

Regulatory Circular RG99-84

Date: April 5, 1999

To: Members

From: Department of Market Regulation

Re: Rule 24.18 - Exercise of OEX Options

KEY POINTS TO REMEMBER

- **GROSS EXERCISE OF OEX OPTIONS IS PROHIBITED.**
- **Only exercise of the “net long position” in any OEX series is permissible at the time of exercise.**
- **Purchase transactions identified as “opening” may not be adjusted to “closing” except to remedy mistakes.**
- **OCC procedures remain the same.**
- **OEX market-makers may advise the Exchange that “ALL” contracts of a series are to be exercised. But, the market-maker must also instruct the clearing firm of the actual net long position to be exercised.**

SUMMARY OF RULE 24.18

BASIC RULE

According to Rule 24.18 members acting on their own behalf or on behalf of a customer can not exercise OEX index options series, if they know or have reason to know that the exercise is for more than the “net long position” of that series in the account. The rule was proposed and adopted by the Exchange’s Board in order to eliminate the perceived risk to writers from the holder’s ability, under the rules of the Options Clearing Corporation (“OCC”), to exercise options that had been the subject of closing transactions. Although applicable to all American-style index options, **this rule currently applies only to OEX options.**

A “net long position” is defined as the net options position of the account of a given series at the opening of

business on the day of exercise, plus the total number of opening purchases less the total number of such options closed in sale transactions up to the time of exercise.¹ Members are also prohibited from adjusting the designation of an “opening transaction” to a “closing transaction” except to remedy mistakes or errors made in good faith.

NETTING OF MARKET-MAKER TRANSACTIONS

For the purpose of applying this rule, every market-maker transaction will be treated as a closing transaction to the extent the market-maker has pre-existing positions (including positions resulting from transactions effected earlier that day) which could be netted against the transaction. For example, a market-maker is long 10 option contracts of a series and sells 15 contracts of that series, the sale will be deemed to be a closing sale transaction for 10 contracts and an opening sale transaction for 5 contracts, resulting in a net short position of 5 contracts. If the market-maker then purchases 20 contracts, the purchase will be deemed a closing purchase for 5 contracts and an opening purchase for 15 contracts resulting in a net long position of 15 contracts. The market-maker would then be permitted to exercise only those 15 contracts pursuant to Rule 24.18.

OCC PROCEDURES UNCHANGED

Finally, it should be noted that this rule is not intended to affect the OCC processing rules and procedures. If a member submits an exercise notice to OCC in violation of the CBOE Rule 24.18, the exercise will be processed by OCC in accordance with its procedures. However, CBOE Rule 24.18 will be enforced through the Exchange’s disciplinary process. Improper adjustments and excess exercises are conduct in violation of Rule 24.18.

MARKET-MAKER EXERCISE ADVICE PROCEDURES

Exercise Advice procedures for OEX options are contained in Regulatory Circular RG98-90. It should be noted that market-makers are permitted to indicate an exercise of “**ALL**” contracts in a given series on an Exercise Advice submitted to the Exchange. However, the market-maker is solely responsible for instructing his or her clearing firm of the exact number of contracts to be exercised. Failure to do so may result in the improper exercise of contracts in excess of the “net long position” in an OEX option series, in contravention of Rule 24.18 or an exercise of contracts inconsistent with the Exercise Advice requirements, a violation of Rule 11.1.

Refer to Regulatory Circular RG99-83, for examples of the application of this rule. Questions pertaining to this matter may be directed to Patricia Cerny at (312) 786-7722 or Karen Charleston at (312) 786-7724.

(RG96-94, revised)

¹In determining the beginning “net long position” for non-market-maker accounts, it is not necessary to net established open long and short positions in the same series maintained for the same account at OCC.