

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

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceeding to determine whether the proposed rule change should be disapproved.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-99-15 and should be submitted by June 22, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41435; File No. SR-CBOE-99-03]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Option Exercise Procedures¹

May 21, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),² and Rule 19b-4 thereunder,³ notice is hereby given that on January 20, 1999, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or the "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The proposal was amended on May 11, 1999.⁴ 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 Substance of the Proposed Rule Change

CBOE proposes to amend Exchange Rules 4.16 and 11.1 to permit the exercise of American-style, cash-settled index options following a trading halt that occurs at or after 3:00 p.m. Such exercises will be permitted at or after 3:00 p.m. through 3:20 p.m. (CT), the normal deadline for exercising such options. The Exchange is also proposing to amend its Regulatory Circular concerning the Exchange's procedures and requirements regarding the exercise of American-style, cash-settled index options ("Exercise Regulatory Circular")⁵ to reflect these changes and to reflect changes to CBOE Rules 4.16 and 11.1 that were recently approved by the Commission. Additionally, the Exchange is proposing to permit CBOE's President or his designee to extend the applicable deadline for the delivery of Exchange-required exercise notifications, for either an American-

¹ The CBOE amended the title of this filing in Amendment No. 1. See *infra* note 4.

² 15 U.S.C. 78s(b)(1).

³ 17 CFR 240.19b-4.

⁴ In Amendment No. 1, the Exchange made typographical corrections to, clarified the purpose of, and expanded the scope of the proposed rule change. ("Amendment No. 1"). See Letter from Arthur B. Reinstein, Counsel, CBOE, to Hong-anh Tran, Attorney, Division of Market Regulation ("Division"), Commission, dated May 10, 1999.

⁵ See Securities Exchange Act Release No. 40334 (August 18, 1998), 63 FR 45275 (August 25, 1998) File No. SR-CBOE-98-34.

style, cash-settled index options or a non-cash settled equity options, if unusual circumstances are present.⁶ Attached as Exhibit A to this Notice is the text of the proposed rule. Proposed new language is *italicized*; proposed deletions are in [brackets].

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

1. Purpose

American-style, Cash-Settled Index Options

The CBOE proposes to modify its rules governing the exercise of American-style, cash-settled index during certain trading halts. Currently, the Exchange trades only one type of American-style, cash-settled index option contract, Standard & Poor's 100 index options ("OEX index options").⁷ Index options generally are traded on the Exchange from 8:30 a.m. to 3:15 p.m. (CT).⁸ CBOE Rule 11.1 governs the exercise of options contracts, including index option contracts. CBOE Rule 11.1 provides that CBOE members shall follow the procedures of the Options Clearing Corporation ("OCC") as well as those of the exchange when exercising option contracts. Options generally may be exercised at any time during the trading day, and proposed CBOE Rule 11.1.03 requires members intending to exercise American-style, cash-settled index option contracts to deliver an "exercise advice" to a place designated by the Exchange no later than five minutes after the close of trading on that

⁶ See Amendment No. 1, *supra* note 4.

⁷ Although OEX index options are the only standardized American-style, cash-settled index options currently traded on the Exchange, the revised Rules also would apply to exercises of American-style, cash-settled FLEX Index Option contracts. All other CBOE index options are European-style, with exercise permitted only upon their expiration.

⁸ CBOE Rule 24.6, *Days and Hours of Business*.

⁹ 17 CFR 200.30-3(a)(12).

day.⁹ However, under CBOE Rule 11.1.05 (which is now proposed to be moved to CBOE Rule 11.1.03(h)), and CBOE Rule 4.16(b),¹⁰ exercises of cash-settled index options are prohibited during any time when trading in such options is delayed, halted or suspended, unless otherwise determined by the President of the Exchange or his designee.¹¹ Thus, although exercises of OEX index options may occur until 3:20 p.m. (CT) in the absence of a trading halt, no exercises of OEX index options currently are permitted when a trading halt in such options is in effect.

The current rules governing the exercise of index options were developed with recognition of the distinction between holders of long and holders of short positions in index options. The Exchange has long noted that one of the distinctive characteristics of a cash-settled option is that its exercise is functionally equivalent to trading out of the long position, and, conversely, the assignment of a short index option eliminates the position as if it had been closed through a purchase transaction. Absent any restrictions upon exercise, holders of long positions would be able to exercise their options after the close of trading and during trading halts. Because holders of short positions are unable to trade out of their positions when trading has been closed or halted, they would be at a disadvantage to holders of long positions. To minimize the effect this disparity might have on holders of short positions in the event of a trading halt immediately prior to expiration of an option, the Exchange amended CBOE Rule 4.16(a) in 1983 to permit the Exchange's Board of Directors to restrict exercises of index options other than on the last trading day before expiration Friday.¹² Exercises of expiring index options cannot be restricted in any way on expiration Friday.

