

## Chapter 8: Special Events

### 8.1 Capital Adjustments

Adjustments to the share price are a common phenomenon arising naturally in the market when a company announces a share sub-division or a share consolidation or makes changes to its capital structure by way of rights issues, bonus issues, cash dividend payments etc. This adjustment occurs naturally in the market place as soon as the share trades ex-entitlement or the corporate action takes effect.

The value of an option portfolio on those shares will be changed unless an appropriate adjustment is made to the terms of the option contracts. Adjustment to the exercise prices and the number of shares of option contracts will keep the option contract value unchanged before and after the ex-entitlement day or the corporate action effective day.

The Exchange, in consultation with SEOCH and where applicable the Commission, is responsible for determining the adjustments to be made to the terms of the options contracts which are currently traded. The required changes will be executed in DCASS. The Exchange and SEOCH generally refer to the processes surrounding this as “capital adjustments”.

### 8.2 Circumstances Which May Give Rise to Capital Adjustment

The procedures below consider two common types of events in which the Exchange will make standard adjustments to the terms of the options contract. They are **entitlement** events and **corporate action** events.

Special events like offering of shares in another company and change of domicile are not common entitlement or corporate events and standard adjustments may not be applicable. Under such circumstances, the Exchange, in consultation with SEOCH and the Commission, will decide on a case by case basis whether an adjustment is needed, and if so, the adjustment method.

#### 8.2.1 Entitlement Events

Entitlement events generally take the form of a dividend payment, cash bonus, rights issue, bonus issue of shares, bonus issue of warrants or spin-off (with entitlement).

Generally, the Exchange will not perform any capital adjustment on option positions for an ordinary cash dividend (whether or not it is offered with a scrip alternative). For any other forms of cash distribution described by a company, such as a cash bonus, special dividend or extraordinary dividend, the Exchange will not perform any capital adjustment on option positions unless the value of the payment is 2 per cent or more of the share's closing price on the day of the announcement.

Under exceptional circumstances, the Exchange reserves its right to consider making capital adjustments on a case by case basis as it deems appropriate, after consultation with SEOCH and the Commission. For example, an exceptional circumstance may include a dividend payment described as a special dividend but which in essence is a regular payment arising from the normal course of business or an exceptionally large ordinary cash dividend payment involving a return of capital.

For rights issues, bonus issue of shares, bonus issue of warrants and spin-off, the Exchange will perform a capital adjustment irrespective of its size in relation to the underlying market price.

In the case of a combined entitlement event, for example, a bonus issue plus a simultaneous special dividend, the Exchange will conduct a combined capital adjustment only if the special dividend in isolation is 2 per cent or more of the share's closing price on the day of the announcement.

#### 8.2.2 Corporate Action Events

Corporate action events may take the form of share sub-division, share consolidation, merger and privatisation.

The Exchange will **always** perform a capital adjustment irrespective of the corporate action's effect on the underlying market price.

### 8.3 Standard Adjustment Methodology

For each capital adjustment, there will be an adjustment ratio. In each case, the old exercise price of the option contract will be **multiplied** by this adjustment ratio to obtain the **adjusted exercise price**. The corresponding **adjusted contract size** is obtained by **dividing** the old contract value by the adjusted exercise price, unless otherwise specified. The old contract value is simply the product of the old exercise price and the old contract size.

The following table describes the rules for all the standard capital adjustment events.

| <b>Figure 1: Standard Terms of Capital Adjustments</b>  |  |                                       |
|---|--|---------------------------------------|
| <b>Event</b>  | <b>Adjusted Exercise Price (AEP) =</b>   | <b>Adjusted Contract Size (ACS) =</b> |
| <b>Rights Issue</b><br><br>‘A’ new shares for ‘B’ old shares at C amount per share; where it closes at closing price S on the last trading day prior to ex-rights day.  | Old Exercise Price (OEP) times <sup>1</sup> :<br><br>$\frac{B + (A * C / S)}{A + B}$   | $\frac{OEP * Old Contract Size}{AEP}$ |
| <b>Bonus Issue of Shares</b><br><br>‘A’ new shares for ‘B’ old shares.  | Old Exercise Price (OEP) times:<br><br>$\frac{B}{A + B}$   | $\frac{OEP * Old Contract Size}{AEP}$ |
| <b>Bonus Issue of Warrants</b><br><br>W is the theoretical value of bonus warrant entitlement per share one day prior to ex-date <sup>2</sup> .<br><br>OD is ordinary cash dividend.<br><br>The share closes at closing price S on the last trading day prior to the ex-date. | Old Exercise Price (OEP) times:<br><br>$\frac{S - OD - W}{S - OD}$<br><br>Note: OD shall be deducted from S only if OD and the bonus warrants have the same ex-date. | $\frac{OEP * Old Contract Size}{AEP}$ |
| <b>Share Consolidation</b><br><br>X shares consolidate into Y shares.   | Old Exercise Price (OEP) times:<br><br>$\frac{X}{Y}$   | $\frac{OEP * Old Contract Size}{AEP}$ |
| <b>Share Sub-division</b><br><br>X shares sub-divided into Y shares.  | Old Exercise Price (OEP) times:<br><br>$\frac{X}{Y}$   | $\frac{OEP * Old Contract Size}{AEP}$ |

