Regulatory Circular RG-02-41

To:	Senior Registered Options Principals Compliance Registered Options Principals
From:	Division of Regulatory Services
Date:	June 12, 2002
Re:	Alerting Customers to Adjustments to Option Contracts

The Options Self-Regulatory Council ("OSRC")[1] has recently become aware that some broker/dealers may not be informing customers about adjustments to their options contracts that arise from corporate actions. The OSRC advises broker/dealers to review or develop procedures as necessary to alert their customers of adjustments to their option contracts caused by corporate actions.

Trading in options entails certain risks and is not suitable for all investors. To help ensure that options customers understand these risks, the rules of the options exchanges and other SROs require members to deliver the options risk disclosure document entitled "Characteristics and Risks of Standardized Options" at or prior to the time a customer's account is approved for options trading. Broker/dealers must provide customers with revised versions of the disclosure document as it is amended.

The options risk disclosure document discusses the effect that corporate actions, such as a stock dividend, stock distribution, stock split, reverse stock split, rights

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[1] The OSRC is a committee comprised of representatives from the options exchanges and other self-regulatory organizations that was created pursuant to a plan of delegation under Exchange Act Rule 17d-2 ("17d-2 Plan"). The 17d-2 Plan was established to reduce regulatory duplication of options-related sales practice matters for firms that are currently members of two or more SROs. The purpose of the OSRC is to administer the 17d-2 Plan and to address options-related sales practice matters in a common forum. The members of the OSRC are: the American Stock Exchange; the Chicago Board Options Exchange; the Chicago Stock Exchange; International Securities Exchange; the National Association of Securities Dealers, Inc.; the New York Stock Exchange; the Pacific Exchange; and the Philadelphia Stock Exchange.

offering, distribution, reorganization, recapitalization, reclassification or similar event in respect to an underlying security, or a merger, consolidation, dissolution or liquidation of the issuer of the underlying security, may have on the terms of an options contract. As a general rule, corporate actions can result in an adjustment in the number of shares underlying an options contract or the exercise price, or both. Adjustments to options contracts are done to maintain fairness, so that the terms of the contract reflect the corporate action.

Adjustments to the terms of listed options contracts are governed by the rules of The Options Clearing Corporation ("OCC"). The OCC is the issuer of listed options and also provides clearance and settlement facilities. The OCC has a series of general adjustment rules to account for corporate actions. Adjustments to options contracts are made by a committee of those SROs on which the particular contract is traded on a case-by-case basis or by following statements of policy or interpretations having general application to specified types of events. The determinations of adjustments to particular contracts are disseminated to each options exchange as they are made. The OCC also provides information about adjustments to contracts on its website at http://www.optionsclearing.com/market/info_memos.jsp. Each options exchange, in turn, provides for the dissemination of information concerning these adjustments to specific option contracts to the exchange's members.

The OSRC is concerned that broker/dealers may not be passing on the specific information about contract adjustments to their affected options customers. Although broker/dealers provide notice to customers of the risks of corporate actions on their options contracts generally through the options risk disclosure document, the OSRC believes that broker/dealers should consider additional steps to ensure that customers are informed of particular adjustments to options contracts they hold. Failure to provide customers with information concerning adjustment to an options contract may violate the rules of an options exchange or SRO, including Just and Equitable Principles of Trade. Accordingly, the OSRC advises broker/dealers to review their procedures, or develop procedures as necessary, to alert customers of adjustments to their options contracts.

Questions concerning this Regulatory Circular can be addressed to Richard Lewandowski at (312) 786-7183 or Lawrence Bresnahan at (312) 786-7713.