Since 1991 the Exchange has permitted the exercise of index options for a "five minute window" subsequent

to the close of trading on the Exchange.¹³ The rule permitting the exercise of cash-settled index options up to 3:20 p.m. (CT) allows market participants to make investment decisions based on the evaluation of their final positions after having completed trading for the day. In addition, by allowing traders and market makers to concentrate on their trading activities, rather than submitting exercise advice prior to the close of the market, and to determine whether or not their hedging orders on other markets were executed, as well as to their exercise their index option positions on the Exchange if necessary to avoid remaining unhedged overnight, the five-minute window benefits options investors generally by fostering higher quality markets. Moreover, the additional five-minute exercise period provides market participants with additional time to evaluate the closing prices of the securities that comprise an index and to determine whether or not to exercise their positions.¹⁴ Thus, in light of these benefits, the Exchange adopted the five-minute window permitting exercises after the close of trading on the Exchange notwithstanding that investors holding short positions in index options would not have the same opportunity to unwind their positions during this period as would holders of long positions. In doing so, the Exchange deemed the benefits to the overall OEX index market from the five-minute exercise period to exceed any potential harm that might result to short holders as a result of the disparity in trading opportunities.

The Exchange has now reconsidered its policy with respect to the exercise of American-style, cash-settled index options and proposes to eliminate the current ban on exercises with respect to trading halts in such options that occur at or after 3:00 p.m. (CT). As mentioned, the trading markets for the equity securities underlying index options generally are closed for trading by 3:00 p.m. (CT), thereby establishing the closing value of a given index. By this time, OEX market participants are already watching the market for opportunities to exercise their options. Many participants in the OEX index options market use the closing value of the index to make trading and hedging decisions (including transactions in the related futures market) contingent upon exercise of an OEX index option

position or the expected assignment of a short position. Given this, the Exchange believes that the occurrence of trading halt at or after 3:00 p.m. (CT) should not fundamentally alter the ability of these market participants to exercise their index options.¹⁵ While permitting the exercise of index options during trading halts that occur at or after 3:00 p.m. (CT) increases the disparity in trading opportunities between holders of short and long positions in OEX index options, the Exchange believes that any increase in disparity is incremental over the situation that exists today by virtue of the five-minute exercise window after the close of the Exchange, and would be exceeded by the additional benefits that would be afforded to the OEX market under the proposed Rule.¹⁶

The Exchange also believes that a uniform policy of permitting exercises of OEX index options after the close of the Exchange will reduce the potential for confusion among its members and customers, especially during late trading halts. In doing so, such a policy would further the efficient operation of the Exchange during such periods. To the extent that a closing rotation were held after a late trading halt, the Exchange proposes that exercises of American-style, cash-settled index options would continue to be permitted during the rotation and for a five-minute period thereafter, as is currently the case.

The Exchange also proposes to amend CBOE Rules 4.16(b) and CBOE Rule 11.1.03, and proposes to reflect these corresponding changes in the Exercise Regulatory Circular to make clear that in the case of an American-style, cash-settled FLEX Index Option, the references in CBOE Rule 4.16(b), CBOE Rule 11.1.03, and the Exercise Regulatory Circular to a trading delay, halt, suspension, resumption, closing rotation, or modified trading hours will mean the occurrence of the applicable condition in the standardized option on the index underlying the FLEX Index Option (rather than the occurrence of

⁹ See Amendment No. 1, *supra* note 4.

¹⁰ *Id.*

¹¹ Notwithstanding this prohibition, the exercise of a cash-settled index option may be processed and given effect in accordance with and subject to the rules of the OCC while trading in an option is delayed, halted, or suspended if it can be documented that the decision to exercise the option was made during allowable time frames prior to the delay, halt or suspension. CBOE Rule 11.1.05 (which is now proposed to be moved to proposed CBOE Rule 11.1.03(h)(i)), Exercise of Option Contracts.

¹² CBOE Rule 4.16(a), *Other Restrictions on Options Transactions and Exercises*; See also, Securities Exchange Act Release No. 19590 (March 10, 1983), 48 FR 11196 (March 16, 1983) (File No. SR-CBOE-83-6); and see Amendment No. 1, *supra* note 4.

¹³ See Securities Exchange Act Release No. 29860 (October 25, 1991), 56 FR 56264 (November 1, 1991) (File No. SR-CBOE-91-28).

¹⁴ *Id.*

¹⁵ While the implementing the standard five-minute exercise window after a trading halt has been announced would provide floor traders with sufficient opportunity to exercise, such a small window may not provide other market participants with a sufficient opportunity to do so and would add to the increased operational burdens of member firms resulting from the trading halt itself.

