

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 19b-4

Proposed Rule Change
by

THE OPTIONS CLEARING CORPORATION

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

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Item 1. Text of the Proposed Rule Change

This filing (the “First Amended Filing”) amends and restates in its entirety rule filing no. SR-OCC-2006-01, which was filed by The Options Clearing Corporation (“OCC”) with the Securities and Exchange Commission (the “Commission”) on January 12, 2006. In that filing, OCC proposed to amend Article VI, Section 11A of its By-Laws as set forth below to (x) eliminate the need to round adjusted strike prices and units of trading and (y) revise the definition of “ordinary dividends and distributions.” The purpose of this First Amended Filing is to provide that the portion of the proposed changes defining “ordinary dividends and distributions,” as originally filed, will be implemented only for events announced on or after February 1, 2009. The proposed changes relating to rounding will become effective upon approval by the Commission and availability of an appropriate supplement to the options disclosure document (“ODD”).

Material proposed to be added is underlined and material proposed to be deleted is bracketed.

THE OPTIONS CLEARING CORPORATION

* * *

BY-LAWS

ARTICLE VI – CLEARANCE OF EXCHANGE TRANSACTIONS

* * *

Adjustments

Section 11A. (a) – (b) [no change]

(c) It shall be the general rule that:

(i) with respect to events announced on or prior to January 31, 2009, there will be no adjustments to reflect ordinary cash dividends or distributions or ordinary stock dividends or distributions (collectively, “ordinary distributions”) by the issuer of the underlying security;

(ii) with respect to events announced on or after February 1, 2009, there will be no adjustment to reflect (x) ordinary distributions by the issuer of the underlying security or (y) any cash dividend or distribution by the issuer of the underlying security if such dividend or distribution is less than \$12.50 per contract; and

(iii) notwithstanding the foregoing, the general rule set forth in clause (i) above will apply to events announced on or after February 1, 2009 in respect of those series of options expiring on or after that date that have been designated by the Corporation as grandfathered for purposes of this Section 11A (“grandfathered series”).

(d) In the case of any series of option contracts having exercise prices stated in fractions of one dollar (e.g., 1/8) rather than in decimals:

(i) It [Subject to paragraph (c) of this Section 11A, it] shall be the general rule that in the case of a stock dividend, stock distribution or stock split whereby [one or more whole numbers of] either one or three additional whole shares of the underlying security are issued with respect to each outstanding share (e.g., a 2 for 1 or 4 for 1 stock split), each option contract covering that underlying security shall be increased by the same number of additional option contracts as the number of additional shares issued with respect to each share of the underlying security, the exercise price per share in effect immediately prior to such event shall be proportionately reduced, and the unit of trading shall remain the same. However, if the proportionate reduction in the exercise price required under this paragraph (d) would result (either because of a previous adjustment to the same series of options or for any other reason) in an exercise price that includes a fraction of an adjustment increment, the foregoing general rule shall not apply and

option contracts on such underlying security shall instead be adjusted in accordance with subparagraph (ii) of this paragraph (d).

(ii) It shall be the general rule with respect to any stock dividend, stock distribution or stock split for which an adjustment is not made pursuant to subparagraph (i) above that each option contract covering the affected underlying security shall be adjusted, solely for purposes of determining the property deliverable upon exercise of the option, by increasing the unit of trading so as to include the number of shares or amount of property distributed (or decreasing the unit of trading to reflect the number of shares eliminated, in the case of a reverse stock split, combination of shares, or similar event). If an adjustment is made in accordance with the preceding sentence, the unit of trading for all such adjusted series of options shall remain unchanged for purposes of determining the aggregate exercise price of the option and for purposes of determining the premium for any such option purchased and sold.

