

C.F.T.C.  
OFFICE OF THE SECRETARIAT  
2010 SEP 1 PM 3 10



THE OPTIONS CLEARING  
CORPORATION

August 31, 2010

**VIA E-MAIL**

Mr. David A. Stawick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

**Re: Rule Filing SR-OCC-2010-15 Rule Certification**

Dear Mr. Stawick:

Attached is a copy of the above-referenced rule filing, which The Options Clearing Corporation ("OCC") is submitting pursuant to the self-certification procedures of Commission Regulation 40.6. This rule filing has been, or is concurrently being, submitted to the Securities and Exchange Commission (the "SEC") under the Securities Exchange Act of 1934 (the "Exchange Act").

In conformity with the requirements of Regulation 40.6(a)(3), OCC states the following: The text of the rule is set forth at Item 1 of the enclosed filing. The date of implementation of the rule is when the proposed rule has been approved by the SEC. No substantive opposing views were expressed to OCC by governing board or committee members, clearing members of OCC, or market participants, that were not incorporated into the rule.

OCC hereby certifies that the rule set forth at Item 1 of the enclosed filing complies with the Commodity Exchange Act and the Commission's regulations thereunder.

JEAN M. CAWLEY

SENIOR VICE PRESIDENT AND DEPUTY GENERAL COUNSEL

ONE N. WACKER DRIVE, SUITE 500 CHICAGO, ILLINOIS 60606 TEL 312.322.6269 FAX 312.322.6280

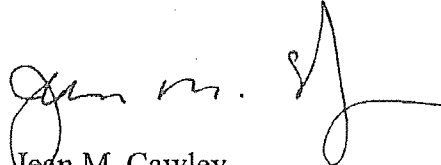
JCAWLEY@THEOCC.COM WWW.OPTIONSCLEARING.COM



Mr. David A. Stawick  
Page Two  
August 31, 2010

Should you have any questions regarding this matter, please do not hesitate to contact the undersigned at (312) 322-6269.

Sincerely,

  
Jean M. Cawley

Attachments

cc: CFTC Central Region (w/ enclosure)  
525 West Monroe Street, Suite 1100  
Chicago, IL 60661  
Attn: Frank Zimmerle

OCC-2010-15 cftc.ltr

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 19b-4

Proposed Rule Change  
by

THE OPTIONS CLEARING CORPORATION

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

**Item 1. Text of the Proposed Rule Change**

The Options Clearing Corporation (“OCC”) proposes to amend its by-laws as set forth below. Material proposed to be added is marked by underlining.

**THE OPTIONS CLEARING CORPORATION**

**BY-LAWS**

\* \* \*

**ARTICLE VI**

**Clearance of Exchange Transactions**

\* \* \*

**Adjustments for Stock Option Contracts**

**Section 11A. [unchanged]**

***...Interpretations and Policies:***

.01 With respect to events announced on or prior to January 31, 2009, cash 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.

In making such determinations, the Securities Committee may take into account such factors as it deems appropriate, including, without limitation, the issuer's stated dividend payment policy, the issuer's characterization of a particular dividend or distribution as "regular" or "special," whether the dividend can be differentiated from other dividends (if any) paid on a quarterly or other regular basis, and the issuer's dividend payment history. Normally, the Securities Committee shall classify a dividend or distribution as non-ordinary when it believes that similar dividends or distributions will not be paid on a quarterly or other regular basis. Notwithstanding that the Securities Committee has classified a dividend or distribution as non-ordinary, it may, with respect to events announced on or after February 1, 2012, classify subsequent dividends or distributions of a similar nature as ordinary if (i) the issuer discloses that it intends to pay such dividends or distributions on a quarterly or other regular basis, (ii) the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment, whether or not the amounts paid were the same from period to period, or (iii) the Securities Committee determines for other reasons that the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis.

.02 - .10 [unchanged]

\* \* \*

## ARTICLE XII

### Adjustments to Futures and Futures Options

#### SECTION 3. (a) - (j)<sup>1</sup>

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<sup>1</sup> Because this rule change is being submitted for immediate effectiveness, the proposed changes to Article XII, Section 3, as set forth in OCC-2010-13, are not reflected here.

*... Interpretations and Policies:*

.01

(a) Cash dividends or distributions by the issuer of the underlying security that 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 distributions” within the meaning of paragraph (c) of Section 3. The Corporation 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.

In making such determinations, the Corporation may take into account such factors as it deems appropriate, including, without limitation, the issuer’s stated dividend payment policy, the issuer’s characterization of a particular dividend or distribution as “regular” or “special,” whether the dividend can be differentiated from other dividends (if any) paid on a quarterly or other regular basis, and the issuer’s dividend payment history. Normally, the Corporation shall classify a dividend or distribution as non-ordinary when it believes that similar dividends or distributions will not be paid on a quarterly or other regular basis. Notwithstanding that the Corporation has classified a dividend or distribution as non-ordinary, it may, with respect to events announced on or after February 1, 2012, classify subsequent dividends or distributions of a similar nature as ordinary if (i) the issuer discloses that it intends to pay such dividends or distributions on a quarterly or other regular basis, (ii) the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment, whether or not the amounts paid were the same from period to period, or (iii) the Corporation determines for other reasons that the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis.

(b) – (c) [unchanged]

.02 - .09 [unchanged]

\* \* \*

**Item 2.        Procedures of the Self-Regulatory Organization**

The proposed interpretation of Article VI, Section 11A was approved by the Securities Committee of OCC’s Board of Directors pursuant to Article VI, Section 11(a) of OCC’s By-Laws, at a meeting held on August 22, 2010. The proposed interpretation of Article

XII, Section 3 was adopted by management on the same date pursuant to Article XII, Section 3(a) of OCC's By-Laws.