¹⁶ The Exchange generally will continue to prohibit American-style, cash-settled index option exercises during any trading halt which occurs before 3:00 p.m. (CT), as the length of time required to provide sufficient notice and opportunity equally to all market participants during an intraday trading halt would unfairly expand the opportunity for holders of long index option positions to exercise when short option holders are prohibited from trading.

the applicable condition in the FLEX Index Option itself).¹⁷ The Exchange states that this is consistent with how the Exchange has historically applied the exercise provisions that are applicable in the above market conditions to American-style, cash-settled FLEX Index Options, and the Exchange proposes herein to codify the Exchange's prior exercise practices as they apply to American-style, cash-settled FLEX Index Options.¹⁸

Thus, for example, if there is a trading halt that occurs before 3:00 p.m. in the standardized Standard & Poor's 500 Index (SPX) options (which are European-style options), exercises of American-style, cash-settled SPX FLEX options will be prohibited during the trading halt.¹⁹ However, based on the proposal, if there is a trading halt in the standardized SPX options that occurs at or after 3:00 p.m., exercises of American-style, cash-settled SPX FLEX options may occur through 3:20 p.m.²⁰ Additionally, based on the proposal, if there is a closing rotation in the standardized SPX options, exercises of American-style, cash-settled SPX FLEX options may occur during the closing rotation and for five minutes after the end of the closing rotation.²¹ If there were no provision which provided for the foregoing, the holder of an American-style, cash-settled SPX FLEX option would have no ability to exercise the option during a closing rotation because CBOE Rule 24A.3 does not permit closing rotations to be conducted in FLEX options.²² The purpose of the provisions discussed above is to avoid this differential treatment and to treat all American-style, cash-settled index options in the same manner with regard to exercise restrictions.²³

Additionally, with the exception of some nonsubstantive wording changes, the Exchange is proposing to move the text of CBOE Rule 11.1.05 to proposed CBOE Rule 11.1.03(h) for ease of reference for Exchange members since CBOE Rule 11.1.05 relates to the exercise of American-style, cash-settled index options and the provisions of Rule 11.1 that specifically relate to the exercise of American-style, cash-settled index options are set forth in Rule 11.1.03.²⁴ The Exchange is also proposing to amend the Exercise Regulatory Circular to reflect recently

adopted changes to CBOE Rule 4.16(b) and CBOE Rule 11.1.05 (which is now proposed to be moved to proposed CBOE Rule 11.1.03(h)),²⁵ which permit the President of the Exchange (or his designee) to allow the exercise of American-style, cash-settled index options during any trading delay, halt or suspension.²⁶ As noted in the Exercise Regulatory Circular, the Exchange anticipates that, in general, such a determination would be based on extraordinary circumstances.²⁷

The Exchange also proposes to narrow the evidence that may be submitted to the Exchange by a member to document that a decision to exercise an American-style, cash-settled option was made prior to a trading delay, halt or suspension. Exchange members are excepted from the general prohibition on exercising such index options during trading halts, delays, or suspensions provided they can document that the decision to exercise was made prior to the trading halt, delay, or suspension.²⁸ The Exchange believes that it would be preferable to rely on and encourage the most objective evidence available as to the timing of an exercise determination. Therefore, the Exchange proposes to no longer, ordinarily, accept internal exercise memoranda prepared by CBOE members as evidence of timely exercises. The Exchange will, however, continue to accept "exercise advices" transmitted via C/MAS or a member's copy of an exercise advice previously submitted to the Exchange as evidence that an exercise determination was made prior to a subsequent trading delay, halt, or suspension.²⁹

Further, the Exchange proposes to permit CBOE's President or his designee to extend the applicable deadline for the delivery of "exercise advice" and "advice cancel" notifications pursuant to CBOE Rule 11.1.03(c) for American-style, cash-settled index options if unusual circumstances are present.³⁰ The exercise deadline for standardized American-style, cash-settled index options is normally 3:20 p.m. (CT) and is in effect on every trading day except that the deadline is not in effect on expiration Friday for expiring contracts.³¹ On occasion, there may be situations in which the regular 3:20 p.m. (CT) deadline for CBOE members to notify the Exchange of exercise

decisions concerning and American-style, cash-settled index option may not allow market participants a sufficient amount of time in which to make and process those exercise decisions due to the presence of unusual circumstances.³² For example, there have been rare occasions in which the reporting authority for an index has been late in reporting the closing index value for the index.³³ Consequently, market participants have found it difficult on those occasions to make and process exercise decisions before the 3:20 p.m. (CT) deadline.³⁴ This amendment proposes to permit the President or his designee to extend the applicable deadline for the delivery of "exercise advice" and "advice cancel" notifications pursuant to CBOE Rule 11.1.03(c) for American-style, cash-settled index options in unusual situations like the foregoing.³⁵

Noncash-Settled Equity Options

The exercise cutoff time for noncash-settled options is 4:30 p.m. (CT) and is in effect on expiration Friday for expiring contracts. The cutoff time is only applicable with respect to expiring contracts on expiration Friday because at other times an option holder who makes a late decision to either exercise or not to exercise an option will always end up holding either the option or the underlying stock, the value of which will be similarly effected by any material late news.³⁶

For reasons comparable to the reasons for proposing to grant the President or his designee the authority to extend the exercise deadline for American-style, cash-settled index options, this amendment also proposes, under CBOE Rule 11.1(b) and CBOE Rule 11.1.06, to grant similar authority to the President or his designee to extend the 4:30 p.m. (CT) exercise cutoff time for a noncash-settled equity option if unusual circumstances are present (in which case, the Exchange proposes that the deadline for the delivery of an exercise instruction, "contrary exercise advice," and "advice cancel" pursuant to CBOE Rule 11.1.06 will be the revised exercise cutoff time designated by the President or his designee).³⁷ For example, there have been rare occasions in which the closing rotation in an equity option has ended shortly before 4:30 p.m. (CT).³⁸ A late-ending closing rotation delays a

¹⁷ See Amendment No. 1, *supra* note 4.