(e) In the case of any series of options having exercise prices that are stated in decimals:

(i) It shall be the general rule that in the case of a stock dividend, stock distribution or stock split whereby a whole number of additional shares of the underlying security is issued with respect to each outstanding share, each option contract covering that underlying security shall be increased by the same number of additional option contracts as the additional number of shares issued with respect to each share of the underlying security, the exercise price per share in effect immediately prior to such event shall be proportionately reduced, and the unit of trading shall remain the same.

(ii) It [Subject to paragraph (c) of this Section 11A, it] shall be the general rule that in the case of a stock dividend, stock distribution or stock split whereby other than a whole number of shares of the underlying security is issued in respect of each outstanding share, the exercise price in effect immediately prior to such event shall be proportionately reduced[, and conversely, in the case of a reverse stock split or combination of shares, the exercise price in effect immediately prior to such event shall be proportionately increased. Whenever the exercise price with respect to an option contract has been reduced or increased in accordance with this paragraph (e),] and the unit of trading shall be proportionately increased [or reduced, as the case may be].

(iii) It shall be the general rule that in the case of reverse stock splits, combinations of shares, or similar events, option contracts shall be adjusted as provided in subparagraph (d)(ii).

(f) – (h) [no change]

(i) It shall be the general rule that (1) all adjustments of the exercise price of an outstanding option contract shall be rounded to the nearest adjustment increment, (2) when an adjustment causes an exercise price to be equidistant between two adjustment increments, the exercise price shall be rounded up to the next highest adjustment increment, (3) all adjustments of the unit of trading shall be rounded down to eliminate

any fraction, and (4) if the adjustment is made pursuant to subparagraph (d)(ii) above, the value of the fractional share so eliminated as determined by the Corporation shall be added to the unit of trading, or if the adjustment is made pursuant to subparagraph (e)(ii) above, if the unit of trading is rounded down to eliminate a fraction, the adjusted exercise price [shall] may be further adjusted, to the nearest adjustment increment, to reflect any diminution in the value of the option contract resulting from the elimination of the fraction.

(j) – (k) [no change]

...Interpretations and Policies:

.01 With respect to events announced on or prior to January 31, 2009, cash dividends [Dividends] or distributions by the issuer of the underlying security in an aggregate amount per dividend or distribution which does not exceed 10% of the market value (as of the close of trading on the declaration date) of the underlying security outstanding will, as a general rule, be deemed to be "ordinary cash dividends or distributions" within the meaning of paragraph (c) of this Section 11A; provided, however, that in the case of grandfathered series, the provisions of this sentence shall apply regardless of the date when an event is announced. With respect to events announced on or after February 1, 2009 (except in the case of grandfathered series), cash dividends or distributions (regardless of size) by the issuer of the underlying security which the Corporation believes to have been declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly or other regular basis will, as a general rule, be deemed to be "ordinary cash dividends or distributions" within the meaning of paragraph (c) of Section 11A. Stock dividends or distributions by the issuer of the underlying security (i) in an aggregate amount per dividend or distribution which does not exceed 10% of the number of shares or other units of the underlying security outstanding as of the close of trading on the declaration date, and (ii) which the Corporation believes to have been declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly basis, will, as a general rule, be deemed to be "ordinary stock dividends or distributions" within the meaning of paragraph (c) of Section 11A. The Securities Committee will determine on a case-by-case basis whether other dividends or distributions are "ordinary distributions" or whether they are dividends or distributions for which an adjustment should be made. Where the Securities Committee determines to adjust for a dividend or distribution, the adjustment shall be made in accordance with paragraph (f) of Section 11A. Any issue as to whether a particular dividend or distribution was declared pursuant to a policy of paying such dividends or distributions on a quarterly or (where applicable) other regular basis shall be referred to the Securities Committee for a determination.