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

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

The principal purpose of this rule change is to amend Interpretation and Policy .01 under Section 11A, Article VI ("Interpretation .01, Section 11A") of OCC's by-laws. Under that Interpretation, cash dividends or distributions of an issuer which are deemed by the Securities Committee<sup>2</sup> to be non-ordinary will usually occasion an adjustment to the terms of listed stock options. OCC is proposing to amend Interpretation .01, Section 11A, to allow the Securities Committee under certain conditions to cease adjusting for recurring cash dividends previously deemed to be non-ordinary dividends. Interpretation .01 under Section 3 of Article XII ("Interpretation .01, Section 3") of OCC's by-laws, which provides that non-ordinary (as determined by OCC) cash dividends or distributions of an issuer will usually occasion an adjustment to the terms of listed stock futures, would similarly be amended. The discussion below addresses the proposed amendments to Interpretation .01, Section 11A, but the purpose behind those changes is equally applicable to the changes proposed to Interpretation .01, Section

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<sup>2</sup> The Securities Committee is comprised of one designated representative of each participant exchange and the Chairman of OCC or his designee. The OCC representative is not a voting member of the Committee except in cases of tie votes. See Article VI, Section 11(c) of OCC's by-laws.

3.<sup>3</sup>

The amendment was prompted by a series of cash dividends declared by Diamond Offshore Corporation (DO). DO characterized these dividends as “special” and differentiated them from the company’s “regular” cash dividends. (The “special” and “regular” DO dividends customarily go “ex-distribution” on the same date.) Initially, the Securities Committee deemed these “special” dividends to be non-ordinary under Interpretation .01, and appropriately adjusted listed options in response.<sup>4</sup> Since Interpretation .01, Section 11A, was revised effective February 1, 2009, DO options have been adjusted for five successive quarterly “special” dividends. Notwithstanding that these dividends were characterized by DO as “special” dividends and clearly differentiated from the company’s “regular” dividends, OCC and the options exchanges have received strong feedback from investors that such dividends have been declared so consistently, and thereby have achieved such predictability, that they should no longer be considered “non-ordinary” for adjustment purposes. Furthermore, the options exchanges and many OCC clearing member firms believe that the proliferation of option strikes caused by successive quarterly adjustments will have an adverse affect on liquidity and occasion other

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<sup>3</sup> Generally speaking, a cash dividend or distribution would be deemed to be “ordinary” if it is declared pursuant to a policy or practice of paying such dividends on a quarterly or other regular basis. Dividends paid outside such practice would be considered “non-ordinary”. Non-ordinary cash dividends usually would trigger an adjustment to options contracts subject to the minimum size requirement. See Article VI, Section 11A, Interpretation and Policy .01, of OCC’s by-laws. See also Release No. 34-55258 (February 8, 2007). Stock futures likewise are adjusted in response to non-ordinary cash dividends or distributions. See Article XII, Section 3, Interpretation and Policy .01, of OCC’s by-laws. See also Release No. 34-46-595 (October 3, 2002).

<sup>4</sup> In like manner, options on Oil Service HLDRS Trust (OIH) which contain DO as a component security and make pro-rata distributions in response to the DO dividends, were also adjusted.



adverse operational effects.<sup>5</sup> The Securities Committee also solicited the opinion of participant members of the OCC Clearing Member Roundtable regarding this issue.<sup>6</sup> The Roundtable respondents strongly supported authorizing the Securities Committee to cease adjusting for “special” cash dividends whose consistency and predictability of payment have been demonstrated.

The proposed amended Interpretation .01, Section 11A, enumerates factors that the Securities Committee may take into account in determining whether a dividend is “ordinary.” Importantly, it allows the Securities Committee to re-classify as “ordinary” dividends previously deemed “non-ordinary”. The conditions under which this may occur are as follows: (i) the issuer discloses that it intends to pay such dividends or distributions on a quarterly or other regular basis, (ii) the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment, whether or not the amounts paid were the same from period to period, or (iii) the Securities Committee determines for other reasons

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<sup>5</sup> The standard method of adjustment is to reduce strike prices by the amount of the dividend. Options with “standard” strike prices are then re-introduced by the listing option exchange(s). With each successive adjustment, this process is repeated, proliferating strike prices. Liquidity naturally gravitates to the standard strike prices at the expense of non-standard strikes.

<sup>6</sup> The OCC Roundtable is an OCC sponsored advisory group comprised of representatives from OCC’s participant exchanges, OCC, a cross-section of OCC clearing members, and industry service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and lower costs in the options industry.

that the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis.<sup>7</sup>

It is the intent of the Securities Committee that any such re-characterization of a dividend as “ordinary” would be announced in advance to investors; for example, after adjusting for a given dividend, announcing that subsequent dividends of the same nature will no longer occasion adjustment. (OCC will follow a similar practice with respect to stock futures.) A discussion of the amended Interpretation .01, Section 11A, also will be included in published interpretative guidance.<sup>8</sup> Clean and marked copies of the interpretative guidance are attached as Exhibit 5. The marked copy shows changes from the current language.

In fairness to existing holders of open interest (especially DO and OIH) who may have assumed option positions with the belief that the Securities Committee would continue to adjust for recurring “special” dividends, the Securities Committee has determined that the portion of Interpretation .01, Section 11A, which allows re-characterization of dividends as ordinary will be effective only for dividends and distributions announced after February 1, 2012. This date is chosen because it occurs after the latest expiration of all existing open interest in DO and OIH options (inclusive of LEAPS options). All existing open interest and any positions

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<sup>7</sup> These same factors would be used by OCC to re-classify a recurrent non-ordinary dividend as “ordinary” in respect of the determination to adjust stock futures.

<sup>8</sup> See Release Nos. 34-58059 (June 30, 2008) and 34-59442 (February 24, 2009). Consistent with past practice, the interpretative guidance will be available on OCC’s public website, but not incorporated into OCC’s by-laws and rules. Other technical or clarifying changes have also been made to update the guidance. For example, the use of the term “special dividend” has been removed in favor of the term “non-ordinary”. No comparable guidance is published with respect to adjustments to stock futures in response to cash dividends given that the methodology used to determine whether a dividend is non-ordinary has been effective since in or about fourth quarter 2002. Nonetheless, OCC will publish appropriate notices regarding this change as it relates to stock futures.

created in new expiration dates occurring before February 1, 2012 will thus be “grandfathered” under the current adjustment approach for these dividends. For consistency, the changes to Interpretation .01, Section 3, relating to stock futures, also will not be effective until February 1, 2012.

