



## NOTICE TO MEMBERS

No. 2009 – 133

December 9, 2009

### **REQUEST FOR COMMENTS**

#### **ADJUSTMENT COMMITTEE FOR OVER-THE-COUNTER DERIVATIVE INSTRUMENTS**

##### **Amendments to Rule A-9 of CDCC's Rules**

### **Summary**

The Board of Directors of the Canadian Derivatives Clearing Corporation (CDCC) approved the amendments to Rule A-9 of CDCC's Rules. The goal of the proposed amendment to CDCC Rule A-9 is to reflect the procedures that have been put in place concerning corporate actions on Over-The-Counter Derivative Instruments (OTC DI) and harmonize the Rule for both Exchange Transactions and OTC DI.

You will find enclosed the analysis document of the proposed rule amendments as well as the proposed regulatory amendments.

### **Process for Changes to the Rules**

CDCC is a recognized self-regulatory organization (SRO) by the Autorité des marchés financiers (the Autorité) and as such, carries on activities as a clearing house and as an SRO in Québec.

The Board of Directors of CDCC has the power to approve the adoption or amendment of Rules of CDCC. The amendments are submitted to the Autorité for approval.

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Comments on the proposed amendments to Rule A-9 of CDCC's Rules must be submitted within 30 days following the date of publication of the present notice. Please submit your comments to:

*Sharon C. Pel*  
*Secretary*  
*Canadian Derivatives Clearing Corporation*  
*Tour de la Bourse*  
*P.O. Box 61, 800 Victoria Square*  
*Montréal, Québec H4Z 1A9*  
*E-mail : [legal@m-x.ca](mailto:legal@m-x.ca)*

A copy of these comments shall also be forwarded to the Autorité to:

*Anne-Marie Beaudoin*  
*Secretary*  
*Autorité des marchés financiers*  
*800 Victoria Square, 22<sup>nd</sup> Floor*  
*P.O. Box 246, Tour de la Bourse*  
*Montréal, Quebec H4Z 1G3*  
*E-mail : [consultation-en-cours@lautorite.qc.ca](mailto:consultation-en-cours@lautorite.qc.ca)*



## **AMENDMENTS TO SECTION A-902 OF THE RULES OF CDCC**

### **I. OVERVIEW**

In the fall of 2007, the Autorité des marchés financiers (AMF) performed an inspection of the Rules and Processes of Canadian Derivatives Clearing Corporation (CDCC). During this inspection, the AMF identified an issue within CDCC's Rule A-9. Section A-902, paragraph (9), establishes the composition and quorum of the Adjustment Committee necessary for adopting a resolution at any meeting of such Committee relative to Transactions where the Underlying Interest is an equity. However, at the time of the introduction of Over-The-Counter Derivative Instruments (OTC DI) equity options in October 2006, CDCC omitted to make the necessary modifications to Section A-902 to account for these instruments.

#### **A – Proposed Amendments**

CDCC proposes to adjust paragraph (9) of Section A-902 by adding language concerning OTC DI whereby CDCC shall designate three (3) representatives and with a quorum of three (3) representatives to adopt any pertinent resolution in respect of OTC DI.

#### **B – Rationale**

The goal of the proposed amendments to CDCC Rule A-9 is to reflect the procedures that have been put in place concerning corporate actions on OTC DI and harmonize the Rule for both Exchange Transactions and OTC DI.

### **II. ANALYSIS**

#### **A – Public Interest**

The proposed amendments to CDCC's Rules will ensure clarity on how the clearinghouse is dealing with this issue, therefore eliminating any possible concern amongst the clearing members with regards to confidentiality in the OTC market place, as well as harmonize the Rules concerning the Adjustment Committee for all CDCC products.

#### **B – Effectiveness**

The proposed amendments to CDCC's Rules are intended for the purpose of clarifying the process being used for OTC DI within the existing rules.

### **III. PROCESS**

The proposed amendments to CDCC's Rules are submitted to the Board of Directors of CDCC for approval. Once the approval has been obtained, they will then be transmitted to the Autorité des marchés financiers (AMF) in accordance with the self-certification process and to the Ontario Securities Commission (OSC) for information. The proposed amendments will also be published for a 30-day comment period.

### **IV. ATTACHED DOCUMENT**

- CDCC Rule A-9

## **RULE A-9 ADJUSTMENTS IN CONTRACT TERMS**

### **SECTION A-901 APPLICATION**

This Rule A-9 is applicable to Transactions where the Underlying Interest is an equity related product.

