices of \$75. New series of OWLS and RISKS

shall be listed when the underlying security price has moved such that existing series are no longer slightly out of the money. OWLS and RISKS shall always be listed in pairs – for example, the listing of an OWLS contract expiring on January 18, 2013 with a strike price of \$75 shall also require that a RISKS contract with the same terms be listed. The Exchange is also proposing to adopt Commentary .02 which states that DIVS, unlike OWLS and RISKS, shall always be listed with a strike price of \$.01 with no value attached. As additional strike prices for the same consecutive year series are added for OWLS and RISKS, there shall be no additional strike prices added for DIVS. DIVS shall be listed for each expiration series that exists for OWLS and RISKS.

f. Symbology

DORS will be listed using a unique symbol. For example, if DORS were listed on Apple Inc., where the stock and the option symbol is AAPL, the symbol AAQ might be adopted as the symbol under which DORS on Apple Inc. are listed. OWLS, as noted earlier, have a risk/reward profile like that of a buy/write. A buy/write is also known as a synthetic short put and has the same risk/reward as a cash secured short put position. Given this risk/reward profile, the Exchange intends to represent OWLS in the systems for quoting, trading and clearance as put options. RISKS options, as noted earlier, have a risk/reward profile like that of a long call position. As such, the Exchange intends to represent RISKS options as call options in the systems used for quoting, trading and clearance.

Consistent with established industry practice, DIVS will utilize the same symbol used by the OWLS and RISKS with a “9” appended to the end. For example, if AAQ denotes the OWLS and RISKS contracts on Apple Inc. (symbol AAPL), AAQ9 will denote the DIVS on Apple Inc. stock because the DIVS contract represents a non-standard deliverable. Further DIVS, will be

represented within the systems used for quoting, trading, and clearance as a call options with a strike price of \$.01. The Exchange believes that adopting a unique symbol, coupled with investor education, will easily allow investors to ascertain that the DORS contracts, which settle into something other than 100 shares of stock, are different from regular, listed, equity options. The Exchange notes that there are a number of products that traded in the past and today based on the performance of a security, or securities, that settle into something other than 100 shares of stock. For example, NASDAQ PHLX, lists and trades options on the relative performance of 2 securities that settle into cash.<sup>8</sup> CBOE currently trades credit event binary options, which utilize a slightly different symbol. These options only pay off cash in the event of a credit event, such as a default on existing debt.<sup>9</sup> The Exchange has traded another type of binary option, called Fixed Return Options, based on the performance of equities and ETF. These options pay either \$0 or \$100 at expiration depending upon whether they finish in the money.<sup>10</sup> The Exchange believes that given the past and current practice of trading non-standard options utilizing different symbols, coupled with appropriate educational efforts, the proposed DORS symbol methodology will be sufficient to make investors aware that the DORS product delivers something other than 100 shares of stock at expiration.

g. Quote and Trade Reporting

The Exchange intends to list and trade the DORS components as standard options contracts. Quotes and trades will be reported over the Securities Information Processor (“SIP”) known as the Options Price Reporting Authority.

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<sup>8</sup> See <http://www.nasdaqtrader.com/Micro.aspx?id=alpha> for a description of NASDAQ OMX Alpha Index Options.

<sup>9</sup> See <http://www.cboe.com/micro/credit/AvailableCebos.aspx>

<sup>10</sup> See Rules 900FRO to 980FRO.

h. Position Limits

The Exchange proposes to adopt a new Rule 904DORS to establish position limits for OWLS and RISKS consistent with the provisions of Rule 904, except as provided for below. Since OWLS and RISKS options are of the type known as European exercise, the Exchange believes that it is appropriate for positions in OWLS and RISKS to be segregated from positions in regular listed options on the same underlying security. For example, Rule 904, Commentary .07 specifies that if XYZ stock had traded more than 100,000,000 shares during the previous six-month trading period, it would qualify for the highest tier of position limits applicable to standard listed options, which is presently 250,000 contracts. OWLS and RISKS contracts that have XYZ stock as the underlying security in turn would have their own position limit of 250,000 contracts, separate and distinct from the 250,000-contract position limit applicable to the standard listed option. The Exchange notes that granting a separate and distinct position limit for OWLS and RISKS that is equal to the position limit for standard options on the same underlying security is warranted since OWLS and RISKS are European style and may not be exercised before expiration. This inability to exercise OWLS and RISKS before expiration means that an investor could not combine a position in OWLS and RISKS with a position in standard options on the same underlying security and attempt to manipulate the underlying security via the exercise of those options.