\* \* \*

The proposed change is consistent with Section 17A of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), because it provides for the prompt and accurate clearance and settlement of securities transactions, ensures the protection of investors and reduces unnecessary costs and burdens on them and persons facilitating transactions on their behalf. It does so by responding to strong investor feedback regarding the need to cease treating certain cash dividends or distributions as “non-ordinary” for adjustment purposes based on the consistent declaration of such dividends, publishing information regarding those factors which would lead the Securities Committee or OCC, as applicable, to make such a determination and reducing the likelihood of series proliferation in the case of options contracts. The proposed rule change is not 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 were not and are not intended to be solicited with respect to the proposed rule change and none have been received.

**Item 6. Extension of Time Period for Commission Action**

OCC does not consent to an extension of the time period for Commission action on the proposed rule change.

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

Pursuant to Section 19(b)(3)(A) and Rule 19b-4(f)(1), the proposed rule change is filed for immediate effectiveness inasmuch as it constitutes a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule. Notwithstanding that the rule change is filed for immediate effectiveness, the portion of the rule change allowing reclassification of recurrent dividends as "ordinary" will be effective only for dividends or distributions announced on or after February 1, 2012.

**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 Register.

Exhibit 5. Interpretative Guidance on the New Adjustment Policy for Cash

Dividends and Distributions.

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, The Options Clearing Corporation has caused this filing to be signed on its behalf by the undersigned hereunto duly authorized.

**THE OPTIONS CLEARING CORPORATION**

By: William H. Navin  
**William H. Navin**  
**Executive Vice President and**  
**General Counsel**

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34-\_\_\_\_\_ ; File No. SR-OCC-2010-15

SELF-REGULATORY ORGANIZATION

Proposed Rule Change By  
The Options Clearing Corporation

Relating to Adopting an Interpretation  
Providing Authority to Reclassify  
Recurrent "Special" Dividends as  
"Ordinary" Dividends

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Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1), notice is hereby given that on \_\_\_\_\_, 2010, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. 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 the Substance of the Proposed Rule Change

The proposed rule change would amend Interpretation and Policy .01 under Section 11A, Article VI, and Interpretation and Policy .01 under Section 3, Article XII.

**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 these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

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

The principal purpose of this rule change is to amend Interpretation and Policy .01 under Section 11A, Article VI (“Interpretation .01, Section 11A”) of OCC’s by-laws. Under that Interpretation, cash dividends or distributions of an issuer which are deemed by the Securities Committee<sup>1</sup> to be non-ordinary will usually occasion an adjustment to the terms of listed stock options. OCC is proposing to amend Interpretation .01, Section 11A, to allow the Securities Committee under certain conditions to cease adjusting for recurring cash dividends previously deemed to be non-ordinary dividends. Interpretation .01 under Section 3 of Article XII (“Interpretation .01, Section 3”) of OCC’s by-laws, which provides that non-ordinary (as determined by OCC) cash dividends or distributions of an issuer will usually occasion an adjustment to the terms of listed stock futures, would similarly be amended. The discussion below addresses the proposed amendments to Interpretation .01, Section 11A, but the purpose behind those changes is equally applicable to the changes proposed to Interpretation .01, Section

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<sup>1</sup> The Securities Committee is comprised of one designated representative of each participant exchange and the Chairman of OCC or his designee. The OCC representative is not a voting member of the Committee except in cases of tie votes. See Article VI, Section 11(c) of OCC’s by-laws.



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The amendment was prompted by a series of cash dividends declared by Diamond Offshore Corporation (DO). DO characterized these dividends as “special” and differentiated them from the company’s “regular” cash dividends. (The “special” and “regular” DO dividends customarily go “ex-distribution” on the same date.) Initially, the Securities Committee deemed these “special” dividends to be non-ordinary under Interpretation .01, and appropriately adjusted listed options in response.<sup>3</sup> Since Interpretation .01, Section 11A, was revised effective February 1, 2009, DO options have been adjusted for five successive quarterly “special” dividends. Notwithstanding that these dividends were characterized by DO as “special” dividends and clearly differentiated from the company’s “regular” dividends, OCC and the options exchanges have received strong feedback from investors that such dividends have been declared so consistently, and thereby have achieved such predictability, that they should no longer be considered “non-ordinary” for adjustment purposes. Furthermore, the options exchanges and many OCC clearing member firms believe that the proliferation of option strikes caused by successive quarterly adjustments will have an adverse affect on liquidity and occasion other adverse operational effects.<sup>4</sup> The Securities Committee also solicited the opinion of participant

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<sup>3</sup> In like manner, options on Oil Service HLDERS Trust (OIH) which contain DO as a component security and make pro-rata distributions in response to the DO dividends, were also adjusted.

<sup>4</sup> The standard method of adjustment is to reduce strike prices by the amount of the dividend. Options with “standard” strike prices are then re-introduced by the listing option exchange(s). With each successive adjustment, this process is repeated, proliferating strike prices. Liquidity naturally gravitates to the standard strike prices at the expense of non-standard strikes.

members of the OCC Clearing Member Roundtable regarding this issue.<sup>5</sup> The Roundtable respondents strongly supported authorizing the Securities Committee to cease adjusting for “special” cash dividends whose consistency and predictability of payment have been demonstrated.

The proposed amended Interpretation .01, Section 11A, enumerates factors that the Securities Committee may take into account in determining whether a dividend is “ordinary.” Importantly, it allows the Securities Committee to re-classify as “ordinary” dividends previously deemed “non-ordinary”. The conditions under which this may occur are as follows: (i) the issuer discloses that it intends to pay such dividends or distributions on a quarterly or other regular basis, (ii) the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment, whether or not the amounts paid were the same from period to period, or (iii) the Securities Committee determines for other reasons that the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis.<sup>6</sup>

It is the intent of the Securities Committee that any such re-characterization of a dividend as “ordinary” would be announced in advance to investors; for example, after adjusting for a given dividend, announcing that subsequent dividends of the same nature will no longer occasion adjustment. (OCC will follow a similar practice with respect to stock futures.) A discussion of the amended Interpretation .01, Section 11A, also will be included in published

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<sup>5</sup> The OCC Roundtable is an OCC sponsored advisory group comprised of representatives from OCC’s participant exchanges, OCC, a cross-section of OCC clearing members, and industry service bureaus. The Roundtable considers operational improvements that may be made to increase efficiencies and lower costs in the options industry.