¹⁸ *Id.*

¹⁹ *Id.*

²⁰ *Id.*

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ *Id.*

²⁵ *Id.*

²⁶ See Securities Exchange Act Release No. 40951 (January 15, 1999), 64 FR 4482 (January 28, 1999) (File No. CBOE-98-33).

²⁷ See Amendment No. 1, *supra* note 4.

²⁸ *Id.*

²⁹ See Exercise Regulatory Circular, Section 11.

³⁰ See Amendment No. 1, *supra* note 4.

³¹ *Id.*

³² *Id.*

³³ *Id.*

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Id.*

³⁸ *Id.*

market participant's ability to take the actions necessary to make and process an exercise decision. For example, in order to make and process an exercise decision, a market participant may need to obtain confirmations of trades executed that day, review the participant's positions in the applicable option and the underlying stock, review the closing price of the option and underlying stock, and/or prepare exercise instruction, "contrary exercise advice," and "advice cancel" forms. This amendment proposes to permit the President or his designee to extend the exercise cutoff time in unusual situations like the foregoing in order to allow market participants sufficient time in which to make and process exercise decisions.³⁹

American-Style, Cash-Settled Index Options and Noncash-Settled Equity Options

Under the Exchange's current rules, there is a time window following the close of trading during which long option holders are permitted to exercise their option positions while at the same time short option holders do not have the ability to trade out of their positions. Accordingly, one of the inherent differences between holding a long or short option position is that there is a disparity between the ability of long and short option holders to take market action following the close of trading.⁴⁰ The purpose of the Exchange's exercise deadline for American-style, cash-settled index options and the exercise cutoff time for noncash-settled equity options is to restrict this disparity to a limited time period following the close of trading in those situations in which long option holders have the ability to take action through the exercise or non-exercise of an option that can affect their position in the market.⁴¹ Although permitting the President or his designee to extend the applicable exercise deadline or cutoff time in unusual circumstances would marginally increase this existing disparity, the Exchange believes any potential detriment that may result from the foregoing would be far exceeded by the benefit to the marketplace as a whole that is derived from allowing the President or his designee to permit market participants sufficient time in which to make and process exercise decisions.⁴² The Exchange also notes that the President or his designee will only exercise this authority in unusual

circumstances and thus extensions in the applicable exercise deadline or cutoff time will not occur often.⁴³

Similarly, in exercising the authority to extend the exercise deadline for an American-style, cash-settled index option or the exercise cut-off time for a noncash-settled equity option in unusual circumstances, the Exchange states that the President or his designee would in no event extend the applicable exercise deadline or cut-off time beyond the exercise cut-off time required by the Options Clearing Corporation ("OCC").⁴⁴ Chapter VIII of OCC's Rules generally sets forth the applicable OCC exercise cut-off-times.⁴⁵

2. Statutory Basis

The proposed rule change will benefit the market for American-style, cash-settled index options (including OEX options) by permitting market participants to utilize the closing value of such indexes to make trading and hedging decisions (including transactions in the related futures market) contingent upon the ability to exercise a long index option position or the expected assignment of a short index option position. The proposed rule change will also benefit market participants by permitting the President or his designee to extend the applicable deadline for the delivery of Exchange-required exercise notifications, for either American-style, cash-settled index options or noncash-settled equity options, to allow market participants sufficient time to make and process exercise decisions in the event that unusual circumstances are present which make it difficult to make and process exercise decisions during the regular time frame for doing so.⁴⁶ Additionally, the proposed rule changes will clarify, refine, and enhance the Exchange's rules relating to the exercise of option contracts.⁴⁷

Accordingly, the exchange believes that the proposed rule change is consistent with Section 6 of the Act, and in particular, with Section 6(b)(5),⁴⁸ in that it is designed to, among other things, foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information regarding the exercise of outstanding option contracts, to remove impediments to and perfect the mechanism of a free and open

market, and to protect investors and the public interest.⁴⁹

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

The exchange does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0069. 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, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to the File No. SR-CBOE-99-03

³⁹ *Id.*

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.*

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ See OCC, Chapter VIII, (Exercise and Assignment).

⁴⁶ See Amendment No. 1, *supra* note 4.

⁴⁷ *Id.*

⁴⁸ 5 U.S.C. 78f(b)(5).

⁴⁹ See Amendment No. 1 *supra* note 4.

and should be submitted by June 22, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵⁰

Margaret H. McFarland,
Deputy Secretary.

EXHIBIT A

(Proposed new language of the Rules of the Exchange as currently in effect is *italicized*; proposed deletions are in [brackets].)

Chicago Board Options Exchange, Incorporated Rules

* * * * *

CHAPTER IV—Business Conduct

Other Restrictions on Options Transactions and Exercises

RULE 4.16

(a) Unchanged.