.02-.07 [unchanged]

.08 Notwithstanding Interpretation and Policy .01 under Section 11A of Article VI of the By-Laws, (i) distributions of short-term [and] or long-term capital gains in

respect of fund shares by the issuer thereof shall not, as a general rule, be deemed to be "ordinary dividends or distributions" within the meaning of paragraph (c) of Section 11A, and (ii) other distributions in respect of fund shares by the issuer thereof shall not, as a general rule, be deemed to be "ordinary dividends or distributions" within the meaning of paragraph (c) of this Section 11A to the extent that [if] (x) the fund tracks the performance of an index that underlies a class of index options or index futures, and the distribution on the funds shares includes or reflects a dividend or other distribution on a portfolio security that resulted in an adjustment of the index divisor; or (y) the distribution on the fund shares includes or reflects a dividend or other distribution on a portfolio security (I) that results in an adjustment of options on other fund shares pursuant to clause (ii)(x), or (II) that is not deemed an ordinary dividend or distribution under Interpretation .01 above[in an aggregate amount exceeding 10% of the market value (as of the close of trading on the declaration date) of the portfolio security outstanding]. Adjustments of the terms of options on such fund shares for distributions described in clause (i) or (ii) above shall be made in accordance with paragraph (f) of Section 11A, unless the Securities Committee determines, on a case-by-case basis, not to adjust for such a distribution; provided, however, that no adjustment shall be made for any such distribution where the amount of the adjustment would be less than \$.125 per fund share.¹

.09 [unchanged]

Item 2. Procedures of the Self-Regulatory Organization

The proposed rule change was approved by OCC's Board of Directors and by two of OCC's five stockholder exchanges at a meeting held on August 24, 2006.

Written consents from the three stockholder exchanges not represented at the meeting were obtained subsequent to the meeting.

Questions regarding the proposed rule change should be addressed to Jean M. Cawley, First Vice President and Deputy General Counsel, at (312) 322-6269.

¹ Clause (ii) of this paragraph was added pursuant to a proposed rule change filed for immediate effectiveness by OCC on September 27, 2004 (SR-OCC-2004-18). Implementation of SR-OCC-2004-18 has been delayed pending the distribution of a supplement to the ODD addressing this change. It is anticipated that such disclosure will be included with the disclosure required by the changes proposed in the current rule filing.

Item 3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

These rule changes are intended to (x) eliminate the need to round strike prices and/or units of trading in the event of certain stock dividends, stock distributions and stock splits and (y) provide for the adjustment of outstanding options for special dividends (i.e., cash distributions not declared pursuant to a policy or practice of paying such distributions on a quarterly or other regular basis). The proposed rule change would also add a \$12.50 per contract threshold amount for cash dividends and distributions to trigger OCC's adjustment rules.

Part I: Changes relating to Adjustments for Certain Stock Dividends, Stock Distributions and Stock Splits

Background

OCC's By-Laws currently specify two alternative methods of adjusting for stock dividends, stock distributions and stock splits. In cases where one or more whole shares are issued with respect to each outstanding share, the number of outstanding option contracts is correspondingly increased and strike prices are proportionally reduced.² In all other cases, the number of shares to be delivered under the option contract is increased and the strike price is reduced proportionately.³

² For example, in the event of a 2-for-1 split, an XYZ \$60 option calling for the delivery of 100 shares of XYZ stock would be subdivided into two XYZ \$30 options, each calling for the delivery of 100 shares of XYZ stock.

³ For example, in a 3-for-2 split, an XYZ \$60 option calling for the delivery of 100 shares would be adjusted to call for the delivery of 150 shares and the strike price would be reduced to \$40.

Although these two methods have been used since the inception of options trading, in certain circumstances either method can produce a windfall profit for one side and a corresponding loss for the other due to rounding of adjusted strike prices.. These profits and losses, while small on a per-contract basis, can be significant for large positions. Because equity option strike prices are currently stated in eighths, OCC's By-Laws require adjusted strike prices to be rounded to the nearest eighth. For example, if an XYZ \$50 option for 100 shares were to be adjusted for a 3-for-2 split, the deliverable would be increased to 150 shares and the strike price would be adjusted to \$33.33, which would then be rounded up to \$33-3/8. Prior to the adjustment, a call holder would have had to pay \$5,000 to exercise ($\50×100 shares). After the adjustment, the caller has to pay \$5,006.25 for the equivalent stock position ($\$33.375 \times 150$ shares). Conversely, an exercising put holder would receive \$5,006.25 instead of \$5,000. The \$6.25 difference represents a loss for call holders and a put writers and a windfall for put holders and call writers.