<sup>6</sup> These same factors would be used by OCC to re-classify a recurrent non-ordinary dividend as “ordinary” in respect of the determination to adjust stock futures.

interpretative guidance.<sup>7</sup> Clean and marked copies of the interpretative guidance are attached as Exhibit 5. The marked copy shows changes from the current language.

In fairness to existing holders of open interest (especially DO and OIH) who may have assumed option positions with the belief that the Securities Committee would continue to adjust for recurring “special” dividends, the Securities Committee has determined that the portion of Interpretation .01, Section 11A, which allows re-characterization of dividends as ordinary will be effective only for dividends and distributions announced after February 1, 2012. This date is chosen because it occurs after the latest expiration of all existing open interest in DO and OIH options (inclusive of LEAPS options). All existing open interest and any positions created in new expiration dates occurring before February 1, 2012 will thus be “grandfathered” under the current adjustment approach for these dividends. For consistency, the changes to Interpretation .01, Section 3, relating to stock futures, also will not be effective until February 1, 2012.

\* \* \*

The proposed change is consistent with Section 17A of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), because it provides for the prompt and accurate clearance and settlement of securities transactions, ensures the protection of investors and reduces unnecessary costs and burdens on them and persons facilitating transactions on their behalf. It does so by responding to strong investor feedback regarding the need to cease treating

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<sup>7</sup> See Release Nos. 34-58059 (June 30, 2008) and 34-59442 (February 24, 2009). Consistent with past practice, the interpretative guidance will be available on OCC’s public website, but not incorporated into OCC’s by-laws and rules. Other technical or clarifying changes have also been made to update the guidance. For example, the use of the term “special dividend” has been removed in favor of the term “non-ordinary”. No comparable guidance is published with respect to adjustments to stock futures in response to cash dividends given that the methodology used to determine whether a dividend is non-ordinary has been effective since in or about fourth quarter 2002. Nonetheless, OCC will publish appropriate notices regarding this change as it relates to stock futures.

certain cash dividends or distributions as “non-ordinary” for adjustment purposes based on the consistent declaration of such dividends, publishing information regarding those factors which would lead the Securities Committee or OCC, as applicable, to make such a determination and reducing the likelihood of series proliferation in the case of options contracts. The proposed rule change is not inconsistent with the existing rules of OCC, including any other rules proposed to be amended.

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

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

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

Written comments 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**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and paragraph (f) of Rule 19b-4 thereunder. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### 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 2010-15 on the subject line.

##### *Paper Comments:*

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-OCC-2010-15. 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 Web site (<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 inspection and copying in the Commission's Public Reference Section, 100F Fifth Street, N.E., Washington, D.C. 20549-1090. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. 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-2010-15 in the caption above and should be submitted on or before [insert date 21 days from publication in the Federal Register.] \_\_\_\_\_.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.

Secretary

Dated: \_\_\_\_\_

**INTERPRETATIVE GUIDANCE ON THE NEW ADJUSTMENT POLICY FOR CASH  
DIVIDENDS AND DISTRIBUTIONS**

**Frequently Asked Questions**

**Disclaimer:** The OCC Securities Committee has reviewed the questions and answers presented below and believes they provide useful guidelines for how the new adjustment policy will be applied in practice. However, as indicated several times below, all adjustments are individually determined by an adjustment panel of the Securities Committee on a case by case basis, and adjustment panels may make exceptions to general rules, interpretations, and policies in cases where they determine such exceptions to be appropriate. In no instance are the examples provided below meant to determine in advance the decisions that any adjustment panel will make in the future.

**Overview of the New Adjustment Policy**

- Q. Who decides if an option adjustment shall be made?
- A. All adjustments are determined on a case by case basis by an adjustment panel of the OCC Securities Committee. Each adjustment panel is comprised of two representatives from each exchange that trades the option in question, plus an OCC representative. The OCC member only casts a vote to break a tie. The adjustment panel decides whether an adjustment is called for and how it should be done.
- Q. What cash dividends call for an adjustment?
- A. "Ordinary" cash dividends do not call for adjustments. An "ordinary" cash dividend is defined as one paid "pursuant to a policy or practice of paying such dividend on a quarterly or other regular basis". A cash dividend which is considered to be *outside* this regular policy is non-ordinary. Assuming a given dividend is non-ordinary according to this definition, a size test is also imposed: the value of the dividend must be at least \$12.50 per option contract. Thus, if the dividend is non-ordinary and yields at least \$12.50 per option contract, then an adjustment will be made.
- Q. What's the rationale for this approach?
- A. In general, dividends declared pursuant to a policy or practice of a company can be anticipated and priced into option premiums according to standard models. Non-ordinary dividends declared outside the normal policy of the company cannot be anticipated and integrated into pricing with the same degree of assurance. Thus, when such dividends are announced, if no adjustment is made, the only way a call holder can capture the dividend is through exercise prior to the ex-dividend date. When this happens, significant option time value can be lost and financial losses due to operational error in submitting exercises may occur. The intention is to allow such dividends to accrue to the benefit of call holders without requiring them to exercise their options.
- Q. So any dividend that can't be *anticipated* will be deemed a non-ordinary dividend?

- A. No. Although such dividends may be unanticipated, the important criterion is whether a dividend is paid pursuant to a program or policy of paying dividends on a quarterly or other regular basis. In some cases, the dividends of a company paid according to such a policy may be highly variable and subject to increases or decreases that some may consider "unanticipated". Nevertheless, these dividends would not normally be deemed non-ordinary.

