

but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Exchange.

Supplemental Material to Rule 1100

.01 For purposes of this Rule 1100, the terms “customer account” and “non-customer account” have the same meaning as defined in the Clearing Corporation By-Laws Article I(C)(28) and Article I(N)(2), respectively.

.02 Each Member shall prepare a memorandum of every exercise instruction received showing the time when such instruction was so received. Such memoranda shall be subject to the requirements of SEC Rule 17a-4(b).

.03 Although the deadline for all option holders to make a final decision to exercise or not exercise is 5:30 p.m. Eastern Time, the deadline for the submission of the Contrary Exercise Advice in the case of non-customer accounts will depend on the manner of the decision to exercise or not exercise.

(i) For electronic time stamp submissions of the exercise decision by non-customer option holders, a Contrary Exercise Advice submitted by Members must be received by the Exchange by 6:30 p.m. Eastern Time.

(ii) For manual submissions of the exercise decision by non-customer option holders, a Contrary Exercise Advice submitted by Members must be received by the Exchange by 5:30 p.m. Eastern Time.

.04 Each Member shall establish fixed procedures to insure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options.

.05 The filing of a Contrary Exercise Advice required by this Rule does not serve to substitute as the effective notice to the Clearing Corporation for the exercise or non-exercise of expiring options.

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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 ISE included statements concerning the purpose of and basis for the proposed rule change 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 Exchange 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 Exchange proposes to simplify the manner in which a CEA is submitted to the Exchange and to extend the cut-off time for submitting CEAs for customer accounts. The Exchange represents that this proposed rule change, as amended, corresponds to an American Stock Exchange LLC (“Amex”) rule change recently approved by the Commission.⁶ The ISE is proposing to modify ISE Rule 1100 to mirror the changes to Amex Rule 980.

The Options Clearing Corporation (“OCC”) has an established procedure, pursuant to OCC Rule 805, known as “Exercise-by-Exception” or “Ex-by-Ex” that provides for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex process, option holders holding option contracts that are in-the-money by a requisite amount and who wish to have their contracts automatically exercised need to take no further action.⁷

However, under OCC Rule 805, option holders who do not want their options automatically exercised or who want their options to be exercised under different parameters than the Ex-by-Ex procedure must file a CEA with the ISE in accordance with ISE Rule 1100 and instruct OCC of their “contrary intention.”⁸ The Exchange states that the rule is designed, in part, 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 satisfy the filing requirement by submitting a CEA form directly to the ISE or by electronically submitting the CEA through OCC's electronic communications system.

The Exchange states that one of the primary goals of ISE Rule 1100 is to maintain a level playing field between holders of long and short positions in

expiring equity options. The ISE 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 positions. To put option holders on equal footing, ISE Rule 1100 attempts to minimize the time period in which a holder can exercise an equity option after the close of trading on the last business day prior to expiration.⁹

The current exercise cut-off time for an option holder to decide whether or not to exercise an equity option is 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior to the expiration date.¹⁰ Under the proposed rule change, the exercise cut-off time established in ISE Rule 1100(c) will not change except in cases of a modified trading session or due to “unusual circumstances.” Current ISE Rule 1100 imposes a uniform 5:30 p.m. ET cut-off time for the submission of CEAs for all accounts without differentiation between customer and non-customer accounts.

The Exchange believes that this proposed rule change is necessary to address a concern that the existing deadline for submitting CEAs is problematic for customer accounts due to logistical difficulties in receiving customer exercise instructions and processing them through retail branch systems and back offices before submitting them to the Exchange.¹¹ Therefore, the Exchange proposes to adopt a cut-off time of 6:30 p.m. ET for Members to submit CEAs for customer accounts. The Exchange also proposes to allow Members to submit CEAs for non-customer accounts by 6:30 p.m. ET provided such Member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders.¹² In

⁹ Expiration, commonly known as “Expiration Friday,” is generally the last business day prior to the expiration of an option contract.

¹⁰ The “expiration date” of an options contract generally is the Saturday immediately following the third Friday of the expiration month of such options. See OCC By-Laws Article I(E)(16). See also Amendment No. 1, *supra* note 3.

¹¹ A “customer account” is defined in OCC By-Laws Article I(C)(28) 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 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). See also Amendment No. 1, *supra* note 3.

¹² 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). See also Amendment No. 1, *supra* note 3.

⁶ See Securities Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (SR-Amex-2001-92).

⁷ “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. See Amendment No. 1, *supra* note 3.

⁸ 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 ISE Rule 1100(c). See Amendment No. 1, *supra* note 3.