

## REGULATORY INFORMATION BULLETIN – 2000-05

**To:** All Members  
**From:** Kim Neff, Associate Director, Market Surveillance  
**Date:** June 13, 2000  
**Re:** **Contrary Exercise Advice Submission Procedures**

### PURPOSE OF CEA SUBMISSIONS

Surveillance of Contrary Exercise Advice (CEA) submissions has been undertaken by options exchanges to detect for compliance with just and equitable principles of trade. The primary purpose of CEAs is to promote fairness among options market participants by ensuring compliance with the SROs' exercise cut-off rules. A decision to either exercise an option that is out-of-the-money, or not exercise an option that is in-the-money, on the basis of news obtained after the exercise cut-off time will be deemed to be conduct inconsistent with just and equitable principles of trade in violation of ISE Rules 400 and 1100(g), and may also be fraudulent activity in violation of the federal securities laws.

ISE Rule 1100(g) states "Clearing Members must follow the procedures of the Clearing Corporation when exercising expiring noncash-settled equity options contracts. Members must also follow the procedures set forth below with respect to the exercise of noncash-settled equity options contracts which would otherwise not be exercised, or the nonexercise of contracts which otherwise would be exercised, by operation of Clearing Corporation Rule 804:

(1) For all contracts so exercised or not exercised, a "contrary exercise advice," must be delivered by the market maker, broker or clearing firm, as applicable, in such form or manner prescribed by the Exchange no later than 5:30 p.m. Eastern Time.

(2) Subsequent to the delivery of a "contrary exercise advice," should the market maker, broker, customer or firm determine to act other than as reflected on the original advice form, the market maker, broker, or clearing firm, as applicable, must also deliver an "advice cancel," in such form or manner prescribed by the Exchange no later than 5:30 p.m. Eastern Time.

(3) Members shall properly communicate to the Exchange final exercise decisions in respect of positions for which they are responsible.

(4) The preparation, time stamping or submission of a “contrary exercise advise” prior to the purchase of the contracts to be exercised or not exercised shall be deemed a violation of this Rule.

(5) All of the above procedures of this paragraph (g) are in full force and effect whether or not the Clearing Corporation waives the exercise by exception provisions of its Rule 804; in the event of such waiver the procedures of this paragraph shall be followed as if such provisions of Clearing Corporation Rule 804 were in full force and effect. The Clearing Corporation rules may require the submission of an affirmative exercise notice even in circumstances where a contrary exercise advice is not submitted;

(6) The failure of any Member to follow the procedures in this paragraph (g) may result in the assessment of a fine, which may include but is not limited to disgorgement of potential economic gain obtained or loss avoided by the subject exercise, as determined by the Exchange.”

The exercise cut-off rules require that exercise decisions relating to expiring equity options that are contrary to the Options Clearing Corporation’s (OCC) Exercise-by-Exception (Ex-by-Ex) procedure, be made and recorded by clearing firms prior to 5:30 p.m. Eastern Standard Time (“EST”), 4:30 p.m. Central Standard Time (“CST”), or 2:30 p.m. Pacific Standard Time (“PST”) on the last business day prior to expiration (i.e., the exercise cut-off time). New rules established in 1994 required that evidence of such contrary exercise decisions must also be **submitted in the form of a CEA to an eligible options exchange or directly to OCC prior to the cut-off time**. In addition, cancellations or changes to previously CEAs also must be submitted to an eligible exchange or to OCC prior to the cut-off time (please refer to SEC Release No. 34–34806, dated October 7, 1994).

The rules require member organizations that maintain proprietary or customer account positions in expiring equity options to be responsible for ensuring that **CEAs are communicated to an eligible exchange or directly to OCC (by OCC clearing members) regarding such positions**. In addition, member organizations may make arrangements to indicate their final exercise decisions to an OCC clearing member that has accepted the responsibility to submit CEA forms on their behalf. The OCC clearing member shall take reasonable steps to ensure that such decisions are properly submitted to an eligible exchange or directly to OCC.

It should be noted that the responsibility of providing an explanation regarding late submissions or the failure to submit a CEA (under the extraordinary circumstance exception of the rules), is the responsibility of the member or member organization holding the options position, unless that member or member organization has appropriately submitted the instruction to a clearing member that has agreed to make the submission on that member's or member organization's behalf. Explanations relating to extraordinary circumstances must be submitted by members or member organizations to each SRO of which they are a member on the business day following expiration.

It is important to note that, while submission of a CEA evidences that a contrary exercise decision was made prior to the exercise cut-off time, it does not serve as an effective notice to OCC to exercise or not exercise the option in question. The Expiration Saturday procedure for the submission of exercise notices to OCC is not affected by these procedures.

### **CEA SUBMISSIONS**

CEA forms may be submitted to the ISE Market Surveillance Department ("Market Surveillance") via fax at (212) 425-4926 prior to the cutoff time of 5:30 p.m. EST. Market Surveillance will provide, upon request, blank CEA forms by fax.

CEA procedures set by the options exchanges in 1994 allow members the option of submitting the CEA form at the other exchanges where the option class is being traded, as long as the member is a member of the other exchange as well. Therefore, CEAs for ISE members can be submitted at the designated area at any of the other options exchange provided that:

- (1) the ISE member is ALSO a member of the other options exchange.
- (2) the ISE options class is ALSO traded at that exchange. For example, CEA forms regarding WFT options can only be submitted to the CBOE and to the ISE. ISE members cannot submit CEA forms regarding WFT options to the AMEX, PHLX or PCX.
- (3) the CEA form is submitted before the cutoff time corresponding to the options exchange (that is, 5:30 p.m. EST for submission at the AMEX or PHLX, 4:30 p.m. CST for submission at the CBOE or 2:30 p.m. PST for submission at the PCX).

CEAs may be submitted by OCC clearing members directly to OCC via the electronic Clearing Management and Control System (C/MACS) using the OCC's automated C/MACS Contrary Exercise Advice page.

Finally, member organizations that **maintain standing instructions from customers or market makers to routinely exercise options contracts at**

**closing values below the OCC Exercise-by-Exception parameters, will not be required to submit a CEA in those instances where the closing value meets or exceeds the standing instruction.** Member organizations must retain such dated standing instructions on file and **submit copies of the instructions to each options SRO of which they are a member (market-maker standing instructions need only be forwarded to the exchange where the market maker is a member).** Should a customer or member elect to take action on a specific occasion that differs from a standing instruction, a CEA must be submitted in the prescribed form and the member organization must prepare for its files a time-stamped written memorandum prior to the exercise cut-off time detailing the change.

ISE must request all copies of standing instructions be forwarded to Market Surveillance. Members may fax these copies on a continuous basis to Market Surveillance at (212) 425-4926 or mail them to the following address:

Market Surveillance  
International Securities Exchange  
60 Broad Street  
New York, NY 10004

If you have any questions regarding the forgoing, please contact James O. Sampson, Director, Market Surveillance (212-897-0235), or Kim Neff, Associate Director (212-897-8126).