New 03/02; amended 04/03, 02/06

### **Section A-902 Adjustments in Terms**

- (1) Whenever there is a dividend, stock dividend, stock distribution, stock split, trust unit split, reverse stock split, reverse trust unit split, rights offering, distribution, reorganization, recapitalization, reclassification or similar event in respect of any Underlying Interest, or a merger, consolidation, dissolution or liquidation of the issuer of any Underlying Interest, the number of Derivative Instruments, the Unit of Trading, the Exercise Price, and the Underlying Interest, or any of them, with respect to all outstanding Derivative Instruments open for trading in that Underlying Interest may be adjusted in accordance with this Section A-902.
- (2) Subject to paragraph 10) of this Section A-902, all adjustments made pursuant to this Section A-902 shall be made by a committee ("Adjustments Committee"). The Adjustments Committee shall determine whether to make adjustments to reflect particular events in respect of an Underlying Interest, and the nature and extent of any such adjustment, based on its judgment as to what is appropriate for the protection of investors and the public interest, taking into account such factors as fairness to Clearing Members and the Corporation, the maintenance of a fair and orderly market in Derivative Instruments on the Underlying Interest, consistency of interpretation and practice, efficiency of exercise settlement procedures, and the coordination with other clearing agencies of the clearance and settlement of transactions in the Underlying Interest. The Adjustments Committee may, in addition to determining adjustments on a case-by-case basis, adopt statements of policy or interpretation having general application to specified types of events. Any such statements of policy or interpretation shall be disseminated to all Clearing Members, exchanges and securities regulatory authorities having jurisdiction over the Corporation. Every determination by the Adjustments Committee pursuant to this Section A-902 shall be within the sole discretion of the Adjustments Committee and shall be conclusive and binding on all Clearing Members and not subject to review, other than review by securities and regulatory authorities having jurisdiction over the Corporation pursuant to applicable provisions of the respective statutes.
- (3) It shall be the general rule that there will be no adjustments to reflect ordinary cash dividends or distributions, or ordinary stock dividends or distributions, or ordinary trust unit dividends or distributions declared by the issuer of the Underlying Interest, or any cash dividend or distribution declared by the issuer of the Underlying Interest if such dividend or distribution is less than \$0.15 per share.
- (4)
  - (i) It shall be the general rule that in the case of a stock dividend, stock distribution, stock split, trust unit dividend, trust unit distribution, trust unit split or similar event whereby either one or three additional whole shares of the Underlying Interest are issued with respect to each outstanding share,(eg. a 2 for 1 or a 4 for 1 stock split), each Derivative Instrument covering that Underlying Interest shall be increased by the same number of additional contracts as the number of additional shares issued with respect to each share of the Underlying Interest. In the case of Options and similar instruments, 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 shall be the general rule with respect to any stock dividend, stock distribution, stock split, trust unit dividend, trust unit distribution or trust unit split whereby other than either one or

three additional whole number of shares are issued, that each Derivative Instrument covering the affected Underlying Interest shall be adjusted, solely for purposes of determining the property deliverable upon settlement of the Derivatives Instrument, 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 or amount of property eliminated, in the case of a reverse stock split or reverse trust unit split, combination of shares or trust units, or similar event).

- (iii) For all Transactions other than Options and similar instruments it shall be the general rule that in the case of a stock dividend, stock distribution, stock split, trust unit dividend, trust unit distribution, trust unit split or similar event whereby either one or more whole number of additional shares of the Underlying Interest are issued with respect to each outstanding share, each Derivative Instrument covering that Underlying Interest shall be increased by the same number of additional contracts as the number of additional shares issued with respect to each share of the Underlying Interest.
- (5) It shall be the general rule that in the case of any distribution made with respect to shares of an Underlying Interest, other than ordinary dividends or distributions subject to paragraph (3) of this Section A-902 and other than dividends or distributions for which adjustments are provided in paragraph (4) of this Section A-902, if an adjustment is determined by the Adjustments Committee to be appropriate,

for Options and similar instruments:

- (i) the Exercise Price in effect immediately prior to such event shall be reduced by the value per share of the distributed property, in which event the Unit of Trading shall not be adjusted, or
- (ii) the Unit of Trading in effect immediately prior to such event shall be adjusted so as to include the amount of property distributed with respect to the number of shares of the Underlying Interest represented by the Unit of Trading in effect prior to such adjustment, in which event the Exercise Price shall not be adjusted;

for all other Transactions for which an Exercise Price is not available:

the Unit of Trading in effect immediately prior to such event shall be adjusted so as to include the amount of property distributed with respect to the number of shares of the Underlying Interest represented by the Unit of Trading in effect prior to such adjustment.

