

Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the ISE. The Exchange amended its proposal on September 9, 2003.<sup>3</sup> The Exchange filed the proposed rule change, as amended, under paragraph (f)(6) of Rule 19b-4 under the Act.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend ISE Rule 1100: (i) To simplify the manner in which a contrary exercise advice ("CEA") is submitted to the Exchange;<sup>5</sup> (ii) to extend by one hour the cut-off time for Members to submit CEAs to the Exchange; and (iii) to add new paragraphs (g) and (h) for the purpose of establishing different cut-off times for options holders to decide whether to exercise or not exercise an expiring option and for members to submit CEAs based on a modified trading session or due to "unusual circumstances." Below is the text of the proposed rule change, as amended. Proposed new language is *italicized*; proposed deleted text is [bracketed].

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#### Rule 1100. Exercise of Options Contracts

(a) Subject to the restrictions set forth in Rule 413 (Exercise Limits) and to such restrictions as may be imposed pursuant to Rule 417 (Other Restrictions on Options Transactions and Exercises) or pursuant to the Rules of the Clearing Corporation, an outstanding options contract may be exercised during the time period specified in the Rules of the Clearing Corporation by the tender to the Clearing Corporation of an exercise notice in accordance with the Rules of the Clearing Corporation. An exercise notice may be tendered to the Clearing Corporation only by the Clearing Member in whose account such options contract is carried with the Clearing Corporation. *Members may establish fixed procedures as to the latest time*

*they will accept exercise instructions from customers.*

[(b) The exercise cut-off time for all noncash-settled options shall be 5:30 p.m. Eastern Time on the business day immediately prior to the expiration date. This is the latest time at which an exercise instruction for expiring noncash-settled options positions may be:

(1) prepared by a Clearing Member for positions in its proprietary trading account;

(2) submitted to a Clearing Member by a market maker or broker for positions in the market maker's account or the broker's error account; or

(3) accepted by a Member from any customer for its positions in the customer's account.]

*(b) Special procedures apply to the exercise of equity options on the last business day before their expiration ("expiring options"). Unless waived by the Clearing Corporation, expiring options are subject to the Exercise-by-Exception ("Ex-by-Ex") procedure under Clearing Corporation Rule 805. This Rule provides that, unless contrary instructions are given, option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to the Rules of the Clearing Corporation, the following Exchange requirements apply with respect to expiring options. Option holders desiring to exercise or not exercise expiring options must either:*

*(1) take no action and allow exercise determinations to be made in accordance with the Clearing Corporation's Ex-by-Ex procedure where applicable; or*

*(2) submit a "Contrary Exercise Advice" to the Exchange by the deadline specified in paragraph (c) below. A Contrary Exercise Advice is a communication either: (A) to not exercise an option that would be automatically exercised under the Clearing Corporation's Ex-by-Ex procedure, or (B) to exercise an option that would not be automatically exercised under the Clearing Corporation's Ex-by-Ex procedure. A Contrary Exercise Advice may be submitted by a Member by using the Exchange's Contrary Exercise Advice Form, the Clearing Corporation's ENCORE system, a Contrary Exercise Advice form of any other national securities exchange of which the firm is a member and where the option is listed, or such other method as the Exchange may prescribe. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" with the Exchange or resubmitted at any time up*

*to the submission cut-off times specified below.*

*(c) Exercise cut-off time. Option holders have until 5:30 p.m. Eastern Time on the business day immediately prior to the expiration date to make a final decision to exercise or not exercise an expiring option. For customer accounts, Members may not accept exercise instructions after 5:30 p.m. Eastern Time but have until 6:30 p.m. Eastern Time to submit a Contrary Exercise Advice. For non-customer accounts, Members may not accept exercise instructions after 5:30 p.m. Eastern Time but have until 6:30 p.m. Eastern Time to submit a Contrary Exercise Advice if such Member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Consistent with Supplemental Material .03, Members are required to submit a Contrary Exercise Advice by 5:30 p.m. for non-customer accounts if such Members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders.*

*(d) If the Clearing Corporation has waived the Ex-by-Ex procedure for an options class, Members must either:*

*(1) submit to the Exchange, a Contrary Exercise Advice, in a manner specified by the Exchange, within the time limits specified in paragraph (c) above if the holder intends to exercise the option; or*

*(2) take no action and allow the option to expire without being exercised.*

*In cases where the Ex-by-Ex procedure has been waived, the Rules of the Clearing Corporation require that Members wishing to exercise such options must submit an affirmative Exercise Notice to the Clearing Corporation, whether or not a Contrary Exercise Advice has been filed with the Exchange.*

*(e) A Member that has accepted the responsibility to indicate final exercise decisions on behalf of another Member or non-member broker-dealer shall take the necessary steps to ensure that such decisions are properly indicated to the Exchange. Such Member may establish a processing cut-off time prior to the Exchange's exercise cut-off time at which it will no longer accept final exercise decisions in expiring options from option holders for whom it indicates final exercise decisions. Each Member that indicates final exercise decisions through another broker-dealer is responsible for ensuring that final exercise decisions for all of its proprietary (including market maker) and public customer account positions*

<sup>3</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated September 6, 2003 ("Amendment No. 1"). In Amendment No. 1, the ISE added footnotes to clarify terminology used in its discussion and made technical corrections to its rule text.

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> The term CEA as used in the filing may also include "Advice Cancels." Advice Cancels are documents used to cancel CEAs. See Amendment No. 1, *supra* note 3.