Long positions in both OWLS and RISKS are considered to be on the same side of the market for purposes of position limit reporting and compliance. Long RISKS contracts are essentially long calls, and long OWLS contracts are essentially synthetic short puts. Conversely, short positions in both OWLS and RISKS are also considered to be on the same side of the market for purposes of position limit reporting and compliance. For example, a position

consisting of long 150,000 OWLS on XYZ and long 150,000 RISKS on XYZ would be considered to have a position of 300,000 contracts on the same side of the market, and absent any hedge exemptions as provided for in Rule 904, such position would be considered to be in violation of that Rule.

The Exchange proposes that position limits in DIVS be subject to their own separate limit, also determined in accordance with Rule 904. DIVS are call options that give investors exposure to the stream of cash flows equivalent to any dividends paid by the underlying security. As such, there is no potential to try to influence the underlying stock price by either purchasing large quantities of DIVS or exercising large quantities of DIVS since they are settled in cash and they are also European style and only exercisable at expiration. Due to their structure, at expiration DIVS will be worthless, having already paid out their value periodically over their life as the underlying stock itself goes ex-dividend. For these reasons, the Exchange believes that this aggregation of position limits for DIVS is not warranted.

The Exchange proposes to allow hedge exemptions for DORS in the case where an investor is long the same quantity of DIVS, OWLS and RISKS all expiring at the same time, and where the OWLS and RISKS having the same strike price can be fully hedged by a short position in the underlying security such that for every 100 shares of stock that are sold short against a long position consisting of 1 DIV, 1 OWL and 1 RISK. Conversely, a short position consisting of 1 DIV, 1 OWL and 1 RISK is deemed to be fully hedged by a long position consisting of 100 shares of the underlying security. Such positions, as fully hedged, are exempt from the position limits described in this Rule 904DORS.

i. Reports of Positions

The Exchange proposes to adopt a new Rule 906DORS that mirrors existing Rule 906 for Reports of Positions. Consistent with current practice, positions in DIVS, OWLS and RISKS will be subject to the 200-contract reporting requirement under Rule 906. In addition, long RISKS and OWLS would be considered to be on the same side of the market and would be aggregated for purposes of this reporting requirement. DIVS would be subject to their own position limit, and accordingly, positions in DIVS would not be aggregated with RISKS or OWLS.

In computing reportable positions under Rule 906DORS, DORS on underlying individual stocks, indexes, Exchange-Traded Fund Shares and Section 107 Securities shall not be aggregated with non-DORS option contracts.

j. Exercise, Settlement and Dividend Equivalent Exchange Date

The exercise style for all DORS components will be European style, where exercise and assignment only take place at expiration. Additionally, all DORS components will be automatically exercised, to be settled in accordance with the policies and procedures of the OCC as further described below.

DIVS Settlement: Settlement of DIVS will be for cash only if there are previously declared but unpaid dividends on the underlying stock. Though all DIVS contracts will be limited to strike prices of \$0.01, settlement will not require delivery (receipt) of \$1 per contract assigned (exercised) because there is no value attached to the strike price; the only amount due will be potentially a cash amount equal to any dividend amount that the underlying security is “ex” on expiration Friday. As noted earlier, a DIVS contract will have paid out any of its value during the life of the contract whenever the underlying security has declared a dividend payment.