**OPERATIONAL TRADING PROCEDURES**  
**SPECIAL EVENTS**

|   |   |   |
|---|---|---|
| <b>Merger (Shares+Cash)</b><br><br>Y shares in new company and Z amount of cash for every X shares in old company; where it closes at closing price S on its last trading day.  | Old Exercise Price (OEP) times:<br><br><div style="background-color: #cccccc; padding: 5px; text-align: center;"> <math display="block">\frac{X-Z/S}{Y}</math> </div>   | $\frac{\text{OEP} * \text{Old Contract Size}}{\text{AEP}}$  |
| <b>Merger (Shares Only)</b><br><br>Y shares in new company for X shares in old company.   | Old Exercise Price (OEP) times:<br><br><div style="background-color: #cccccc; padding: 5px; text-align: center;"> <math display="block">\frac{X}{Y}</math> </div>   | $\frac{\text{OEP} * \text{Old Contract Size}}{\text{AEP}}$  |
| <b>Privatisation / Merger (Cash Only)</b>   | <ul style="list-style-type: none"> <li>The Exchange will announce a Last Day of Dealing (“LDD”) on the contracts, which is subject to conditions of the offer being satisfied.</li> <li>Contracts will be cash-settled based on the share offer price/cancellation price immediately after the LDD if the offer has become unconditional.</li> <li>No physical delivery of the underlying shares will be involved.</li> </ul> |   |
| <b>Spin-off<sup>3</sup> (with Entitlement)</b><br><br>E is the value of the entitlement of the spin-off calculated using VWAP <sup>4</sup> on its first trading day.<br><br>S is the value of the share calculated using VWAP <sup>4</sup> on E’s first trading day.    | Old Exercise Price (OEP) times:<br><br><div style="background-color: #cccccc; padding: 5px; text-align: center;"> <math display="block">\frac{S}{S + E}</math> </div>   | If S/S+E is equal to or above the Exchange’s prescribed limit <sup>5</sup><br><br>$\frac{\text{OEP} * \text{Old Contract Size}}{\text{AEP}}$<br><br>If S/S+E is below the Exchange’s prescribed limit <sup>5</sup><br><br>$\frac{\text{Old Contract Size}}{\text{the Exchange’s prescribed limit}^5}$ |
| <b>Other forms of Cash Distribution (CD), such as a special dividend, cash bonus or extraordinary dividend</b><br><br>No capital adjustment unless CD is 2% or more of the share's closing price on the dividend announcement day.<br><br>OD is ordinary cash dividend. | Old Exercise Price (OEP) times:<br><br><div style="background-color: #cccccc; padding: 5px; text-align: center;"> <math display="block">\frac{S - \text{OD} - \text{CD}}{S - \text{OD}}</math> </div><br><br>Note: OD shall be deducted from S only if OD and CD have the same ex-date.   | $\frac{\text{OEP} * \text{Old Contract Size}}{\text{AEP}}$  |

## OPERATIONAL TRADING PROCEDURES

### SPECIAL EVENTS

|   |  |  |
|---|--|--|
| The share closes at closing price S on the last trading day prior to the ex-date. |  |  |
| The shaded area is the “adjustment ratio”   |  |  |

<sup>1</sup> Capital adjustment will only be made if the adjustment ratio is smaller than 1.

<sup>2</sup> The theoretical value is determined by SEOCH based on such pricing parameters from such market makers as it may consider appropriate.

<sup>3</sup> No capital adjustment will be made in respect of any preferential offering arising from a spin-off as entitlement will not be extended to all shareholders. Capital adjustments in respect of spin-offs which do not involve the listing of the relevant company's shares will be considered on a case-by-case basis.

<sup>4</sup> The Volume Weighted Average Price (VWAP) is determined by calculating the summation of the value of each transaction (i.e. price multiplied by number of shares traded) and then dividing it by the total shares traded for the day.

<sup>5</sup> The Exchange's prescribed limit shall be such adjustment ratio floor value as may be prescribed by the Exchange from time to time.

In cases where a cash or scrip alternative is offered, the capital adjustments will be based on the cash version of the payout. If the cash payment is in a currency other than that in which the underlying securities are traded, it will be converted to that currency at the conversion rate determined by SEOCH.

#### 8.4 Capital Adjustment Announcement

As soon as the company makes an announcement which may require a capital adjustment, the Exchange, in consultation with SEOCH and where applicable the Commission, will determine what effect it will have on the options contracts. The decision as to whether or not an adjustment will be made to the terms of all existing options contracts, and the nature of that adjustment, will be announced no later than the tenth trading day after the company announcement is made.

For details regarding the capital adjustment process conducted by SEOCH in DCASS, please refer to the *Operational Clearing Procedures*.

#### 8.5 Effective Day of Capital Adjustment

The adjustment will take effect on the ex-date of the entitlement events or on the effective date of the corporate action events. In case of typhoon or rainstorm, the adjustment timing will follow the guidelines in Practice Note 8 of the Rules Governing the Listing of Securities, where applicable.

#### 8.6 Changes to Capital Adjustment Announcement by Company

If there is any change to the corporate action events announced by the company after the underlying stock has traded ex-all entitlements, the Exchange, in consultation with SEOCH and where applicable the Commission, will determine on a case by case basis any necessary further action.