(b) [With the exception of the last business day prior to expiration, exercises of cash-settled index options shall be prohibited during any time when trading in such options is delayed, halted, or suspended, unless otherwise determined by the President or his designee. Notwithstanding such a prohibition, the exercise of a cash-settled index option may be processed and given effect in accordance with and subject to the rules of the Clearing Corporation while trading in the option is delayed, halted, or suspended if it can be documented that the decision to exercise the option was made during allowable time frames prior to the delay, halt, or suspension.] *Exercises of American-style, cash-settled index options shall be prohibited during any time when trading in such options is delayed, halted, or suspended, subject to the following exceptions:*

(i) *The exercise of an American-style, cash-settled index option may be processed and given effect in accordance with and subject to the rules of the Clearing Corporation while trading in the option is delayed, halted, or suspended if it can be documented, in a form prescribed by the Exchange, that the decision to exercise the option was made during allowable time frames prior to the delay, halt, or suspension.**

(ii) *Exercises of expiring American-style, cash-settled index options shall not be prohibited on the last business day prior to their expiration.**

(iii) *Exercises of American-style, cash-settled index options shall not be prohibited during a trading halt that occurs at or after 3:00 p.m. (CT). In the event of such a trading halt, exercises*

may occur through 3:20 p.m. (CT). In addition, if trading resumes following such a trading halt (such as by closing rotation), exercises may occur during the resumption of trading and for five (5) minutes after the close of the resumption of trading. The provisions of this subparagraph (b)(iii) are subject to the authority of the Board to impose restrictions on transactions and exercises pursuant to paragraph (a) of this Rule.

(iv) *The President or his designee may determine to permit the exercise of American-style, cash-settled index options while trading in such options is delayed, halted, or suspended.**

In the case of an American-style, cash-settled FLEX Index Option, the references in this paragraph (b) to a trading delay, halt, suspension, resumption, or closing rotation shall mean the occurrence of the applicable condition in the standardized option on the index underlying the FLEX Index Option (rather than the occurrence of the applicable condition in the FLEX Index Option itself).

. . . Interpretations and Policies:

.01 Unchanged.

.02 Unchanged.

* With the exception of some wording changes, these provisions are currently generally set forth in Rule 4.16(b) and are not newly proposed provisions.

* * * * *

CHAPTER XI—Exercises and Deliveries

Exercise of Option Contracts

RULE 11.1

(a) Unchanged.

(b) The exercise cutoff time for all noncash-settled options shall be 4:30 p.m. (CT) on the business day immediately prior to the expiration date. This is the latest time at which an exercise instruction for expiring noncash-settled positions may be (1) Prepared by a Clearing Member for its proprietary positions, (2) submitted to a Clearing Member by a member (including, but not limited to, a Market Maker or Floor Broker), or (3) accepted by a Clearing Member from or on behalf of a customer. *The President or his designee may determine to extend the 4:30 p.m. (CT) exercise cutoff time for a noncash-settled options if unusual circumstances are present.* Notwithstanding the foregoing, members may prepare, submit or accept exercise instructions for noncash-settled options after the applicable exercise cutoff time but prior to expiration (i) In order to remedy mistakes or errors made in good faith, (ii) to take appropriate action as the result of a failure to

reconcile unmatched Exchange transactions, or (iii) where exceptional circumstances relating to a customer's or member's ability to communicate exercise instructions to a Clearing Member (or a Clearing Member's ability to receive exercise instructions) prior to such cutoff time warrant such action.

(c)–(d) Unchanged.

. . . Interpretations and Policies:

.01–.02 Unchanged.

.03 Clearing Members must follow the procedures of the Clearing Corporation when exercising American-style, cash-settled index option contracts issued or to be issued in any account at the Clearing Corporation. Members must also follow the procedures set forth below with respect to American-style, cash-settled index options:

(a) For all contracts exercised by the member or by any customer of the member, an "exercise advice" must be delivered by the member in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 3:20 p.m. (CT), or if trading hours are extended or modified in the applicable option class, no later than five (5) minutes after the close of trading on that day.

(b) Subsequent to the delivery of an "exercise advice", should the member or a customer of the member determine not to exercise all or part of the advised contracts, the member must also deliver an "advice cancel" in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 3:20 p.m. (CT), or if trading hours are extended or modified in the applicable option class, no later than five (5) minutes after the close of trading on that day.

(c) *The President or his designee may determine to extend the applicable deadline for the delivery of "exercise advice" and "advice cancel" notifications pursuant to this Interpretation .03 if unusual circumstances are present.*

(d)[(c)] No member may prepare, time stamp or submit an "exercise advice" prior to the purchase of the contracts to be exercised if the member knew or had reason to know that the contracts had not yet been purchased.

(e)[(d)] The failure of any member to follow the procedures in this Interpretation .03 may be referred to the Business Conduct Committee and result in the assessment of a

⁵⁰ 17 CFR 200.30–3(a)(12).

