

## AMSTERDAM NOTICE No. 07/017

A similar Notice will be distributed by the Brussels, Lisbon, London and Paris markets.

**ISSUE DATE:** 24 April 2007

### **CORPORATE ACTIONS POLICY – MARKET CONSULTATION**

#### **Cash adjustments for rounding errors and fractional lot sizes**

##### **Executive summary**

Members are invited to comment on proposals to reduce possible rounding errors resulting from corporate action adjustments, based on the concept of trading with contracts having fractional lot sizes.

#### **1. Introduction**

- 1.1 When a ratio adjustment is made in accordance with the Corporate Action Policy, the ratio is used to adjust the strike prices and the lot size of the option. As adjusted lot sizes are currently rounded off to the nearest whole share, the adjustment generally leads to small changes in the economic value of affected option contracts.
- 1.2 The purpose of this consultation is to obtain Members' views on two alternative solutions to cater for potential rounding errors incurred as a result of lot size rounding. Both alternatives are based on the concept of trading contracts with unrounded, fractional lot sizes.

#### **2. Adjustments**

- 2.1 The alternatives proposed for option contract adjustments are set out in Appendix A to this Notice.
- 2.2 The first example uses the current approach. The strike prices are multiplied by the ratio and the lot sizes are divided by the ratio. Each lot size is then rounded to the nearest whole share, which inevitably leads to a small difference in the economic value of the contract before and after the adjustment.

- 2.3 In the second example (alternative I) the strike prices are adjusted first. As with the current approach, the adjusted strike prices are rounded (in the example rounding is done to two decimal places but this may vary depending on the product and market in question). The adjusted strike prices are then used to determine an adjusted lot size for each individual series (with four decimal places) by dividing the product of the original contract size and strike price by the adjusted strike price. Upon exercise, the integer part of the contract is physically delivered (provided that the contract is a physically delivered contract) and the fractional part settled in cash. This approach is used by Eurex and has the advantage of minimising the change in the economic value due to the adjustment. However, this approach would impede strategy trading on LIFFE CONNECT® where such strategies consist of legs with different lot sizes.
- 2.4 In the third example (alternative II) the strike prices are adjusted in the same way as in examples 1 and 2. The lot size is adjusted as in the first example, but then rounded to four decimal places. This means that all series would have the same adjusted lot size. Upon exercise, the integer part of the contract would be physically delivered and the fractional part settled in cash. Please note that in this approach the economic value of a contract is still affected by the adjustment, albeit to a relatively small extent. This approach would maintain the consistency of lot size across adjusted strike prices, reducing the impact upon strategy trading.

### **3. Responses**

- 3.1 Members are invited to make their views known. Appendix B contains a reply form that they might find useful for indicating their preferences. Responses can be sent to the quality of derivative markets department by fax (+ 31 20 5504926), email (derivativescorporateactions@liffe.com) or post (P.O. Box 19163, 1000 GD Amsterdam, The Netherlands). The closing date for responses is 15 May 2007.

For further information in relation to this Notice, please contact:

Quality of Derivative Markets                      +31 20 5504296                      derivativescorporateactions@liffe.com

Web site: [www.euronext.com/derivatives](http://www.euronext.com/derivatives)

The Euronext Derivatives Markets ("Euronext.liffe") include the markets for derivatives operated by Euronext Amsterdam, Euronext Brussels, Euronext Lisbon, Euronext Paris and LIFFE Administration and Management, referred to respectively as the Amsterdam, Brussels, Lisbon, Paris and London markets.

**Euronext N.V., PO Box 19163, 1000 GD Amsterdam, The Netherlands**

Appendix A: examples adjustment approaches (options)

	Original Contract			Contract Adjustments					
Ratio 0.98765	Strike	Lotsize	Economic Value	Strike	Lotsize	Economic Value	Difference	Phys. Deliv.	Cash Settl.
<b>Current Approach</b>	26.00	100	2600.00	25.68	101	2593.68	6.32	101	
	28.00	100	2800.00	27.65	101	2792.65	7.35	101	
	30.00	100	3000.00	29.63	101	2992.63	7.37	101	
<b>Alternative I</b>	26.00	100	2600.00	25.68	101.2461	2600.00	0.00	101	0.2461
	28.00	100	2800.00	27.65	101.2658	2800.00	0.00	101	0.2658
	30.00	100	3000.00	29.63	101.2487	3000.00	0.00	101	0.2487
<b>Alternative II</b>	26.00	100	2600.00	25.68	101.2504	2600.11	0.11	101	0.2504
	28.00	100	2800.00	27.65	101.2504	2799.57	0.43	101	0.2504
	30.00	100	3000.00	29.63	101.2504	3000.05	0.05	101	0.2504

(application of O-classes)

	Original Contract	Standard Contract	O-class
	Lotsize	Lotsize    Deliv.	Lotsize    Deliv.    Cash
<b>Current Approach</b>	100	100    100	1    1
<b>Alternative I</b>	100	100    100	1.2461    1    0.2461
	100	100    100	1.2658    1    0.2658
	100	100    100	1.2487    1    0.2487
<b>Alternative II</b>	100	100    100	1.2504    1    0.2504

# Amsterdam market

Appendix B

## Options

Current Approach

Alternative I

Alternative II

Please check one of the boxes below to indicate your first choice of preference

Please check one of the boxes below to indicate your second choice of preference

Remarks:

Member: .....

Name: .....

Telephone nr. ....