The Adjustments Committee shall, with respect to adjustments under this paragraph or any other paragraph of this Section A-902, have the authority to determine the value of distributed property.

- (6) In the case of any event for which adjustments are not provided in any of the foregoing paragraphs of this Section A-902, the Adjustments Committee may make such adjustments, if any, with respect to the Derivative Instrument affected by such event as the Adjustments Committee determines.
- (7) Adjustments pursuant to this Section A-902 as a general rule shall become effective in respect of Transactions outstanding on the "ex-dividend date" established by the exchange or exchanges on which the Underlying Interest is traded. In the event that the "ex-dividend date" for an Underlying Interest traded on exchanges differs from one exchange to another, the Corporation shall deem the earliest date to be the "ex-dividend date" for the purposes of this Section A-902. "Ex-dividend dates" established by any other exchange or exchanges on which an Underlying Interest may be traded shall be disregarded.
- (8) Notwithstanding the general rules set forth in paragraphs (3) through (7) of this Section A-902 or which may be set forth as interpretations and policies under this Section A-902, the Adjustments

Committee shall have the power to make exceptions in those cases or groups of cases in which, in applying the standards set forth in paragraph (2) thereof the Adjustments Committee shall determine such exceptions to be appropriate. However, the general rules shall be applied unless the Adjustments Committee affirmatively determines to make an exception in a particular case or group of cases.

- (9) For Exchange Transactions, the Adjustments Committee shall consist of two designated representatives of each exchange that lists the Derivative Instrument that the adjustments apply to, and one representative of the Corporation. ; and (The quorum for transacting business at any meeting of the Adjustments Committee shall be one from each exchange that lists the Derivative Instrument that the adjustments apply to and one from the Corporation. For OTC DI, the Adjustment Committee will consist of three designated representatives of the Corporation; and the quorum for transacting business at any meeting of the Adjustments Committee is three designated representatives of the Corporation. The vote of a majority of the members of the Adjustments Committee in attendance at any meeting shall constitute the determination of the Adjustments Committee. The Adjustments Committee may transact its business by means of a telephonic, electronic or other communication facility that permits all participants to communicate appropriately with each other during the meeting. Notwithstanding the foregoing provisions of this paragraph, for Exchange Transactions, any representative of the Corporation or of an exchange may designate any other representative of the Corporation or of the exchange, respectively, to serve in his place at any meeting of the Adjustments Committee. In the event of such designation, the designee, for the purposes of such meeting, shall have all of the powers and duties under this Section A-902 of the person designating him. Neither the Corporation nor any exchange shall designate to serve on the Adjustment Committee, any person, who, to the knowledge of the self-regulatory organization designating such person, is the beneficial holder of a long or short position in the Derivative Instrument as to which the Adjustments Committee is to make a determination. As stipulated in the By-laws of the Corporation, a majority of the members of the Adjustments Committee shall be resident Canadians.
- (10) In the event that the Adjustments Committee is unable to determine whether to make adjustments in any particular case, the matter shall be referred to the Board for a determination.

## INTERPRETATIONS AND POLICIES

(1) (i) Cash dividends or distributions (regardless of size) declared by the issuer of the Underlying Interest which the Corporation considers to have been declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly basis or other regular basis, as well as resumption of dividends or distributions will, as a general rule, be deemed to be "ordinary cash dividends or distributions" within the meaning of paragraph (3) of this Section A-902. Cash dividends or distributions declared by the issuer of the Underlying Interest which are declared outside of a policy or practice of paying such dividends or distributions on a quarterly basis or other regular basis will be deemed to be "special cash dividends or distributions" if they exceed the threshold of \$0.15 per share.

(ii) Stock dividends or distributions, or trust unit dividends or distributions declared by the issuer of the Underlying Interest in an aggregate amount that per dividend or distribution does not exceed 10% of the number of shares of the Underlying Interest outstanding as of the close of trading on the declaration date, and which the Corporation considers to have been declared pursuant to a policy or practice of paying such dividends or distributions on a quarterly basis or other regular basis will, as a general rule, be deemed to be "ordinary stock dividends or distributions" or "ordinary trust unit dividends or distributions" within the meaning of paragraph (3) of this Section A-902.