OWLS and RISKS Settlement: Settlement of OWLS and RISKS will be made via a combination of shares of the underlying security plus cash in lieu of any fractional shares of the underlying security, except that RISKS may expire worthless and convey nothing at expiration upon assignment. At expiration, holders of OWLS will receive shares of the underlying security plus cash in lieu of fractional shares equal to the lesser of the composite closing price of the stock or the strike price of the OWLS contract.

For example, at the close of trading on expiration (typically the third Friday in January), XYZ security has a composite closing price of \$78.35. There are two series of expiring OWLS contracts, one having a strike price of \$75 and one having a strike price of \$80. The holder of the OWLS contract with a strike price of \$75 would receive a combination of shares and cash in lieu of fractional shares equal to \$75. With the stock closing at \$78.35, this would mean the holder of the \$75 strike OWLS contract would receive 95 shares of XYZ plus cash in lieu of .724313 shares or cash of \$56.75. This result is arrived at by computing how many shares are needed to deliver \$75 per share or \$7,500 per contract in value to the long OWLS holder. By dividing \$75 by the current value of the stock, one can calculate the number of shares required to settle the OWLS contract at expiration. In this example, \$75 divided by \$78.35 results in .95724313. This figure, when multiplied by the contract multiplier (100), results in 95 whole shares of XYZ plus fractional shares of .724313 that will be paid in cash. The holder of the OWLS contract with a strike price of \$80 would receive 100 shares of XYZ equal in value to the composite closing price of the stock – in this case 100 shares at \$78.35.

RISKS contracts will settle for shares of stock equal to the value – if any – between the difference of the composite closing price of the stock at expiration and the strike price of the RISKS contract. For example, at the close of trading on expiration (typically the third Friday in

January), XYZ security has a composite closing price of \$78.35. There are two series of expiring RISKS contracts, one having a strike price of \$75 and one having a strike price of \$80. The holder of the RISKS contract with a strike price of \$75 would receive shares of XYZ plus cash in lieu of any fractional shares, equal in value to \$3.35 (the difference between the composite close in the security and the strike price). In this case that would translate into four shares of XYZ (having a value of \$313.40) plus cash in lieu of .275686 fractional shares (having a value of \$21.60), resulting in a long position of cash and stock worth a total of \$335. The RISKS contract with a strike price of \$80 would expire worthless and the holder would receive nothing at expiration.

As noted previously, DIVS holders are entitled to receive cash payments during the time they hold the contract that are equivalent to the dividend stream on the underlying security. The transfer of payments between those with long and short positions in DIVS contracts of the same terms will occur on the Dividend Equivalent Exchange Date (“DExD”). The DExD will coincide with the “ex-dividend” date for the underlying security. The OCC will credit long DIVS with cash equal to the dividend on the “ex-dividend” date based on publicly available information from sources including, but not limited to, Bloomberg, Reuters, information circulars from listing exchanges and press releases by the underlying security’s issuer. This cash will be debited from those accounts that are short DIVS contracts of the same terms. If, for example, XYZ stock goes “ex” \$.50 per share, the holder of the DIVS contract on XYZ would receive \$50 per DIVS contract held long in its account on the DExD, which is also the “ex-dividend” date of the underlying security XYZ. Short positions in DIVS on XYZ would be debited \$50 per contract on the DExD.

The exercise, settlement, and dividend exchange date practices and procedures outlined above will be codified in new Rule 980DORS.

k. Hedging

A position consisting of a long DIVS contract, a long OWLS contract and a RISKS contract of the same strike, all expiring at the same time, will have yielded investment returns identical to those of an investor long 100 shares of the underlying stock for the same period of time. By virtue of this, hedging of DORS is fairly straightforward and the introduction of DORS should create additional arbitrage opportunities between the underlying stock, listed options on the same underlying stock and the DORS, which will be beneficial to investors in any of the related instruments due to the increased liquidity and the transparency DORS bring to the market.

