

Options: Contrary Exercise Advice

Amendments to Standardized Options Exercise Procedures and Extension of Contrary Exercise Advice Cut-Off Time

Effective Date: September 7, 2010

Executive Summary

Effective September 7, 2010, amendments to FINRA Rule 2360 (Options) extend the cut-off time for the submission of certain contrary exercise advices (CEAs)¹ by one hour to 7:30 p.m. Eastern Time (ET).² Additionally, in the event of a modified close of trading, the amendments extend the deadline for option holders to make a final exercise decision for an expiring standardized option by two minutes to one hour and 30 minutes following the modified closing time.

The amended rule text is set forth in Attachment A.

Questions concerning this *Notice* should be directed to:

- Gary Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or
- Kathryn Moore, Assistant General Counsel, OGC, at (202) 974-2974.

Background & Discussion

FINRA Rule 2360(b)(23)(A) and similar rules of the options exchanges set forth procedures for the exercise of standardized options on the last business day before expiration. An option holder with an expiring standardized option has two choices:

- take no action and permit the option to automatically be exercised in accordance with The Options Clearing Corporation's (OCC) exercise-by-exception (Ex-by-Ex) procedures³; or

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Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Institutional
- Legal
- Operations
- Options
- Senior Management
- Trading

Key Topics

- Contrary Exercise Advice (CEA)
- Expiring Exercise Declaration (EED)
- Options Expiration
- Standardized Options

Referenced Rules & Notices

- FINRA Rule 2360

- ▶ submit a CEA that overrides the Ex-by-Ex procedures; *i.e.*, an instruction to let expire an option that otherwise would be exercised, or an instruction to exercise an option that otherwise would expire.

The rule provides that option holders have until 5:30 p.m. ET on the business day immediately prior to the expiration date to make a final decision to exercise or not exercise an expiring option. Firms may not accept exercise instructions for any account (customer or non-customer) after this time. This deadline has not been changed.

If the option holder elects not to follow the Ex-by-Ex procedure, then the firm must submit a CEA. The rule change has extended by one hour (from 6:30 p.m. to 7:30 p.m. ET) the time by which firms must submit a CEA for customer accounts, and for non-customer accounts if the firm uses an electronic submission procedure with a time stamp for the submission of exercise instructions by option holders. For firms that do not use such electronic time stamps, the deadline to submit such CEAs continues to be 5:30 p.m. ET.

In addition, if a modified close of trading is announced (*i.e.*, a time other than 4 p.m. ET), the rule change extends by two minutes (from one hour and 28 minutes to one hour and 30 minutes) the time by which option holders must make a final exercise decision following the modified closing time.⁴ In these circumstances, the rule change affords a firm up to 7:30 p.m. ET to submit a CEA for customer accounts, and for non-customer accounts if the firm uses an electronic submission procedure with a time stamp for the submission of exercise instructions by option holders. However, for firms that do not employ an electronic time stamp, the rule change only extends by two minutes the time by which firms must submit a CEA, requiring such CEAs to be submitted within one hour and 30 minutes after the modified close of trading for its non-customer accounts.

Finally, FINRA made certain changes to reorganize the rule text to improve readability.

As noted above, the implementation date of these amendments is September 7, 2010.

Endnotes

- 1 Contrary exercise advices also are referred to as expiring exercise declarations (EEDs) in The Options Clearing Corporation rules.
- 2 See Securities Exchange Act Release No. 62711 (August 12, 2010), 75 FR 51124 (August 19, 2010) (Notice of Filing and Immediate Effectiveness of File No. SR-FINRA-2010-041).
- 3 Under the Ex-by-Ex procedures an option will be automatically exercised if the option contract is in-the-money by a requisite amount.
- 4 This change conforms with the rules of the options exchanges, which were modified to correspond to the two-minute difference in trading time created by the change in the close of trading time from 4:02 p.m. to 4 p.m. ET. See Securities Exchange Act Release Nos. 53519 (March 20, 2006), 71 FR 15229 (March 27, 2006) (SR-AMEX-2006-26); 53249 (February 7, 2006), 71 FR 8035 (February 15, 2006) (SR-PCX-2005-138); 53407 (March 3, 2006), 71 FR 12764 (March 13, 2006) (SR-PHLX-2006-12); 53439 (March 7, 2006), 71 FR 13643 (March 16, 2006) (SR-ISE-2006-11); and 53438 (March 7, 2006), 71 FR 13641 (March 16, 2006) (SR-CBOE-2006-19).