(iii) Cash dividends or distributions declared by the issuer of the Underlying Interest which the Corporation considers to have been declared outside of a regular policy or practice of paying such dividends or distributions and that exceeds \$0.15 per share will be deemed to be "special cash dividends or distributions".

(iv) Stock dividends or distributions, or trust unit dividends or distributions declared by the issuer of the Underlying Interest which the Corporation considers to have been declared outside of a regular policy and that exceeds 10% of the number of shares of the Underlying Interest will be deemed to be "special stock dividends or distributions" or "special trust unit dividends or distributions".

Nevertheless, the Adjustments Committee will determine, on its sole discretion, on a case-by-case basis whether other dividends or distributions are "ordinary dividends or distributions" or whether they are dividends or distributions for which adjustments should be made, regardless of the threshold of \$0.15 per share applied to "special dividends or distributions".

(2) (i) Adjustments will not ordinarily be made to reflect the issuance of so-called "poison pill" rights that are not immediately exercisable, trade as a unit or automatically with the Underlying Interest, and may be redeemed by the issuer. In the event such rights become exercisable, begin to trade separately from the Underlying Interest, or are redeemed, the Adjustments Committee will determine whether adjustments are appropriate.

(ii) Adjustments will not be made to reflect a take-over bid or issuer bid made for the Underlying Interest, whether such offer is for cash, Securities or other property. This policy will apply without regard to whether the price of the Underlying Interest may be favourably or adversely affected by the offer or whether the offer may be deemed to be "coercive". Outstanding Transactions ordinarily will be adjusted to reflect a merger, amalgamation, arrangement or similar event that becomes effective following the completion of a take-over bid.

(iii) Adjustments will not be made to reflect changes in the capital structure of an issuer where all of the Underlying Interest in the hands of the public (other than dissenters' shares) are not changed into another Security, cash or other property. For example, adjustments will not be made merely to reflect the issuance (except as a distribution on an Underlying Interest) of new or additional debt, stock, trust units, or options, warrants or other securities convertible into or exercisable for the Underlying Interest, the refinancing of the issuer's outstanding debt, the repurchase by the issuer of less than all of the Underlying Interest outstanding or the sale by the issuer of significant capital assets.

(iv) When an Underlying Interest is converted into a right to receive a fixed amount of cash, such as in a merger, amalgamation, arrangement or similar event, outstanding Options or similar instruments will be adjusted to require the delivery upon exercise of cash in an amount per share equal to the conversion price. As a result of such adjustments, the value of all outstanding In-the-money Options or similar instruments will become fixed, and all At-the-money and Out-of-the-money Options or similar instruments will become worthless.

(v) In the case of a spin off or similar event by the issuer of an Underlying Interest which results in a property distribution, Derivatives Instruments will be adjusted to reflect such distribution. The value of the property distributed shall be reflected in the shares deliverable.

(vi) In the case of a corporate reorganization or similar occurrence by the issuer of an Underlying Interest which results in an automatic share-for-share exchange of the Underlying Interest for shares of another class in the capital of the issuer or in the resulting company, the Transactions on the Underlying Interest will ordinarily be adjusted to require delivery upon exercise of a like number of units of the shares of such other class or of the resulting company. Because the Securities are generally exchanged only on the books of the issuer and/or the resulting company, as the case may be, and are generally not exchanged physically, deliverable shares will ordinarily include certificates that are denominated on their face as shares in the original class of shares of the original issuer, but which, as a result of the corporate transaction, represent shares in the other class or in the resulting company, as the case may be.

(vii) When an Underlying Interest is converted in whole or in part into a debt security and/or a preferred stock, as in a merger, and interest or dividends on such debt security or preferred stock are payable in the form of additional units thereof, outstanding option contracts that have been adjusted to call for delivery of such debt security or preferred stock shall be further adjusted, effective as of the ex-date for

each payment of interest or dividends thereon, to call for delivery of the securities distributed as interest or dividends thereon.

(viii) Notwithstanding Interpretation and Policy (1) of this Section A-902, a distribution of short-term and long-term capital gains in respect of index participation units by the issuer thereof, if such distribution equals or exceeds \$ 0.15 per unit shall not, as a general rule, be deemed to be "ordinary dividends or distributions" within the meaning of paragraph (3) of this Section A-902, and adjustments of the terms of Options on such units for any such distributions shall be made in accordance with paragraph (6) of this Section A-902 unless the Adjustments Committee determines, on a case-by-case basis, not to adjust for such a distribution.

| Amended 7/88, 1/89, 6/96, 4/98, 03/02, 04/03, 02/06, 02/09, [00/00](#)