l. Margin

For both RISKS and OWLS, customer purchases must be paid for in full, consistent with how purchases of option contracts are handled under present margin rules. Customers who are selling RISKS and OWLS will be subject to standard options margining. For example, the seller of an 85 strike RISKS contract on XYZ stock that expires on 1/21/17 will be expected to post margin equivalent to 100% of the current market value of the contract, reduced by any out-of-the-money amount not to be less than 20% for initial and/or for maintenance purposes, with a 10% minimum margin requirement. If XYZ were trading at \$87.00 per share and the current price of the 85 RISKS contract is \$16.20,<sup>11</sup> a Customer selling the 85 strike RISKS contract would be expected to post margin equal to \$1,740 (20% of \$8,700, which is the current market

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<sup>11</sup> Using a standard pricing model such as Black-Scholes, the price of the 85 strike RISKS expiring on 1/21/17 would be higher than the \$2 difference between the current price of XYZ and the 85 strike price principally due to the length of time until expiration.

value of 100 shares of XYZ) because that amount is greater than the current market price of the RISKS contract ( $\$16.20 \times 100 = \$1,620$ ). A covered writer of a RISKS contract is someone who is long 100 shares of the underlying security for each RISKS contract sold short, and such a person would not be required to post margin for that covered position.

Similarly, if the 85 strike OWLS contract on XYZ stock that expires on 1/21/17 is trading at \$60.40, the seller of that OWLS contract would be required to post margin equal to 100% of the market value of the OWLS contract (\$6,040, as this is greater than 20% of the current market value of the underlying security after being reduced by the out-of-the-money amount, if any (20% of \$8700 is \$1,740)). A covered writer of OWLS is anyone who is long 100 shares of the underlying security for each OWLS contract sold short, and such a person would not be required to post margin for that covered position.

DIVS also have an existing contract with similar risks. Specifically, the Chicago Board Options Exchange (“CBOE”) lists and trades options on several indexes designed to track the dividends paid by the constituents of the index. Existing margin rules for those products require that “[p]urchases of puts or calls with 9 months or less until expiration must be paid for in full. Writers of uncovered puts or calls must deposit / maintain 100% of the option proceeds plus 15% of the aggregate contract value (current index level x \$100) minus the amount by which the option is out-of-the-money, if any, subject to a minimum for calls of option proceeds plus 10% of the aggregate contract value and a minimum for puts of option proceeds plus 10% of the aggregate exercise price amount.”<sup>12</sup> The Exchange notes that while there is no “underlying contract value,” there is an underlying security associated with DIVS. Extending the margin requirements in place for the existing dividend-based product to DIVS and utilizing the value of

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<sup>12</sup> See CBOE Rule 12.3.

the underlying security in lieu of the “underlying contract value” makes economic sense.

Therefore, the Exchange proposes that writers of uncovered DIVS contracts be margined as follows:

Except as provided below, no DIVS contract carried for a customer shall be considered of any value for the purpose of computing the margin required in the account of such customer.

The initial and maintenance margin on any DIVS contract carried long in a customer account is 100% of the purchase price of such DIVS contract. The margin required for any DIVS contract carried short in a customer account is: (a) for Initial Margin, 100% of the DIVS contract sale proceeds plus 20% of the value of 100 shares of the security underlying the DIVS for each DIVS contract carried short; and (b) for Maintenance Margin, 100% of the DIVS current market price for DIVS contracts plus a minimum of 10% of the value of 100 shares of the security underlying the DIVS for each DIVS contract carried short.

The Exchange may also require uncovered writers to post additional margin if it deems it necessary; any such increase will be disseminated via an information circular sent to all ATP Holders. A covered writer of DIVS contracts is someone who is long 100 shares of the underlying security for each DIVS contract sold short. A buyer of DIVS will be required to pay for the contract in full.

Margin on Spreads: Under the proposed rule change, no margin is required on a DIVS contract carried short in a customer account that is offset by a long DIVS contract for the same underlying security or instrument that expires after the date on which the short DIVS contract expires.