- fine, which may include but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Committee.
- (f)[(e)] Preparing or submitting an "exercise advice" or "advice cancel" after the applicable deadline on the basis of material information released after such deadline, in addition to constituting a violation of this Rule, is activity inconsistent with just and equitable principles of trade.
- (g)[(f)] The procedures set forth in subparagraphs (a)–(b) of this Interpretation .03 do not apply (i) on the business day prior to expiration in series expiring on a day other than a business day or (ii) on the expiration day in series expiring on a business day.
- (h)[(g)] *Exercises of American-style, cash-settled index options (and the submissions of corresponding "exercise advice" and "advice cancel" forms) shall be prohibited during any time when trading in such options is delayed, halted, or suspended, subject to the following exceptions:**
- (i) *The exercise of an American-style, cash-settled index option may be processed and given effect in accordance with and subject to the rules of the Clearing Corporation while trading in the option is delayed, halted, or suspended if it can be documented, in a form prescribed by the Exchange, that the decision to exercise the option was made during allowable time frames prior to the delay, halt, suspension. Acceptable documentation shall ordinarily be limited to an "exercise advice" previously transmitted via C/MACS or a member's copy of an "exercise advice" previously submitted to the Exchange.**
- (ii) *Exercises of expiring American-style, cash-settled index options shall not be prohibited on the last business day prior to their expiration.**
- (iii) *Exercises of American-style, cash-settled index options shall not be prohibited during a trading halt that occurs at or after 3:00 p.m. (CT). In the event of such a trading halt, exercises may occur through 3:20 p.m. (CT). In addition, if trading resumes following [such] a trading halt (such as by closing rotation), exercises may occur during the resumption of trading for five (5) minutes after the close of the resumption of trading. The provisions of this subparagraph (iii) are subject to the authority of the Board to impose restrictions on transactions and exercises pursuant to Rule 4.16(a).*
- (iv) *The President or his designee may determine to permit the exercise of American-style, cash-settled index options while trading in such options is delayed, halted, or suspended.**
- In the case of an American-style, cash-settled FLEX Index Option, the references in this paragraph (h) to a trading delay, halt, suspension, resumption, or closing rotation shall mean the occurrence of the applicable condition in the standardized option on the index underlying the FLEX Index Option (rather than the occurrence of the applicable condition in the FLEX Index Option itself).*
- .04 Unchanged.
- .05 [With the exception of the last business day prior to expiration, exercises of cash-settled index options (and the submission of corresponding "exercise advice" and "advice cancel" forms) shall be prohibited in accordance with Rule 4.16(b) during any time when trading in such options is delayed, halted or suspended, unless otherwise determined by the President or his designee. Notwithstanding such a prohibition, the exercise of a cash-settled index option may be processed and given effect in accordance with and subject to the rules of the Clearing Corporation while trading in the option is delayed, halted, or suspended if it can be documented that the decision to exercise the option was made during allowable time frames prior to the delay, halt, or suspension.] Deleted effective, 1999(99–).
- .06 Clearing Members must follow the procedures of the Clearing Corporation when exercising expiring noncash-settled equity option contracts. Members must also follow the procedures set forth below with respect to the exercise of noncash-settled equity option contracts which would otherwise not be exercised, or the nonexercise of such contracts which otherwise would be exercised, by operation of the exercise by exception provisions of Clearing Corporation Rule 805:
- (a) For all contracts so exercised or not exercised by the member or by any customer of the member, as "contrary exercise advice" must be delivered by the member in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 4:30 p.m. (CT).
- (b) Subsequent to the delivery of a "contrary exercise advice", should the member or a customer of the member determine to act other than as reflected on the original advice form, the member must also deliver an "advice cancel" in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 4:30 p.m. (CT).
- (c) The procedures set forth in subparagraphs (A)–(B) of this Interpretation .06 shall not apply with respect to any option class that is not subject to the exercise by exception provisions of Clearing Corporation Rule 805 ("Non Ex-by-Ex Option Class"). Instead, for all option contracts in a Non Ex-by-Ex Option Class that are exercised by the member or by a customer of the member, each exercise instruction that is prepared, submitted or accepted by the member with respect to such contracts must also be delivered by the member in such form or manner prescribed by the Exchange to a place designated by the Exchange no later than 4:30 p.m. (CT).
- (d) *The President or his designee may determine pursuant to Rule 11.1(b) to extend the 4:30 p.m. (CT) exercise cutoff time for a noncash-settled equity option if unusual circumstances are present. In the event of such an extension, the deadline for the delivery of an exercise instruction, "contrary exercise advice" and "advice cancel" pursuant to this Interpretation .06 shall be the revised exercise cutoff time designated by the President or his designee pursuant to Rule 11.1(b).*
- (e) [d] The member shall be excused from compliance with the procedures set forth in subparagraphs (a)–(c) of this Interpretation .06 in the event that one of the exceptions set forth in clause (i), (ii) or (iii) of Rule 11.1(b) is applicable and the member complies with the requirements of Interpretation .01 of this Rule.
- (f) [(e)] The failure of any member to follow the procedures in this Interpretation .06 may be referred to the Business Conduct Committee and result in the assessment of a fine, which may include but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as

determined by the Committee.
(g)(f) Preparing or submitting an exercise instruction, "contrary exercise advice" or "advice cancel" after *the applicable deadline* [4:30 p.m. (CT)] on the basis of material information released after such *deadline* [time], in addition to constituting a violation of this Rule, is activity inconsistent with just and equitable principles of trade.

