

forth in clauses (i), (ii) or (iii) of paragraph [(d)](f) of Rule 980, the member or member organization shall maintain a memorandum setting forth the circumstances regarding such exception and shall file a copy of the memorandum with the Exchange's Market Surveillance Department no later than 12 noon on the first business day following the respective expiration.

.07 [.03] The filing of a Contrary Exercise Advice required by this rule does not serve to substitute as the effective notice to OCC for the exercise or non-exercise of expiring options.

\* \* \* \* \*

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

In its filing with the Commission, the Amex included statements concerning the purpose of and basis for the proposed rule change, as amended, and discussed any comments it received on the proposed rule change, as amended. The text of these statements may be examined at the places specified in Item IV below. The Amex 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**

The Options Clearing Corporation ("OCC"), the issuer of all Amex-traded options contracts, has an established procedure for options holders wishing to exercise in-the-money options<sup>8</sup> before they expire. Known as Ex-by-Ex, the procedure provides for the automatic exercise at expiration of any equity option contract that is  $\frac{3}{4}$  of a point or more in-the-money for customer accounts or  $\frac{1}{4}$  point or more in-the-money for any other accounts.<sup>9</sup> Option holders who wish to have their contracts exercised in accordance with the Ex-by-Ex procedure need to take no further action; those contracts that are in-the-money by the appropriate amount will be automatically exercised. Option holders who do not wish to have their options automatically exercised or who wish their options to be exercised under different parameters than the Ex-by-Ex

procedure, must file a CEA with the Exchange pursuant to Amex rule 980, and instruct OCC of their "contrary" intention.<sup>10</sup> The rule is designed to deter individuals from taking improper advantage of late-breaking news by requiring evidence of an option holder's intention to exercise or not exercise expiring equity options via the submission of a CEA. Members and member organizations satisfy the filing requirement by manually submitting a CEA form or by electronically submitting the CEA through OCC's Clearing Management and Control System (C/MACS).

The principal goal of Amex rule 980 is to maintain a level playing field between persons holding long and short positions in expiring equity options. The Amex believes that after trading has ended on the final trading day before expiration, persons who are short the option have no way to close out their short position. To put option holders on equal footing, Amex Rule 980 attempts to keep to a minimum the time period in which a holder can exercise the option after the close of trading on the last business day prior to expiration, generally known as "Expiration Friday."<sup>11</sup>

The current exercise cut-off time for an option holder to decide whether or not to exercise is 5:30 p.m. (NY time) on the business day immediately prior to the expiration date.<sup>12</sup> Under the proposal, the exercise cut-off time set forth in amended Amex Rule 980(c) will not change except in cases of a modified trading session or due to "unusual circumstances." Current Amex rule 980 imposes a uniform 5:30 p.m. cut-off time for the submission of CEAs for all accounts without differentiating between customer and non-customer accounts.

The proposed rule change was prompted by concerns expressed by clearing firms that the deadline for submitting CEAs is problematic for customer accounts,<sup>13</sup> due to the

logistical difficulties of receiving customer exercise instructions and processing them through their retail branch systems and back office areas before submitting them to the Exchange. Therefore, the Exchange proposes to adopt a cut-off time of 6:30 p.m. (NY time) for members and member organizations to submit CEAs for customer accounts. In response to concerns expressed by commenters, the Exchange also proposes to allow members and member organizations to submit CEAs for non-customer accounts<sup>14</sup> by 6:30 p.m. (NY time) provided such member or member organization employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. In those cases where members or member organizations do not employ an electronic submission procedure for the submission of exercise instructions, CEAs for non-customer accounts must be submitted to the Exchange by 5:30 p.m. (NY time). The different CEA submission deadlines are set forth in amended Amex Rule 980(c) and new Commentary .04.

Although most firms have electronic submission procedures, the Exchange is concerned that those firms that manually submit CEAs could have an opportunity to improperly extend the 5:30 p.m. (NY time) deadline to exercise or not exercise an option if *all* non-customer accounts were subject to the 6:30 p.m. (NY time) deadline for the submission of CEAs. This concern on the part of the Exchange is based on the difficulty in monitoring a manual procedure that has different times for deciding whether or not to exercise the option and for the submission of the CEA.

Accordingly, in the case of non-customer accounts, the Exchange has proposed to limit the 6:30 p.m. (NY time) deadline for submitting CEAs to those member firms that have an electronic submission procedure for deciding whether to exercise or not exercise an option. In connection with the use of an electronic submission procedure by member firms, the Exchange proposes the addition of new Commentary .05 that requires members and member organizations employing electronic submissions to establish procedures to secure time stamps in connection with their electronic systems employed for the recording of

<sup>10</sup> A CEA may be canceled by filing an "Advice Cancel" with the Exchange at any time up to the submission cut-off deadline specified in proposed amended Amex Rule 980(c).

<sup>11</sup> "Expiration Friday" is generally the last business day prior to the expiration of an option contract.

<sup>12</sup> The "expiration date" of an options contract generally is the Saturday immediately following the third Friday of the expiration month of such option. See OCC By-Laws Article I (E)(k).

<sup>13</sup> A "customer account" is defined in OCC By-Laws Article I (C)(25) as an account of a Clearing Member which is confined to Exchange transactions cleared and positions carried by the Clearing Member on behalf of its securities customers, other than those transactions of market-makers which are cleared through a market-makers account. OCC By-Laws define a "securities customer" as a person

<sup>8</sup> "In-the-money" for a call option occurs if the current market value of the underlying security is above the exercise price of the option. For put options, "in-the-money" means the current value of the underlying security is below the exercise price of the option.

<sup>9</sup> See OCC Rule 805(d).

having a securities account at a broker or dealer other than a non-customer of such broker or dealer. See OCC By-Laws Article I (S)(1).

<sup>14</sup> A "non-customer account" generally means a person that is not a customer of a broker or dealer defined in Rule 8c-1 and 15c2-1 under the Act. See OCC By-Laws Article I (N)(2).