Fully Hedged Positions: Under the proposed rule change, a position consisting of a DIVS contract carried short in a customer account that expires at the same time as an OWLS

contract and an RISKS contract with the same strike prices, on the same underlying security or instrument, that are also carried short in a customer account, shall be treated as fully hedged if such position is offset by a long position consisting of the appropriate number of shares of the underlying security or instrument. Such a short position shall not require any additional margin to be posted.

Cash Account Positions: Under the proposed rule change, a DIVS, OWLS, or RISKS contract carried short in a customer account would be deemed a covered position, and eligible for the cash account, as described below:

A DIVS contract carried short in a customer account is deemed a covered position, and eligible for the cash account, provided any one of the following either is held in the account at the time the contract is written or is received into it promptly thereafter: a long DIVS contract on the same underlying security or instrument that expires after the date on which the short DIVS contract expires.

An OWLS contract carried short in a customer account is deemed a covered position, and eligible for the cash account, provided any one of the following either is held in the account at the time the contract is written or is received into it promptly thereafter: a long OWLS contract on the same underlying security or instrument, having a strike price equal to or higher than the short OWLS contract, that expires on or after the date on which the short OWLS contract expires.

A RISKS contract carried short in a customer account is deemed a covered position, and eligible for the cash account, provided any one of the following either is held in the account at the time the contract is written or is received into it promptly thereafter: a long RISKS contract on the same underlying security or instrument, having a strike price equal to or lower than the

short RISKS contract, that expires on or after the date on which the short RISKS contract expires.

m. Voting Rights

As with regular listed options, none of the DORS components convey any of the voting rights a shareholder of the common stock enjoys until the option contract(s) are exercised, and, where appropriate, settled into shares of the underlying security. At that time, after exercise and assignment have taken place, anyone who ends up with a long position in shares of the underlying security would be deemed to be a shareholder of record in the security, and he or she would be afforded all the rights of a shareholder at that time.

n. Surveillance

The Exchange represents that the existing surveillance systems that are in place for listed options are adequate to perform surveillance for the DORS components.

o. Systems Capacity

The Exchange represents that DORS will not place an undue burden on its systems capacity.

p. FLEX Trading

The Exchange does not initially intend to allow DORS components to trade via the FLEX trading procedures in Rules 900G to 909G. If the Exchange makes a determination to permit DORS to trade via FLEX trading procedures, it will submit a proposed rule change to the Commission to clarify the manner in which such trading will be permitted at that time.

q. Implementation Date

In addition to Commission approval, the implementation of this proposed rule change will be contingent on other factors, including the completion of any changes that may be

necessary to the Exchange's regulatory and surveillance program. Accordingly, the Exchange does not intend to implement the proposed rule change immediately upon Commission approval. The Exchange intends to issue a notice announcing the implementation date of this rule change within six months after Commission approval of the proposed rule change.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Exchange Act,<sup>13</sup> in general, and furthers the objectives of Section 6(b)(5) of the Exchange Act,<sup>14</sup> in particular, in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanisms of a free and open market and a national market system and, in general, protect investors and the public interest by offering three new products that allow investors to hedge their risks in ways that do not currently exist. The DORS structure will allow investors for the first time to separate the total return of a security into three distinct components of varying levels of risk to allow individuals to further refine the risk within their portfolio. An especially novel aspect is the DIVS component, which will for the first time allow investors to hedge the expected stream of dividends to be paid by a security.

### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

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<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

### 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 (i) as the Commission may designate up to 90 days of such date 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 the 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 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-NYSEMKT-2012-14 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 20549-1090.

All submissions should refer to File Number SR-NYSEMKT-2012-14. 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 Section, 100 F Street, NE, Washington, DC 20549 on official business days between 10:00 a.m. and 3:00 p.m. Copies of the filing will also be available for inspection and copying at the NYSE's principal office and on its Internet website at [www.nyse.com](http://www.nyse.com). 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-NYSEMKT-2012-14 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>15</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>15</sup> 17 CFR 200.30-3(a)(12).