A loss/windfall can also occur when the split results in a fractional deliverable (e.g., when a 4-for-3 split produces a deliverable of 133.3333 shares). In those cases, OCC's By-Laws currently require that the deliverable be rounded down to eliminate the fraction and, if appropriate, the strike price be further adjusted to the nearest eighth to compensate for the diminution in the value of the contract resulting from the elimination of the fractional share. However, even if these steps are taken, small rounding inequities may remain.

The windfall profits and offsetting losses resulting from the rounding process have historically been accepted as immaterial. Due to recent substantial increases in trading volume and position size, however, they have become a source of concern to exchanges and market participants. In addition, OCC has been informed that some traders may be exploiting announcements of splits and similar events by quickly establishing positions designed to capture rounding windfalls at the expense of other market participants.

Solution

The inequity that results from the need to round strike prices can be eliminated by using a different adjustment method: namely, adjusting the deliverable but not the strike prices or the values used to calculate aggregate exercise prices and premiums. As an illustration, in the XYZ \$50 option 3-for-2 split example described above, under this revised methodology, the resulting adjustment would be a deliverable of 150 shares of XYZ stock, while the strike price remained at \$50. In this case, the pre-split multiplier of 100, used to extend aggregate strike price and premium amounts, is unchanged. For example, a premium of 1.50 would equal \$150 (1.5×100) both before and after the adjustment. An exercising call holder would continue to pay \$50 times 100 (for a total of \$5,000), but would receive 150 shares of XYZ stock instead of 100.⁴ This is the method currently used for property distributions such as spin-offs and special dividends large enough to require adjustments under OCC's By-Laws.

⁴ The same adjustment methodology would apply to reverse stock splits or combination of shares. For example, in a 3-for-4 reverse stock split on a XYZ \$50 option calling for the delivery of 100 shares, the resulting adjustment would be a deliverable of 75 shares of XYZ stock, while the strike price remained at \$50.

The inequity that results from the need to eliminate fractional shares from the deliverable, and to compensate by further reducing the strike price to the nearest eighth, can be eliminated by adjusting the deliverable to include cash in lieu of the fractional share. As an illustration, consider a 4-for-3 split of the stock underlying an XYZ \$80 option with a 100 share deliverable. Employing the proposed adjustment method, the deliverable would be adjusted to 133.3333 shares, which would be rounded down to 133 shares, and the strike price would remain \$80. However, instead of compensating for the elimination of the .3333 share by reducing the strikes, the strike prices would be left unchanged and the deliverable would be adjusted to 133 shares plus the cash value of the eliminated fractional share (.3333 x the post-split value of a share of XYZ stock, as determined by OCC). The adjusted option would also continue to use 100 as the multiplier to calculate aggregate strike and premium amounts.

The revised adjustment methodology would not generally be used for 2-for-1 or 4-for-1 stock distributions or splits (since such distributions / splits normally result in strike prices that do not require rounding to the nearest eighth). In addition, the revised adjustment methodology would not generally be used for stock dividends, stock distributions or stock splits with respect to any series of options having exercise prices stated in decimals.⁵ For those options, the existing adjustment rules would apply. The reason for this is that, once the market has converted to decimal strikes, the rounding

⁵ Although there are currently no decimal strikes for equity options, OCC wants to avoid the need for further amendments to its By-Laws and the options disclosure document in the event that such strikes are introduced in the future. Compare definition of "adjustment increment" in Article I of OCC's By-Laws. Also see the last sentence of the paragraph in which this footnote appears.

errors created by rounding to the nearest cent would be immaterial even given the larger positions taken in today's markets and the other factors discussed above. Because conversion to decimal strikes might be phased in rather than applied to all series of equity options simultaneously, the rule has been drafted to cover both methods of expressing exercise prices, applying the appropriate rule to each.

