

Regulatory Circular RG00-96

DATE: June 14, 2000

TO: Members and Member Organizations

FROM: Regulatory Services Division

SUBJECT: Disclosure of Adjusted Options Series Information to Public Customers

EXCHANGE  
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The purpose of this Regulatory Circular is to address the need for member organizations conducting a non-member customer business that provide quote information and order entry capability electronically to their customers to disclose adjusted option series information before allowing these customers to enter option trades in these adjusted series.

KEY ISSUE

- Member organizations conducting a non-member customer business, who provide quote and option symbol information via computer to their customers, and allow them to electronically enter option orders on an unsolicited basis in an adjusted options series utilizing the option symbols obtained from the member organization's quote screens, must advise their customers of the specifics relating to the adjustment before allowing the entry of the order.
- At a minimum, such member organizations should provide a warning to customers on the electronic order entry screen that adjusted options series may not be identified in the quotation screen, and to refer to other specific sources of information in order to determine the terms of adjusted options series prior to order entry.
- Member organizations should not allow an order to be entered in an adjusted option series which could establish a partially uncovered position in contravention of the strategy level for which the account was approved.
- At a minimum, such member organizations should implement monitoring procedures reasonably designed to detect the existence of uncovered or partially uncovered

options positions in accounts unapproved for uncovered writing in order to correct such positions established in error by customers unaware of the non-standard terms of the adjusted series.

## DISCUSSION

With the increased popularity of public customers entering option trades on an unsolicited basis electronically via computer, the CBOE considers it vital to the integrity of the options marketplace and protection of customers that member organizations who provide electronic option symbol and quote information as well as electronic option order entry capability properly divulge relevant adjusted series information to their customers before accepting these orders over their systems.

Mergers or stock splits result in changes to different series symbol identifiers. In many of these instances, the adjustment to the option series will impact either the option multiplier or the number of shares required to be delivered upon exercise and assignment plus cash in lieu. In some adjustment situations, a new option series may be established that is identical in strike price to a pre-adjusted option series. The lack of disclosure concerning the factors that led to an option series adjustment may cause some customers to inadvertently open an option position in a series they had actually intended to close. In addition, some customers may be intent on opening a covered write position or establishing a spread position; however, due to the terms of the adjusted series, a portion of the position may not be fully covered. Some supervisory or margin systems are failing to detect these partially uncovered positions in accounts not approved for this level of activity. Therefore, the CBOE believes that it is imperative that member organizations that electronically offer quote and option symbol information to their customers and allow these customers to electronically enter option orders on an unsolicited basis in an adjusted option series utilizing option symbols obtained from the member organization's quote screen, must provide adequate disclosure of the factors affecting the terms of the adjusted option series to its customers on its electronic order entry systems before a customer may be allowed to enter a trade in an adjusted option series. Such disclosure should be specific as to the reason for the adjustment and the factors effecting the option multiplier and number of shares to be delivered upon exercise or assignment. As an alternative, an electronic notice to require the customer to contact a person within the organization for further details concerning the adjustment and to enter the order manually would be adequate.

The Exchange requests that member organizations review their policies and procedures relating to the disclosure of adjusted series information to their customers and to implement changes, if necessary, to satisfy this disclosure requirement. Failure to comply with the disclosure requirement may result in Exchange disciplinary proceedings and be deemed a violation of Exchange Rule 4.1 - Just and Equitable Principles of Trade.

The Exchange also requests that member organizations review their policies and procedures for the surveillance of option trading in adjusted option series of non-member customer accounts, and to take steps, if necessary, to identify those accounts that are trading beyond the scope of the account's approved strategy level. Inadequate procedures to detect out-of-level trading in adjusted options may result in Exchange disciplinary proceedings and be deemed a violation of Exchange Rules 4.2 - Adherence to Law and 9.8 - Supervision of Accounts.

*Questions concerning this Regulatory Circular should be directed to Barry J. Szurgot at (312) 786-7756 or David Carlson at (312) 786-7052 in the Department of Financial and Sales Practice Compliance.*