**Examples: What if...?**

- Q. Can you give an example of how the \$12.50 adjustment threshold will work in practice?  
A. In order for an option to be adjusted, the value of the dividend must be at least \$12.50 per option contract. However, if the security on which the dividend is paid underlies option contracts with more than one contract size – e.g., as a result of adjustments for previous splits – then the nonstandard contracts would be adjusted only if the value of the dividend on the nonstandard contract is at least \$12.50 *and* the standard-size contract (normally 100 shares) would also be adjusted.

For example, suppose an option covers 100 shares of stock and a \$0.10 special cash dividend is declared. This dividend, although non-ordinary, would yield only \$10.00 in value for this option contract. Therefore, no adjustment would be made.

A second example: Suppose an option covers 100 shares of stock and another option covers 150 shares of the same stock (as the result of a previous adjustment for a 3 for 2 split). A \$0.10 special dividend is declared. The dividend would yield \$10.00 in value for the 100 share option and \$15.00 for the other. However, in this case, since the standard-size (100 share) contract would not be adjusted (the \$12.50 threshold not being met), the 150 share option would also *not* be adjusted.

A third: Suppose an option covers 100 shares of stock and another option covers 50 shares of the same stock (as a result of a previous adjustment for a 1 for 2 reverse split). A \$0.15 special dividend is declared. The dividend would yield \$15.00 in value for the 100 share option and \$7.50 for the 50 share option. In this case, the standard-size (100 share) option would be adjusted, but the 50 share option would *not* be adjusted because the value of the dividend per contract would be only \$7.50, and a nonstandard option is not adjusted if the value of the dividend per contract is less than \$12.50 even if the standard-size option is adjusted.

These examples also illustrate that, in general, the \$12.50 threshold is applied at the *option contract* level – *not* per share.

Occasionally only nonstandard options exist. In these cases, since there is no standard-size option to refer back to, the application of the \$12.50 per contract threshold will determine whether an adjustment is made.

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<sup>1</sup> A threshold of .125 per share is used in determining contract adjustments for capital gains and other distributions for fund shares, as described in Interpretation .08 to Article VI, Section 11A of the OCC By-Laws



Exhibit 5 to File No. SR-OCC-2010-15

- Q. Who determines if a cash dividend is “non-ordinary”?
- A. The adjustment panels of the OCC Securities Committee will make this determination. In doing so, adjustment panels may consider the company’s characterization of the dividend but the company’s characterization is not binding on adjustment panels. Adjustment panels may take into account other factors deemed appropriate including, but not limited to, the company’s stated dividend policy and payment history, prior option adjustments, and factors bearing on the maintenance of a fair and orderly market.
- Q. What if a company that previously paid no dividends initiates a regular dividend program – would the initial dividend be considered “non-ordinary” and therefore adjustable?
- A. No. The initial dividend would be paid pursuant to a policy under which the company intends to pay dividends on a regular basis. Therefore, it would not be deemed “non-ordinary” and adjustable.
- Q. What if a company announced a dramatic increase in a regular dividend? For example, what if a company’s last quarterly dividend was \$.20 and the current quarterly dividend was bumped to \$1.00 – wouldn’t that be a “non-ordinary”, one-time event that would call for an adjustment?
- A. No – most likely not. As mentioned earlier, we would start with the company’s description of its dividend. If the company has a quarterly dividend program and the company says this quarter’s dividend is \$1.00, then we anticipate the adjustment panel would deem the dividend to be ordinary and not adjustable. However, as mentioned, the decisions of the adjustment panels are always made on a case by case basis, in light of the circumstances and facts as understood at the time.
- Q. What about REITs, natural resource trusts, and similar companies that pay very irregular dividends? Such companies could pay no dividends for many months and then suddenly pay a dividend. Would that be considered a “non-ordinary”, adjustable dividend?
- A. No – most likely not. The kinds of companies mentioned in the question often have very regular dividend *policies* but will *actually* pay dividends only when certain conditions are met, or in response to market conditions. REITs, for example, are generally required to pay out profits to shareholders when and if profits are realized. They may determine dividends monthly, although the cash amount available for distribution may actually be zero in any given month. Thus, although the dividend payouts of such companies may be irregular, insofar as they occur *pursuant to the policy of the company*, they would be considered ordinary and not adjustable.
- Q. What if a company is reorganizing itself into a REIT and is required to pay out accumulated profits in a large dividend as it commences a dividend program. You said before that *initial* dividends would not normally call for adjustment. Would you adjust in this case?
- A. In our experience, companies reorganizing themselves into REITS or income trusts often designate this initial required pay-out as a “special” dividend. Precedent exists for adjusting for such dividends under OCC’s existing adjustment rules, and it is likely that they will be adjusted for under the new rules. Even if the company did not specifically

Exhibit 5 to File No. SR-OCC-2010-15

characterize such a dividend as "special", the adjustment panels could decide to deem them special and adjust.

- Q. Fund share or ETF options have previously been adjusted in response to special dividends declared with respect to component securities of the fund. The most notable instance was the Microsoft \$3.00 special dividend in 2004. How will these kinds of distributions be handled?
- A. If a fund (ETF, HOLDR, etc.) is making a cash distribution which is identified (in whole or part) by the fund as attributable to a special dividend on a component security, then the appropriate amount of the cash distribution will also be considered a special, adjustable distribution. For example, if an ETF is making a \$1.00 quarterly cash distribution, \$.25 of which is attributable to a special dividend on a component security, the adjustment panel will normally consider \$0.25 of the aggregate distribution as a special dividend and adjust for \$25.00 per option contract (assuming a 100 share option).

Note: The \$.125 threshold test will be applied: the portion of the distribution attributable to the component security's special dividend must yield \$.125 value per share before an adjustment is done.