The proposed changes in adjustment methodology will not be implemented until the exchanges have conducted appropriate educational efforts and definitive copies of an appropriate supplement to the options disclosure document, *Characteristics and Risks of Standardized Options*, are available for distribution.

Part II: Changes to the Definition of "Ordinary Dividends and Distributions"

Background

Article VI, Section 11A(c) of OCC's By-Laws currently provides that as a general rule, outstanding options will not be adjusted to compensate for ordinary cash dividends. Interpretation and Policy .01 under Section 11A of Article VI provides that a cash dividend will generally be deemed to be "ordinary" if the amount does not exceed 10% of the value of the underlying stock on the declaration date (the "10% Rule"). The Securities Committee is authorized to decide on a case-by-case basis whether to adjust for dividends exceeding that amount. As a result, OCC historically has not adjusted for special cash dividends unless the amount of the dividend was greater than 10% of the stock price at the close of trading on the declaration day.

The 10% Rule predated a number of significant developments, including the introduction of LEAPS options, the sizeable open interest seen today, the large contract volume associated with trading and spreading strategies, and modern option pricing models that take dividends into account. When open interest and individual positions were smaller, not adjusting for dividends of less than 10% did not have the pronounced impact it does today. Additionally, changes to the tax code which now tax dividends more favorably have provided an incentive for companies to pay more dividends, including special dividends. In light of these considerations, it is appropriate that the 10% Rule now be revised.

Solution

Under the revision proposed by OCC, a cash dividend or distribution would be considered ordinary (regardless of size) if the Securities Committee determines that such dividend or distribution was declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly or other regular basis. In addition, as a general rule, a cash dividend or distribution that is less than \$12.50 per contract would not trigger the adjustment provisions of Article VI, Section 11A.

Notwithstanding the foregoing, OCC understands that certain option traders may have integrated into their pricing decisions the probability of special dividends based on the rules currently in effect, and that eliminating the 10% Rule with respect to existing contracts may be unfair. To ensure that no options series that were opened before disclosure of the rule change are affected by elimination of the 10% Rule, OCC will delay implementation of this portion of the rule change so that the 10% Rule

will be eliminated only for corporate events announced on or after February 1, 2009. OCC plans to provide ODD disclosure of this rule change before May 29, 2007 (after which the exchanges would normally begin introducing LEAPS expiring in 2010, making a 2009 implementation impracticable). The delay in implementation will ensure that all options series opened before the ODD disclosure is made available (other than certain “flex” options, which will be grandfathered under the old rule) will have expired before the change is effected.⁶ While delaying the implementation until 2009 postpones the benefit of making this needed change to the 10% Rule, it accommodates the many firms that find the operational hurdles associated with an earlier implementation onerous.

Discussion

The following discussion describes the benefits of the new rule that will apply to announcements made on or after February 1, 2009.

No Adjustment for Regularly-Scheduled Dividends Needed. Dividends declared by an issuer pursuant to a policy or practice of such issuer are known and can thus be priced into option premiums. By definition, however, special dividends cannot be anticipated in advance and therefore cannot be integrated into option pricing models.⁷ If adjustments

⁶ OCC intends to take a “snapshot” of flex series expiring after January 31, 2009 that are outstanding at the time when ODD disclosure of the rule change is made. These series will be assigned distinctive trading symbols and “grandfathered” under the old rule. Trading will continue normally in grandfathered series until their expiration, but the exchanges would be free to open otherwise identical non-grandfathered series, which would be identified by conventional flex trading symbols. If ODD disclosure is not made until after the December, 2006 expiration, it may also be necessary to grandfather two classes of LEAPs with December expirations (SPY and S&P 100 i-Shares), because the exchanges would ordinarily introduce new series expiring in December 2009 after the December, 2006 expiration.

