

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69977; File No. SR-OCC-2013-05)

July 11, 2013

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving 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

I. Introduction

On May 15, 2013 The Options Clearing Corporation (“OCC”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change SR-OCC-2013-05 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder.² The proposed rule change was published for comment in the Federal Register on June 3, 2013.³ The Commission received no comment letters. This order approves the proposed rule change.

II. Description

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. The principal purpose of this rule change is to authorize OCC, rather than adjustment panels of the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 34-69642 (May 28, 2013), 78 FR 33138 (June 3, 2013).

Securities Committee,⁴ to determine option contract adjustments and to determine the value of distributed property involved in such adjustments.

Article VI, Section 11 of OCC's By-Laws provide that all adjustments to option contracts are currently determined on a case-by-case basis by an adjustment panel of the Securities Committee composed of two representatives⁵ 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).

Discussions among OCC and the options 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

⁴ 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.

⁵ 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.

decisions, thereby eliminating adjustment panels convened for the purpose of determining adjustments of particular option contracts. Under the rule change:

- (i) The policy making role of the Securities Committee will be unchanged. As members of the Securities Committee, exchanges will retain authority to determine adjustment policy in general.
- (ii) OCC will 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 will not be called to determine a particular adjustment.
- (iii) OCC and the exchanges will retain unrestricted ability to mutually discuss considerations pertaining to any adjustment decision or policy.
- (iv) OCC will have authority to determine the value of distributed property involved in contract adjustments.

Notwithstanding the elimination of exchange representative adjustment panels, panels of exchange representatives will retain their existing functions and authority under other provisions of OCC's By-Laws.⁶ The types of adjustments for which exchange representative panels may continue to be convened will be limited to rare situations involving market closures or the unavailability of accurate pricing.

As a result of this rule change, adjustment panels for the purpose of determining adjustments of particular options contracts will cease to exist and exchanges will have no obligation or authority to determine a particular adjustment. OCC will determine the appropriate

⁶ For example, those panels will retain the authority to fix exercise settlement amounts for cash-settled options where a closing price for the underlying is otherwise unavailable.

application of the By-Laws and Interpretations and Policies, but the exchanges will retain policy making authority as members of the Securities Committee. In this policy making capacity, actions of the Securities Committee will continue to require approval by a majority vote.

OCC states that 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 this rule change, if OCC determines such aspects to be present, OCC will determine in its sole discretion any adjustment to be applied in the particular case. The Securities Committee will 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, will determine the appropriateness of adopting prospective policy changes or clarifications.⁷

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.⁸ Accordingly, this rule change does not prohibit

⁷ 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 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.

⁸ 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

either the exchanges or OCC from initiating conversations concerning adjustment policy or particular adjustment decisions, but neither would such consultation be required. Furthermore, to ensure continued exchange involvement in determining adjustment policy, OCC intends to call periodic meetings of the Securities Committee, to be held on a quarterly or more frequent period basis, to discuss policy issues and review recent experience with contract adjustments.⁹

The rule change will 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. The Securities Committee – or panels comprised of representatives of the Securities Committee – in respect of actions that do not involve option contract adjustments will 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 and similar actions.

In addition to the principal purpose underlying this rule change, OCC is making certain other conforming and/or clarifying changes to the By-Laws relating to adjustments and/or adjustment panels. Specifically, OCC is modifying or eliminating 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. OCC is eliminating other stale provisions, including those found within Interpretation and Policy .01 under the Article VI, Section 11, which relate to the determination of “ordinary cash dividends or distributions” for which no adjustment is ordinarily made. OCC is also making changes to Article XIV, Section 3A(a)(3) in relation to binary

now brought to bear in adjustment decisions.

⁹ 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.

options for which the underlying is an equity interest. OCC is also making changes to Article XIV Section 3A to reflect a clarifying interpretation issued by the Securities Committee with respect to determinations of corporate issuers to accelerate or defer payments of otherwise ordinary dividends.¹⁰ Other conforming changes being made by OCC update cross-references to By-Laws and Rules that are being amended.

III. Discussion

Section 19(b)(2)(C) of the Act¹¹ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. Section 17A(b)(3)(F) of the Act¹² requires that the rules of a clearing agency are designed to, among other things, promote the prompt and accurate clearance and settlement of securities transactions and foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions.

By providing OCC with sole discretion for particular adjustment decisions, the rule change helps to ensure that decisions are consistent, efficient and free from undue influence. As a result, the rule change should help to promote the prompt and accurate clearance and settlement of securities transactions as well as foster cooperation and coordination with persons engaged in

¹⁰ 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. 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.

¹¹ 15 U.S.C. 78s(b)(2)(C).

¹² 15 U.S.C. 78q-1(b)(3)(F).

the clearance and settlement of securities transactions consistent with Section 17A(b)(3)(F) of the Act.¹³ Furthermore, in addition to ensuring consistency with Section 17A(b)(3)(F) of the Act,¹⁴ the conforming and clarifying changes to OCC's By-Laws and Rules should help ensure that OCC maintains a well-founded, transparent and enforceable legal framework as required by Rule 17Ad-22(d)(1).¹⁵

¹³ 15 U.S.C. 78q-1(b)(3)(F).

¹⁴ 15 U.S.C. 78q-1(b)(3)(F).

¹⁵ 17 CFR 240.17Ad-22(d)(1).

IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act¹⁶ and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁷ that the proposed rule change (File No. SR-OCC-2013-05) be and hereby is APPROVED.¹⁸

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.¹⁹

Elizabeth M. Murphy
Secretary

¹⁶ 15 U.S.C. 78q-1.

¹⁷ 15 U.S.C. 78s(b)(2).

¹⁸ In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁹ 17 CFR 200.30-3(a)(12).