

## Regulatory Circular RG02-46

To: Member Organizations

From: Division of Regulatory Services

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Subject: Time at Which Expiring AM-Settled Index Options  
are Considered Exercised, Assigned or Purged

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### KEY POINTS

- The fact that AM-settled index options technically expire on Saturday does not necessitate that such options be deemed as effective through the close of trading on the business day immediately preceding their Saturday expiration.
- Expiring AM-settled index options effectively cease to exist once the securities that compose the index open for trading on the business day immediately preceding Saturday expiration.
- Expiring AM-settled index options should be considered exercised, assigned or purged at the point the securities that compose the index open for trading on the business day immediately preceding Saturday expiration.

### DISCUSSION

For a typical expiration week,<sup>1</sup> expiring AM-settled (European style) index options cease trading at the close on Thursday. The value of the index for purposes of settling expiring AM settled index options is determined on Friday based upon the opening prices of the securities that compose the index.<sup>2</sup> Expiration occurs on Saturday.

Expiring AM-settled index options carried short are considered assigned on Friday at the point in time the securities that compose the index open for trading, if the options are in-the-money by .01 of a point or more in relation to an index value derived by using the

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<sup>1</sup> "Typical" means the Exchange is not closed on the Thursday or Friday immediately preceding the Saturday of expiration.

<sup>2</sup> CBOE Rule 24.9(a)(4).

opening prices. Such index options effectively convert to a cash debit at Friday's opening since it is the opening prices that render the final index value (or "Exercise Settlement Value") against which the options are compared.<sup>3</sup>

For example, assume the securities that compose an index have opened for trading on the Friday immediately preceding expiration Saturday. Assume that using the opening prices to calculate the Exercise Settlement Value for expiring AM-settled index options produces a value of 1150. Assume that at Friday's opening, an account is short an expiring AM-settled index call option that has an exercise price of 1100 (in-the-money). The account is considered assigned and is debited \$5,000  $[(1150 - 1100) \times 100]$ . The option then ceases to exist.

To further demonstrate the point in time at which expiring AM-settled index options reach a final disposition, consider the case of a protective put strategy. Assume that at Friday's opening, an account is long an expiring AM-settled index put option and long a basket of securities that matches the index composition. The expiring put will not protect against declines in the value of the index once the securities composing the index have opened for trading. The expiring put ceases to have any protective capability because an index value for final settlement purposes is then fixed and will not change, but the market will continue to change. A new long put position would have to be established immediately after the opening of the securities composing the index on Friday, in order to continue protection on the basket of securities carried long.

An equity option ceases to exist on the day that an assignment or exercise is posted to an account, and an expiring AM-settled index option should be viewed no differently. An expiring AM-settled index option is, effectively, assigned or exercised or of no further consequence once the securities composing the index open for trading on the Friday (or business day) immediately preceding Saturday expiration.

In the case of an expiring AM-settled index option carried short and treated as "covered", the writing of a new index option on Friday after the opening to replace the assigned or expiring (out-of-the money) option will not be deemed by the Exchange to constitute an "uncovered" transaction.

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<sup>3</sup> Out-of-the-money options carried short pose no risk and are inconsequential. They cannot become in-the-money options because the Exercise Settlement Value is final. Pursuant to OCC rules, long options are automatically exercised if in-the-money by .01 of a point or more and convert to a cash credit.