⁷ OCC has been told that some traders form judgments as to the likelihood that certain issuers may declare special cash dividends and factor those judgments into their pricing models. However, that is clearly not the case with all traders or all issues.

are not made in response to special dividends – by calling for the delivery of the dividend – call holders can capture the dividends only by exercising their options. Often in these cases, especially with LEAPS options (or “flex” options which can exist for 5 – 10 years), early exercise would sacrifice substantial option time value. This economic disadvantage can be further magnified if the option position is large, as is often the case today. (Conversely, put holders often receive a windfall benefit, benefiting from the increase in the in-the-money value on the ex date.) To the extent that equity options can be priced accurately and consistently without dislocations due to unforeseen special dividends, these economic disadvantages can be avoided. Moreover, because special dividends are one-off events, adjusting for them would not cause the proliferation of outstanding series that would result from adjusting for regular dividends.

De Minimis Threshold. Adjusting for dividends can cause a proliferation of outstanding option symbols and series.⁸ In the interest of providing some limit on option symbol proliferation, the proposed rule change includes a de-minimis threshold of \$12.50 per contract fixed amount. Special dividends smaller than these amounts would not trigger an adjustment.

OCC believes that a set dollar amount is preferable to a percentage threshold (like the 10% Rule) because there are operational problems with applying a percentage threshold. Under the existing 10% Rule, to determine whether this threshold

is met, the per share dividend amount is applied to the closing price of the underlying security on the dividend declaration date. The date the dividend is announced (by press release, or some other means), is not normally the “declaration date” when the dividend is officially declared by an issuer’s board of directors. Until the actual declaration date, investors and traders may not know whether or not an announced dividend will trigger an adjustment based on the company’s share price. In the interim, it is difficult for traders and investors to price their options, as they do not know if an adjustment will be made.

The advantage of a fixed dollar threshold is avoiding uncertainty: the per contract value of the dividend can be immediately determined without the need to wait until the declaration date and without the need to do a calculation based on the closing price of the underlying shares.

* * *

The proposed rule changes are consistent with Section 17A of the Securities Exchange Act of 1934, as amended (the “Act”), because (x) they are intended to eliminate inequities which result from certain rounding practices currently required by OCC’s By-Laws and therefore protect investors, and (y) they are intended to make it more predictable when cash distributions by an issuer will result in an adjustment to an option contract, thus making it fairer for all investors. The proposed rule change is not

⁸ Symbols proliferate when adjustments are made because often the dividend amount must be added to the deliverable, yielding a non-standard option, and the exchanges then introduce standard options with the same strikes.

inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

Item 4. Self-Regulatory Organization's Statement on Burden on Competition

OCC does not believe that the proposed rule change would impose any burden on competition.

Item 5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

Written comments have been received with respect to the proposed rule change, and OCC intends to respond to those comments in a separate submission to the Commission.

Item 6. Extension of Time Period for Commission Action

OCC does not consent to an extension of the time period specified in Section 19(b)(2) of the Securities Exchange Act of 1934. OCC will not implement this rule change until definitive copies of an appropriate supplement to the ODD, *Characteristics and Risks of Standardized Options*, are available for distribution.

Item 7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

Not applicable.

Item 8. Proposed Rule Change Based on Rule of Another Self-Regulatory Organization or of the Commission

Not applicable.

Item 9. Exhibits

Exhibit 1. Completed Notice of Proposed Rule Change for publication in the Federal Registrar.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the self-regulatory organization has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

THE OPTIONS CLEARING CORPORATION

By:

A handwritten signature in black ink, appearing to read "Bruce Kelber", is written over a horizontal line.

Bruce Kelber
Associate General Counsel