- Q. What if a company declares a non-ordinary dividend which is ex-distribution on the same date that a regular dividend is "ex"? Would these be considered one event or two separate events?
- A. Two separate events.
- Q. The Diamond Offshore (DO) special dividends present an interesting case. DO has paid a series of special dividends on a quarterly basis, alongside their regular quarterly dividend. Some investors feel these special dividends have demonstrated such consistency over time that they should be deemed ordinary and should no longer occasion adjustments. How will the Securities Committee approach such a situation?
- A. Even though the adjustment panels may have previously adjusted for a series of non-ordinary dividends, they have the authority to stop adjusting for such dividends if the panels believe the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis, or the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment. The panels could make this determination whether or not the amounts paid were the same from period to period. The adjustment panels would announce decisions to no longer adjust for each affected option. Such determinations would be made on a case by case basis.
- Q. How and when will the Securities Committee provide notification of decisions to cease adjusting for recurring non-ordinary dividends on existing options?
- A. Notification will be provided in an OCC Information Memo. In most cases, it is anticipated that notification from the Securities Committee will be given when an option's final adjustment for recurring non-ordinary dividends is made and will generally be included in the final adjustment information memo. For example, if XYZ Stock has

announced its 4<sup>th</sup> recurring non-ordinary quarterly dividend, an information memo will be published indicating an adjustment will occur for the 4<sup>th</sup> dividend. In addition, this memo will also include the Securities Committee's decision that subsequent non-ordinary quarterly dividends will not be adjusted for.

- Q. What if the underlying security on a newly listed option has a history of recurring non-ordinary dividends? Will options be adjusted for subsequent non-ordinary dividends since there have been no previous adjustments?
- A. No, generally not. In a case involving a newly listed option for which no prior dividend adjustments have occurred, adjustments will generally not be made for recurring non-ordinary dividends because a consistent pattern of non-ordinary dividends exists for the underlying security. In such a situation, recurring non-ordinary dividends typically will not result in an adjustment for the newly listed option, even though no prior notification has been given that no adjustment would be made.
- Q. What if a company's regular quarterly dividend is a "return of capital"? Would that make it a special, adjustable dividend?
- A. No. Insofar as the dividend is still a regular quarterly dividend, it would not call for an adjustment. Ordinarily, the source of cash to be paid will not be determinative of the adjustment decision. In the past, however, adjustment panels have determined to adjust for any dividends paid pursuant to a plan of liquidation – even regular dividends of the company included in the plan. They may follow this precedent in the future as well for companies undergoing liquidation.

#### Operational Matters

- Q. Will we have to wait until the official declaration date of a dividend before a decision is made about option adjustment?
- A. Not necessarily. The adjustment panels will be motivated to make their adjustment decisions as soon as practicable. The panels may decide it is appropriate to base a decision on the company's press release or similar announcement, in advance of the formal declaration date. Of course, if this is done, the adjustment decision would be appropriately conditional. For example, "if declared and paid as described in the press release, then...."

For example, suppose a company announces its intention in a press release to pay a special dividend, but this dividend is contingent on shareholder approval or other conditions. Until the conditions are met, it will not be officially declared. Under the new policy, it will be easy to see if the dividend meets the size criterion: would it yield \$12.50 per contract? If "yes", then if the adjustment panel determines it is a non-ordinary dividend, investors will immediately know an adjustment will occur if the dividend is actually declared.

- Q. If an adjustment is called for, *how* will it be done?

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- A. There will be no changes to the *methods* of adjustment. There are two methods of adjustment: 1) simply reduce the strike prices by the amount of the dividend. This is the preferred method and will normally be used if the exact dividend amount is known in advance of the ex-date. 2) If the exact dividend amount is not known or if strike reduction would result in a strike of zero or less, then the amount of the dividend will be added as a cash component to the option deliverable. When this is done, an option symbol change normally occurs.

Adjustments will continue to be made on the ex-date for the cash dividend as determined by the appropriate market.

ALL CLEARING MEMBERS ARE REQUESTED TO IMMEDIATELY ADVISE ALL  
BRANCH OFFICES AND CORRESPONDENTS ON THE ABOVE.

Questions regarding this memo can be addressed to Member Services at (800) 544-6091. Within  
Canada call (800) 424-7320.

## INTERPRETATIVE GUIDANCE ON THE NEW ADJUSTMENT POLICY FOR CASH DIVIDENDS AND DISTRIBUTIONS

### Frequently Asked Questions

**Disclaimer:** The OCC Securities Committee has reviewed the questions and answers presented below and believes they provide useful guidelines for how the new adjustment policy will be applied in practice. However, as indicated several times below, all adjustments are individually determined by an adjustment panel of the Securities Committee on a case by case basis, and adjustment panels may make exceptions to general rules, interpretations, and policies in cases where they determine such exceptions to be appropriate. In no instance are the examples provided below meant to determine in advance the decisions that any adjustment panel will make in the future.

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### Overview of the New Adjustment Policy

Q. Who decides if an option adjustment shall be made?

A. All adjustments are determined on a case by case basis by an adjustment panel of the OCC Securities Committee. Each adjustment panel is comprised of two representatives from each exchange that trades the option in question, plus an OCC representative. The OCC member only casts a vote to break a tie. The adjustment panel decides whether an adjustment is called for and how it should be done.

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Q. What cash dividends call for an adjustment?

A. "Ordinary" cash dividends do not call for adjustments. An "ordinary" cash dividend is defined as one paid "pursuant to a policy or practice of paying such dividend on a quarterly or other regular basis". A cash dividend which is considered to be *outside* this regular policy is non-ordinary, or "special". Assuming a given dividend is "special" non-ordinary according to this definition, a size test is also imposed: the value of the dividend must be at least \$12.50 per option contract. Thus, if the dividend is "special" non-ordinary and yields at least \$12.50 per option contract, then an adjustment will be made.

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Q. What's the rationale for this approach?

A. In general, dividends declared pursuant to a policy or practice of a company can be anticipated and priced into option premiums according to standard models. (For example, Pfizer has announced it will pay \$.24 quarterly dividends as part of an established dividend program.) "Special" Non-ordinary dividends declared outside the normal policy of the company cannot be anticipated and integrated into pricing with the same degree of assurance... Thus, when special such dividends are announced, if no adjustment is made, the only way a call holder can capture the dividend is through exercise prior to the ex-dividend date. When this happens, significant option time value can be lost and

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financial losses due to operational error in submitting exercises may occur. The intention is to allow "special" such dividends to accrue to the benefit of call holders without requiring them to exercise their options.

