

Regulatory Circular RG98-84

Date: August 11, 1998

To: Members and Member Organizations

From: American Stock Exchange  
Chicago Board Options Exchange  
Pacific Exchange  
Philadelphia Stock Exchange  
The Options Clearing Corporation

Re: Exercises During Volatile Market Conditions

This memorandum is being issued to remind members and member organizations of the exercise procedures and possible restrictions on exercises which may be instituted during a trading halt including a "circuit breaker" trading halt initiated in response to extraordinary market conditions. It should be noted that the information contained in this circular is similar to information previously published in a memo from the Exchanges issued on January 14, 1991. Please also refer to the Exchanges' and The Options Clearing Corporation (OCC) rules and to the options disclosure booklet entitled Characteristics and Risks of Standardized Options.

**Cash Settled Index Option Exercises (American Style Exercise)<sup>1</sup>**

Since exercising a cash settled index option is viewed as taking market action, the Exchanges intend to prohibit exercises of cash settled index option contracts during any time when trading in such options is delayed, halted or suspended.<sup>2</sup> These restrictions will remain in effect until regular trading resumes. In addition, the "five minute window" for the submission of exercise advices, normally in place following the close of trading on a non-halt trading day, will not be in effect during a trading halt.

It will still be possible, as a technical matter, for OCC clearing members to submit exercise notices to OCC via C/MACS during trading halts. OCC will process and give effect to any exercise notices submitted in accordance with its rules, including exercise notices submitted during trading halts. However, an Exchange member that submits an exercise notice to OCC during a trading halt, or causes an exercise notice to be submitted to OCC during a trading halt, will be deemed to have violated Exchange rules except where it can be documented that the decision to exercise was made during allowable time frames prior to the trading halt. Acceptable documentation shall ordinarily be limited to an "exercise advice" submitted prior to the trading halt via C/MACS, an internal exercise instruction memorandum prepared and time-stamped by a member prior to the halt or a member's copy of an "exercise advice" previously submitted to the appropriate Exchange.

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<sup>1</sup> References in this memorandum to index options also apply to FLEX index option contracts.

<sup>2</sup> Exercises in expiring index option series on the last business day prior to expiration are not subject to any exercise restrictions that are imposed due to a trading halt.

## **Index Option Exercise Settlement Value**

The index option exercise settlement value is the current index value as calculated by the reporting authority therefor, subject to and in accordance with Exchange and OCC rules. In the event a trading halt is in place in the primary market of all or a substantial portion of the component underlying stocks, the current index value ordinarily will be the last reported index value. Exercises effected on a day when a trading halt is in effect at the close of trading will be settled on the basis of the current index level value, determined as provided in the preceding sentence.

## **Equity Options**

While the Exchanges retain the authority to restrict exercises in equity options at any time up until ten business days prior to expiration, the Exchanges currently do not plan on restricting exercise of equity option contracts during a suspension, delay or halt in trading.

## **Exercise by Exception**

Unless otherwise advised, it is expected that the Exercise by Exception (ex-by-ex) process will be utilized by OCC at expiration for expiring contracts, even in the event that a trading halt is in effect at the close of trading. The ex-by-ex report, which identifies in the money options based on the "closing price" in the underlying security, requires a review by member firms and the determination of a customer's intent to exercise. Normally, the last available stock price will be considered the "closing price" as a reference for the processing of expiring option contracts even if a trading halt is in place and without regard to market trends before that trading halt. Based on the foregoing circumstances, member firms should carefully review the exercise instructions they received from their customers and determine whether to exercise any or all of the options listed on the ex-by-ex report and whether additional options should be exercise pursuant to OCC's rules.

Members are also reminded that the procedures for submitting Contrary Exercise Advices (CEAs) will remain in full force and effect. These procedures require that all exercise decisions with respect to expiring equity option contracts be communicated to the appropriate Exchange no later than 4:30 p.m. (CT) on expiration Friday.

Questions concerning this memorandum can be directed to the individuals listed below:

American Stock Exchange: Jim Alaimo (212) 306-1540

Chicago Board Options Exchange: Pat Cerny (312) 786-7722

Pacific Exchange: Jim Sampson (415) 393-7952

Philadelphia Stock Exchange: Amy Kitzen (215) 496-5378

Options Clearing Corporation: Jim Yong (312) 322-4451

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