The ChicagoBoard Options Exchange

LaSalle at Van Buren
Chicago, Illinois 60605 312 786-5600

Regulatory Circular RG-94-03

DATE: January 12, 1994

TO: Members, Member Firms and Clearing Firms

FROM: Regulatory Services Division
Legal Services Division

RE: Expiration Exercise and Assignment of Expiring Options

The possibility of significant news being disseminated after the close of trading on the last business day before expiration makes it imperative that clearing firms review their expiration exercise procedures in order to avoid improper exercises and possible serious rule violations. Also, all members, member firms and clearing firms are urged to remind their clients of risks associated with holding short expiring options.

Clearing firms are warned in particular not to accept exercise instructions for expiring options after 4:30 p.m. Chicago time (5:30 p.m. Eastern time) on the last business day before expiration for Equity Options and after 5:30 p.m. Chicago Time (6:30 p.m. Eastern) for Index Options which are tendered for the purpose of reacting to late-breaking news.

Members, member firms and clearing firms are strongly urged to advise clients who have positions in expiring options that late-breaking news could affect exercises and assignments. For example, if an underlying security closes on expiration Friday at a price of 58-1/2, an expiring call option with a strike price of 60 normally expires worthless, and a holder of a short position will normally not be assigned. However, if strongly favorable news is released after the close, it is possible that the calls may be exercised, and holders of the short position will have to deliver the stock at a price of 60. Similarly, holders of an expiring short 60-strike put position would normally expect to purchase the stock at a price of 60; however, bullish news may cause short in-the-money puts to not be assigned. Of course, the converse of the foregoing could be true for bearish news.

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As you are aware, Exchange Rule 11.1(b) reads as follows:

> (b) The exercise cutoff time for all Member Organizations shall be 4:30 p.m. Chicago Time on the business day immediately prior to the expiration date. This is the latest time at which an exercise instruction for expiring option positions may be (1) prepared by a clearing Member Organization for positions in its proprietary trading account, (2) accepted by a clearing Member Organization from a Market Maker or Floor Broker for positions in the Market Maker's account or the Floor Broker's error account, (3) accepted by a Member Organization from any customer for positions in the customer's account. Notwithstanding the foregoing, member organizations may receive exercise instructions after the exercise cutoff time but prior to expiration (i) in order to remedy mistakes or errors made in good faith, (ii) to take appropriate action as the result of a failure to reconcile unmatched Exchange transactions, or (iii) where exceptional circumstances relating to a customer's or member's ability to communicate exercise instructions to the Member Organization (or the Member Organization's ability to receive exercise instructions) prior to such cutoff time warrant such action. As used herein with respect to any Member Organization, the word "customer" shall mean every person or organization other than a Market Maker, Floor Broker or the Member Organization itself. The term "exercise instruction" shall encompass, with respect to a customer, a notice that is given to a Member Organization to exercise an option contract. The term "exercise instruction" with respect to a Market Maker, Floor Broker and clearing Member Organization, shall mean a notice either not to exercise an option position, which would otherwise be automatically exercised pursuant to Clearing Corporation Rule 805, or to exercise an option position which would otherwise not be automatically exercised pursuant to Clearing Corporation Rule 805. All exercise instructions must be time stamped at the time they are prepared by the receiving Member Organization.

The term "exercise instruction" includes instructions to cancel previously submitted exercise instructions.

Instances of clearing firms accepting and processing exercise instructions after this cutoff time which do not meet the criteria in phrases (i) through (iii) above, will be vigorously investigated with a view to the taking of formal disciplinary action by the Exchange. **Please be advised that neither the Exchange nor the Options Clearing Corporation accepts any responsibility for any financial harm which may result in connection with a violation of the Rules of the Exchange or the Options Clearing Corporation by their members and member firms, including the provisions of Exchange Rule 11.1(b) quoted above.**

These issues were previously addressed in CBOE Circular 88-48 dated November 10, 1988. Questions regarding this memorandum may be directed to Barbara J. Casey at (312) 786-7712 or Patricia L. Cerny at (312) 786-7722.

{Regulatory Circular RG 92-24 Re-issued (Regulatory Circular RG 92-04 Revised)}