Q. So any dividend that can't be *anticipated* will be deemed a special non-ordinary dividend?

A. No. Although special such dividends may be unanticipated, the important criterion is whether a dividend is paid pursuant to a program or policy of paying dividends on a quarterly or other regular basis. In some cases, the dividends of a company paid according to such a policy may be highly variable and subject to increases or decreases that some may consider "unanticipated". Nevertheless, these dividends would not normally be deemed "special" non-ordinary.

**Examples: What if...?**

Q. Can you give an example of how the \$12.50 adjustment threshold will work in practice?

A. In order for an option to be adjusted, the value of the special dividend must be at least \$12.50 per option contract. However, if the security on which the dividend is paid underlies option contracts with more than one contract size – e.g., as a result of adjustments for previous splits – then the nonstandard contracts would be adjusted only if the value of the dividend on the nonstandard contract is at least \$12.50 and the standard-size contract (normally 100 shares) would also be adjusted.

For example, suppose an option covers 100 shares of stock and a \$0.10 special cash dividend is declared. This dividend, although "special" non-ordinary, would yield only \$10.00 in value for this option contract. Therefore, no adjustment would be made.

A second example: Suppose an option covers 100 shares of stock and another option covers 150 shares of the same stock (as the result of a previous adjustment for a 3-for-2 split). A \$0.10 special dividend is declared. The dividend would yield \$10.00 in value for the 100 share option and \$15.00 for the other. However, in this case, since the standard-size (100 share) contract would not be adjusted (the \$12.50 threshold not being met), the 150 share option would also *not* be adjusted.

A third: Suppose an option covers 100 shares of stock and another option covers 50 shares of the same stock (as a result of a previous adjustment for a 1-for-2 reverse split). A \$0.15 special dividend is declared. The dividend would yield \$15.00 in value for the 100 share option and \$7.50 for the 50 share option. In this case, the standard-size (100 share) option would be adjusted, but the 50 share option would *not* be adjusted because the value of the dividend per contract would be only \$7.50, and a nonstandard option is not adjusted if the value of the dividend per contract is less than \$12.50 even if the standard-size option is adjusted.

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These examples also illustrate that, in general, the \$12.50 threshold is applied at the option contract level not per share.

Occasionally only nonstandard-size options exist. In these cases, since there is no standard-size option to refer back to, the application of the \$12.50 per contract threshold will determine whether an adjustment is made.

Q. Who determines if a cash dividend is "specialnon-ordinary"?

A. The adjustment panels of the OCC Securities Committee will make this determination. In most cases, we anticipate being able to rely on the description of the company itself in describing its dividend. In our experience, dividends that are called "special" or "extraordinary" (or similar terms) by the company in fact describe the non-ordinary dividend events that we want to capture by adjustment. However, doing so, adjustment panels may consider the company's characterization of the dividend but the company's characterization is not binding on adjustment panels. Adjustment panels may take into account other factors deemed appropriate including, but not limited to, the company's stated dividend policy and payment history, prior option adjustments, and factors bearing on the maintenance of a fair and orderly market.

Q. What if a company that previously paid no dividends initiates a regular dividend program - would the initial dividend be considered "specialnon-ordinary" and therefore adjustable?

A. No. The initial dividend would be paid pursuant to a policy under which the company intends to pay dividends on a regular basis. Therefore, it would not be deemed "specialnon-ordinary" and adjustable.

Q. What if a company announced a dramatic increase in a regular dividend? For example, what if a company's last quarterly dividend was \$.20 and the current quarterly dividend was bumped to \$1.00 - wouldn't that be a "specialnon-ordinary", one-time event that would call for an adjustment?

A. No - most likely not. As mentioned earlier, we would start with the company's description of its dividend. If the company has a quarterly dividend program and the company says this quarter's dividend is \$1.00, then we anticipate the adjustment panel would deem the dividend to be ordinary and not adjustable. However, as mentioned, the decisions of the adjustment panels are always made on a case by case basis, in light of the circumstances and facts as understood at the time.

Q. What about REITs[s], REITs, natural resource trusts, and similar companies that pay very irregular dividends? Such companies could pay no dividends for many months and then suddenly pay a dividend. Would that be considered a "specialnon-ordinary", adjustable dividend?

<sup>2</sup> A threshold of .125 per share is used in determining contract adjustments for capital gains and other distributions for fund shares, as described Interpretation .08 to Article VI, Section 11A of the OCC By-Laws

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A. No – most likely not. The kinds of companies mentioned in the question often have very regular dividend *policies* but will *actually* pay dividends only when certain conditions are met, or in response to market conditions. REITS/REITs, for example, are generally required to pay out profits to shareholders when and if profits are realized. They may determine dividends monthly, although the cash amount available for distribution may actually be zero in any given month. Thus, although the dividend payouts of such companies may be irregular, insofar as they occur *pursuant to the policy of the company*, they would be considered ordinary and not adjustable. The adjustment panels would look to the company's characterization of the dividend and its dividend policy.

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Q. What if a company is reorganizing itself into a REIT and is required to pay out accumulated profits in a large dividend as it commences a dividend program. You said before that *initial* dividends would not normally call for adjustment. Would you adjust in this case?

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A. In our experience, companies reorganizing themselves into REITs or income trusts often designate this initial required pay-out as a "special" dividend. Precedent exists for adjusting for such dividends under OCC's existing adjustment rules, and it is likely that they will be adjusted for under the new rules. Even if the company did not specifically characterize such a dividend as "special", the adjustment panels could decide to deem them special and adjust.

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Q. Fund share or ETF options have previously been adjusted in response to special dividends declared with respect to component securities of the fund. The most notable instance was the Microsoft \$3.00 special dividend in 2004. How will these kinds of distributions be handled?

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A. If a fund (ETF, HOLDR, etc.) is making a cash distribution which is identified (in whole or part) by the fund as attributable to a special dividend on a component security, then the appropriate amount of the cash distribution will also be considered a special, adjustable distribution. For example, if an ETF is making a \$1.00 quarterly cash distribution, \$.25 of which is attributable to a special dividend on a component security, the adjustment panel will normally consider \$.25 of the aggregate distribution as a special dividend and adjust for \$25.00 per option contract (assuming a 100 share option).

