

Amex responded to the issues raised in the comment letters in Amendment No. 2, which Amex filed with the Commission on June 19, 2002.<sup>6</sup> On March 6, 2003, Amex submitted Amendment No. 3 to the proposal.<sup>7</sup> Amendment No. 3 was published for comment in the **Federal Register** on March 26, 2003.<sup>8</sup> The Commission received no comments regarding Amendment No. 3. On April 29, 2003, Amex submitted Amendment No. 4.<sup>9</sup> This order approves the proposed rule change, as amended.

## II. Description of the Proposed Rule Change

The Options Clearing Corporation ("OCC") has an established procedure that provides for the automatic exercise of certain options that are in-the-money by a specified amount known as Exercise-by-Exception or "Ex-by-Ex." 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 want their options automatically exercised or who want their options to be exercised under parameters different than the Ex-by-Ex parameters must file a CEA<sup>10</sup> with the Exchange pursuant to Amex Rule 980 and instruct OCC of their contrary intention.<sup>11</sup>

In its Original Proposal, Amex proposed to amend Amex Rule 980 to simplify the manner in which a CEA is

submitted to the Exchange and extend by one hour the cut-off time for members to submit customer CEAs and Advice Cancels to the Exchange. Specifically, Amex proposed to: (1) Eliminate the requirement that a CEA be submitted if the option holder does not want to exercise an option when OCC has waived its Ex-by-Ex procedure for that options class;<sup>12</sup> (2) extend the cut-off time for members to deliver CEAs and Advice Cancels for customer accounts to the Exchange by one hour (from 5:30 p.m. to 6:30 p.m. (EST)); (3) extend the time for making a final decision whether to exercise an expiring option and submit the CEA or Advice Cancel when the Exchange announces a modified time for the close of trading in equity options to 1 hour and 28 minutes after the announced close of trading for accounts of members and member firms, and establish a time period of 1 hour and 28 minutes following the time announced for the close of trading for customers to make a final decision on whether to exercise an expiring option, but a time period of 2 hours and 28 minutes after the close of trading instead of the current 6:30 p.m. to deliver a CEA or Advice Cancel to the Exchange; and (4) provide the Exchange with the ability to establish different exercise cut-off times on a case-by-case basis to address unusual circumstances.

## III. Summary of Comments and Amex's Response

The Commission received four comment letters regarding the Original Proposal.<sup>13</sup> Amex filed Amendment Nos. 2 and 3 to address the issues raised by the commenters.<sup>14</sup>

One commenter specifically expressed support for the Exchange's proposal to eliminate the requirement that a CEA be submitted if the holder does not want to exercise the option when OCC has waived its Ex-by-Ex procedure for that options class. The commenter stated that "it makes sense to only require members to submit exercise notices for option positions they affirmatively want to exercise."<sup>15</sup>

Two commenters also supported the Exchange's proposal to extend the cut-off time for members to deliver CEAs for customer accounts to the Exchange by one hour (from 5:30 p.m. to 6:30 p.m.

(EST)).<sup>16</sup> However, they expressed concern that extending the cut-off time for customer accounts only and not firm accounts would increase processing burden<sup>17</sup> and create operational inefficiencies.<sup>18</sup> The commenters believed that the proposal would burden them with the process of having to separate firm and customer exercise notices into two batches in order to avail themselves of the extra hour given to deliver notices for customer accounts.

The Exchange responded to these comments by explaining that the Original Proposal was prompted by concerns expressed by clearing firms that the current 5:30 p.m. (EST) cut-off time was problematic for customer accounts 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.<sup>19</sup> The proposal had originally retained the 5:30 p.m. (EST) deadline for submission of CEAs for firm proprietary accounts because proprietary accounts did not present the same logistical difficulties as customer accounts. However, because the commenters stated that it would be operationally burdensome to develop different CEA processes for customer and firm accounts, Amex revised the proposal to adopt a single extended deadline of 6:30 p.m. (EST) for submission of CEAs for all accounts. The proposal to extend the deadline to 6:30 p.m. (EST) for firm accounts only applies to those member firms that have an electronic submission procedure that records the time that decisions whether to exercise or not exercise an option are received by the firm. The Exchange explicitly outlined the different CEA submission deadlines for non-customer accounts, in proposed Commentary .04, depending on the manner of the decision whether to exercise or not exercise, and required, in proposed Commentary .05, that each member organization establish fixed procedures to ensure that the time stamps used for the recording of the time of receipt of exercise decisions are secure.

Three commenters addressed Amex's Original Proposal to change the time period for members and member firms and customers to make a final decision and deliver the CEA or Advice Cancel when the Exchange announces a modified time for the close of trading in

Director and Counsel, Morgan Stanley, dated February 11, 2002 ("Morgan Stanley Letter"); and Mark Straubel, Assistant Vice President, Pershing, dated February 5, 2002 ("Pershing Letter").

<sup>6</sup> See letter (with exhibit) from Jeffrey P. Burns, Assistant General Counsel, Amex, to Nancy Sanow, Assistant Director, Division, Commission, dated June 18, 2002 ("Amendment No. 2"). The exhibit to Amendment No. 2 set forth proposed rule text, which was subsequently replaced by Amendment No. 3.

<sup>7</sup> See letter from Jeffrey P. Burns, Assistant General Counsel, Amex, to Nancy Sanow, Assistant Director, Division, Commission, dated March 5, 2003, replacing Form 19b-4 in its entirety ("Amendment No. 3").

<sup>8</sup> See Securities Exchange Act Release No. 47540 (March 19, 2003), 68 FR 14717.

<sup>9</sup> See letter from Jeffrey P. Burns, Assistant General Counsel, Amex, to Cyndi Rodriguez, Special Counsel, Division, Commission, dated April 28, 2003 ("Amendment No. 4"). In Amendment No. 4, Amex added rule text to proposed Amex Rule 980(d) that was included in Amendment No. 1 but inadvertently deleted in Amendment No. 3. This was initially subject to notice and comment in the Original Proposal.

<sup>10</sup> A CEA is a communication either to not exercise an option that would be automatically exercised under OCC's Ex-by-Ex procedure, or to exercise an option that would not be automatically exercised under OCC's Ex-by-Ex procedure.

<sup>11</sup> Amex Rule 980 also applies to the submission of Advice Cancels, which cancel CEAs.

<sup>12</sup> Currently, when OCC waives its Ex-by-Ex procedure for an options class, Amex Rule 980 requires the submission of a CEA evidencing the intention to exercise or not exercise.

<sup>13</sup> See *supra* note 5.

<sup>14</sup> See Amendment Nos. 2 and 3, *supra* notes 6 and 7.

<sup>15</sup> See Morgan Stanley Letter.

<sup>16</sup> See Goldman Sachs Letter and Morgan Stanley Letter.

<sup>17</sup> See Goldman Sachs Letter.

<sup>18</sup> See Morgan Stanley Letter.

<sup>19</sup> See Amendment No. 2, *supra* note 6.