.07 Unchanged.

* With the exception of some wording changes, these provisions are proposed to be moved from Rule 11.1.05 and are not newly proposed provisions.

* * * * *

Regulatory Circular RG [98-90] 99-

DATE: [August 24] ____, [1998] 1999

TO: Members and Member Organizations

FROM: Regulatory Services Division

RE: S&P 100 Index and American-Style FLEX Index Option Exercise Procedures

This memorandum *describes* [is being issued to remind members and member organizations of the] exercise procedures and requirements of Exchange Rules 11.1 and 24.18 as they pertain to the exercise of Standard & Poor's 100 Stock Index option contracts, American-Style FLEX Index Option contracts, and any other American-style cash-settled index option contracts.

1. Members who prepare their own exercise instruction memoranda must prepare and time stamp such memoranda upon making the decision to exercise.

2. Clearing firms must prepare and time stamp an exercise instruction memorandum upon receipt of instructions to exercise from a customer or market-maker or upon making the decision to exercise on behalf of a proprietary account.

3. An "exercise advice" must be submitted to the Exchange no later than 3:20 p.m. (CT) for all American-style, cash-settled index option contracts exercised. However, "exercise advices" are not required to be submitted to the Exchange (i) on the business day prior to expiration with respect to expiring non-FLEX American-style, cash-settled index option contracts, (ii) on the day of expiration with respect to expiring FLEX American-style cash-settled index option contracts that expire on a business day, or (iii) on the business days prior to expiration with respect to expiring FLEX American-style, cash-settled index option contracts that expire on a day other than a business day.

4. An "exercise advice" must be clearly and accurately completed prior to submission. Staff will not remove an

"exercise advice" for any alteration once it has been deposited in a drop-off box.

5. Clearing firms may enter exercises for any market-maker, customer, or proprietary account on OCC's Clearing Management and Control System (C/MACS) in lieu of physically delivering an "exercise advice" to the Exchange trading floor. Such entries must be made no later than 3:20 p.m. (CT) and serve as both an exercise instruction to OCC and an "exercise advice" to the Exchange.

6. Members acting on their own behalf or on behalf of a customer may only submit an "exercise advice" and exercise instruction for the "net long position" open in any series of American-style index options for the account at the time the advice or instruction is submitted. For a complete explanation of this requirement, members should refer to Exchange Rule 24.18 and to Exchange Regulatory Circular RG96-94.

7. If a member decides not to exercise all or part of the amount indicated on an "exercise advice" previously submitted to the Exchange, he or she must submit another "exercise advice" to the Exchange, with the cancel box checked, no later than 3:20 p.m. (CT). ("Exercise advice cancellations" do not cancel exercise instruction memoranda already submitted to the clearing firm).

8. The "exercise advice" drop-off boxes are located on the Exchange's trading floor adjacent to the OEX trading crowd. The drop-off boxes are removed at 3:20:59 p.m. (CT). Submitting an "exercise advice" or "exercise advice cancellation" after this time is a violation of Exchange Rule 11.1, and doing so on the basis of material information released after this time, in addition to violating Rule 11.1, may constitute activity inconsistent with just and equitable principles of trade. If a member inadvertently fails to submit an "exercise advice" or "exercise advice cancellation" before the applicable deadline, the member should still consider submitting the advice or cancellation to the Exchange's Department of Market Regulation as soon as possible after the deadline (even though a violation of Rule 11.1 will still exist) in order to help to establish the time at which the exercise decision was made.

9. The joint account participant who makes the decision to exercise on behalf of the joint account must indicate both the joint account acronym and his or her individual acronym on both the exercise instruction memorandum and the "exercise advice".

10. The submission of an "exercise advice" to the Exchange does not initiate an exercise at OCC; members must also submit an exercise instruction memorandum to their clearing firm.

11. In the event that any of the following market conditions are declared, the below provisions will apply (including C/MACS entries): [Delayed Opening other than on the Last Business Day Prior to Expiration: The "exercise advice" drop-off boxes will not be placed in the designated areas until trading commences. Exercises may not be effected, nor will "exercise advices" be accepted until trading commences.]

Delayed Opening or Trading Halt [other than on the Last Business Day Prior to Expiration]: *Exercises of American-style, cash-settled index options (and the submission of corresponding "exercise advice" and "advice cancel" forms) shall be prohibited during any time when trading in such options is delayed, halted, or suspended, subject to the following exceptions:*

(i) *The exercise of an American-style, cash-settled index option may be processed and given effect in accordance with and subject to the rules of the Clearing Corporation while trading in the option is delayed, halted, or suspended if it can be documented, in a form prescribed by the Exchange, that the decision to exercise the option was made during allowable time frames prior to the delay, halt, or suspension. Acceptable documentation shall ordinarily be limited to an "exercise advice" previously transmitted to via C/MACS or a member's copy of an "exercise advice" previously submitted to the Exchange.**

(ii) *Exercises of expiring American-style, cash-settled index options shall not be prohibited on the last business day prior to their expiration.**

(iii) *Exercises of American-style, cash-settled index options shall not be prohibited during a trading halt that occurs at or after 3:00 p.m. (CT). In the event of such a trading halt, exercises may occur through 3:20 p.m. (CT). In addition, if trading resumes following such a trading halt (such as by closing rotation), exercises may occur during the resumption of trading and for five (5) minutes after the close of the resumption of trading. The provisions of this subparagraph (iii) are subject to the authority of the Board to impose restrictions on transactions and exercises pursuant to Rule 4.16(a).*

(iv) *The President or his designee may determine to permit the exercise of American-style, cash-settled index*

options while trading in such options is delayed, halted, or suspended.*

In general, such a determination would be based on extraordinary circumstances.