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Note: The \$12.50 size\$.125 threshold test will also be applied: the portion of the distribution attributable to the component security's special dividend must yield \$12.50\$.125 value per option contractshare before an adjustment is done.

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Q. What if a company declares a specialnon-ordinary dividend which is ex-distribution on the same date that a regular dividend is "ex"? Would these be considered one event or two separate events?

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A. Two separate events.

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Q. The Phelps Dodge (PDDiamond Offshore (DO) special dividends present an interesting case. PD announced they intended to pay a certain aggregate cash amount in DO has paid a series of special dividends and/or effect stock buy-backs over the upcoming year. Wouldon a quarterly basis, alongside their regular quarterly dividend. Some investors

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Exhibit 5 to File No. SR-OCC-2010-15

feel these special dividends have demonstrated such consistency over time that they should be considered "special"; or would they be considered "deemed ordinary" because they were paid pursuant to an announced program?

- A. In the case of PD, each dividend was characterized by the company as "special" and although paid pursuant to and should no longer occasion adjustments. How will the Securities Committee approach such a "program", PD gave no indications it would be permanent. The "program" allowed special cash dividends to be paid in lieu of stock buy-backs. PD also continued to pay quarterly dividends which were separate from the special dividends. Thus, it is likely the adjustment panels would consider each dividend paid by PD pursuant to this program to be "special" and call for an adjustment. As mentioned earlier, the adjustment panels address each dividend on a case by case basis.situation?

- Q. What if A. Even though the adjustment panels may have previously adjusted for a series of non-ordinary dividends, they have the authority to stop adjusting for such dividends if the panels believe the issuer has a policy or practice of paying such dividends or distributions on a quarterly or other regular basis, or the issuer has paid such dividends or distributions for four or more consecutive months or quarters or two or more years after the initial payment. The panels could make this determination whether or not the amounts paid were the same from period to period. The adjustment panels would announce decisions to no longer adjust for each affected option. Such determinations would be made on a case by case basis.

- Q. How and when will the Securities Committee provide notification of decisions to cease adjusting for recurring non-ordinary dividends on existing options?

- A. Notification will be provided in an OCC Information Memo. In most cases, it is anticipated that notification from the Securities Committee will be given when an option's final adjustment for recurring non-ordinary dividends is made and will generally be included in the final adjustment information memo. For example, if XYZ Stock has announced its 4<sup>th</sup> recurring non-ordinary quarterly dividend, an information memo will be published indicating an adjustment will occur for the 4<sup>th</sup> dividend. In addition, this memo will also include the Securities Committee's decision that subsequent non-ordinary quarterly dividends will not be adjusted for.

- Q. What if the underlying security on a newly listed option has a history of recurring non-ordinary dividends? Will options be adjusted for subsequent non-ordinary dividends since there have been no previous adjustments?

- A. No, generally not. In a case involving a newly listed option for which no prior dividend adjustments have occurred, adjustments will generally not be made for recurring non-ordinary dividends because a consistent pattern of non-ordinary dividends exists for the underlying security. In such a situation, recurring non-ordinary dividends typically will not result in an adjustment for the newly listed option, even though no prior notification has been given that no adjustment would be made.

- Q. What if a company's regular quarterly dividend is a "return of capital"? Would that make it a special, adjustable dividend?

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- A. No. Insofar as the dividend is still a regular quarterly dividend, it would not call for an adjustment. Ordinarily, the source of cash to be paid will not be determinative of the adjustment decision. In the past, however, adjustment panels have determined to adjust for any dividends paid pursuant to a plan of liquidation – even regular dividends of the company included in the plan. They may follow this precedent in the future as well for companies undergoing liquidation.

**Operational Matters**

Q. Will we have to wait until the official declaration date of a dividend before a decision is made about option adjustment?

- A. Not necessarily. The adjustment panels will be motivated to make their adjustment decisions as soon as practicable. The panels may decide it is appropriate to base a decision on the company’s press release or similar announcement, in advance of the formal declaration date. Of course, if this is done, the adjustment decision would be appropriately conditional. For example, “if declared and paid as described in the press release, then....”

For example, suppose a company announces its intention in a press release to pay a special dividend, but this dividend is contingent on shareholder approval or other conditions. Until the conditions are met, it will not be officially declared. Under the new policy, it will be easy to see if the dividend meets the size criterion: would it yield \$12.50 per contract? If “yes”, then if the adjustment panel determines it is a “special” non-ordinary dividend, investors will immediately know an adjustment will occur if the dividend is actually declared.

Q. Won’t this new adjustment policy result in option symbol proliferation?

- A. Yes, to some extent. Contract adjustments under the new policy will be more frequent and in many cases a new symbol will be required. However, OCC and the exchanges feel the benefits of the new policy outweigh the operational costs.

One should note that when equity option strike prices can be denominated in decimals and the need for “ticker codes” for each strike is eliminated, adjustments will be possible *without* the need to change option symbols (as the strike prices can be reduced by the exact amount of the dividend). When that happens, symbol proliferation will not occur. The option industry is looking forward to this capability in 2010.

Q. If an adjustment is called for, *how* will it be done?

- A. There will be no changes to the *methods* of adjustment. There are two methods of adjustment: 1) simply reduce the strike prices by the amount of the dividend. This is the preferred method and will normally be used if the strike prices can be reduced *without*

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*rounding.* 2) If strike prices can't be reduced without rounding exact dividend amount in known is advance of the ex-date. 2) If the exact dividend amount is not known or if strike reduction would result in a strike of zero or less, then the amount of the dividend will be added as a cash component to the option deliverable. When this is done, an option symbol change normally occurs.

Adjustments will continue to be made on the ex-date for the cash dividend as determined by the appropriate market.

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ALL CLEARING MEMBERS ARE REQUESTED TO IMMEDIATELY ADVISE ALL BRANCH OFFICES AND CORRESPONDENTS ON THE ABOVE.

Questions regarding this memo can be addressed to Member Services at (800) 544-6091. Wi

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