To the extent that exercises of American-style, cash-settled index options are not permitted due to a delayed opening, the "exercise advice" drop-off boxes will not be placed in the designated areas until trading commences. Exercises may not be effected, nor will "exercise advices" be accepted until trading commences. Exercises may not be effected, nor will "exercise advices" be accepted until trading commences.

To the extent that exercises of American-style, cash-settled index options are not permitted due to a trading halt, the "exercise advice" drop-off boxes will be immediately removed from the designated areas upon the declaration of the trading halt and will be returned to the designated areas upon the resumption of trading. [Exercises may not be effected, nor will "exercises advices" be accepted during a trading halt.] These restrictions shall remain in place until trading resumes.

[Notwithstanding both of the above, an exercise may be processed and given effect in accordance with and subject to OCC rules if it can be documented that the decision to exercise was made during allowable time frames prior to the delayed opening or trading halt. Acceptable documentation shall ordinarily be limited to an "exercise advice" previously transmitted via C/MACS, an internal exercise memorandum previously prepared and time-stamped by a member, or a member's copy of an "exercise advice" previously submitted to the Exchange.]

[Modified Trading Hours: The "exercise advice" drop-off boxes will be removed five minutes after the designated closing time in the event that trading hours are modified. Exercises may not be effected, nor will "exercise advices" be accepted after such time.]*

Closing Rotation: The "exercise advice" drop-off boxes will remain at the designated areas and "exercise advices" will be accepted until five minutes after the completion of the closing rotation.

Modified Trading Hours: If trading hours are extended or modified, the exercise deadline will be five minutes after the close of trading on that day instead of 3:20 p.m. (CT). The "exercise advice" drop-off boxes will be removed after the modified exercise deadline, and exercises may not be effected, nor will "exercise advices" be accepted, after such time.

FLEX Index Options: In the case of an American-style, cash-settled FLEX Index Option, the references in this Paragraph 11 to a trading delay, halt, suspension, resumption, closing rotation, or modified trading hours shall mean the occurrence of the applicable condition in the standardized option on the index underlying the FLEX Index Option (rather than the occurrence of the applicable condition in the FLEX Index Option itself).

12. The President or his designee may determine to extend the applicable deadline for the delivery of "exercise advice" and "advice cancel" notifications if unusual circumstances are present.

Any questions pertaining to index option exercises can be addressed to Karen Charleston at (312) 786-7724 or Pat Cerny at (312) 786-7722.

(Regulatory Circulars RG89-13, RG92-02, RG94-61, [and] RG96-95, and RG 98-90 Revised)

* With the exception of some wording changes, these provisions are currently generally set forth in Rule 4.16(b) and Rule 11.1.05 (which is now proposed to be moved to proposed Rule 11.1.03(h)) and are not newly proposed provisions, except that acceptable documentation under Section 11(i) of the Exercise Regulatory Circular is proposed to no longer include internal exercise memoranda.

** The provision regarding modified trading hours is proposed to be moved to after the provision regarding closing rotations and to be reworded without changing its substance.

[FR Doc. 99-13811 Filed 5-28-99; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41437; File No. SR-DTC-99-03]

Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Implementing the Pending Transfer Account

May 21, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on March 3, 1999, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared primarily by DTC. The Commission is

publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The purpose of the proposed rule change is to implement a pending transfer account to facilitate the use of collateral in financing transactions.

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

In its filing with the Commission, DTC 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. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.²

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

DTC subjects deliveries and pledges to DTC's risk management controls.³ A delivery or pledge of securities is pending and not completed if the securities are then serving as collateral to secure the obligations of the delivering or pledging participant to DTC. Also, a free delivery or pledge is pending if the securities are money market instruments and were received by the delivering or pledging participant on that day in a valued delivery. The risk management controls remain in effect, and the pending delivery or pledge is recycled until daily money settlement is completed at DTC, which usually occurs at approximately 5:00 p.m. (eastern time). Prior to daily money settlement, a pending delivery or pledge (other than a free delivery or pledge of money market instruments received on that day in a valued delivery) will be completed if the participant subsequently has other collateral available to support the participant's obligations to DTC.

In financing transactions, a lender or tri-party agent often performs an evaluation of the collateral to insure that the collateral meets certain criteria. A tri-party agent acting on behalf of

² The Commission has modified the text of the summaries prepared by DTC.

³ DTC's risk management controls are a set of procedures designed to protect DTC against the loss that may result from a participant failure.

¹ 15 U.S.C. 78s(b)(1).