Attachment A

Text of Amended Rule

Proposed new language is underlined; proposed deletions are in brackets.

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2300. Special Products

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2360. Options

(a) No Change.

(b) Requirements

(1) through (22) No Change.

(23) Tendering Procedures for Exercise of Options

(A) Exercise of Options Contracts

(i) No Change.

[(ii) Final exercise decisions of options holders to either exercise or not to exercise an expiring standardized equity option must be indicated to an options exchange that is a national securities exchange (national options exchange) that lists and trades the option, either directly to such national options exchange or via a member of such national options exchange if it is not a member of such exchange, by the respective member no later than 5:30 p.m. Eastern time (“ET”) on the business day immediately prior to the expiration date. For customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice (as defined below). For non-customer accounts, members may not accept exercise instructions after 5:30 p.m. ET but have until 6:30 p.m. ET to submit a Contrary Exercise Advice if such member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Members are required to submit a Contrary Exercise Advice by 5:30 p.m. ET for non-customer accounts if such members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Each member shall establish fixed

procedures to ensure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options. For purposes of this Rule 2360(b)(23)(A), the terms “customer account” and “non-customer account” shall have the meanings as defined in The Options Clearing Corporation By-laws.]

~~[(iii)]~~(ii) Special procedures apply to the exercise of standardized equity options on the last business day before their expiration (“expiring options”). Unless waived by The Options Clearing Corporation, expiring standardized equity options are subject to the Exercise-by-Exception (“Ex-by-Ex”) procedure under The Options Clearing Corporation Rule 805. This Rule provides that, unless contrary instructions are given, standardized equity option contracts that are in-the-money by specified amounts shall be automatically exercised. In addition to The Options Clearing Corporation rules, the following FINRA requirements apply with respect to expiring standardized equity options. Option holders desiring to exercise or not exercise expiring standardized equity options must either:

a. take no action and allow exercise determinations to be made in accordance with The Options Clearing Corporation’s Ex-by-Ex procedure where applicable; or

b. submit a “Contrary Exercise Advice” by the deadline specified [in paragraph (ii) above]~~below~~.

(iii) Exercise cut-off time. Option holders have until 5:30 p.m. Eastern Time (“ET”) on the business day immediately prior to the expiration date to make a final exercise decision to exercise or not exercise an expiring option. Members may not accept exercise instructions for customers or non-customers accounts after 5:30 p.m. ET.

(iv) Submission of Contrary Exercise Advice. A Contrary Exercise Advice is a form approved by the national options exchanges, FINRA or The Options Clearing Corporation for use by a member to submit a final exercise decision committing an options holder to either: (1) not

exercise an option position which would automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure; or (2) to exercise a standardized equity option position which would not automatically be exercised pursuant to The Options Clearing Corporation's Ex-by-Ex procedure. A Contrary Exercise Advice may be canceled by filing an "Advice Cancel" or resubmitted at any time up to the submission cut-off times specified herein[in subparagraph (ii)]. For customer accounts, members have until 7:30 p.m. ET to submit a Contrary Exercise Advice. For non-customer accounts, members have until 7:30 p.m. ET to submit a Contrary Exercise Advice if such member employs an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Members are required to manually submit a Contrary Exercise Advice by 5:30 p.m. ET for non-customer accounts if such members do not employ an electronic submission procedure with time stamp for the submission of exercise instructions by option holders. Each member shall establish fixed procedures to ensure secure time stamps in connection with their electronic systems employed for the recording of submissions to exercise or not exercise expiring options. For purposes of this Rule 2360(b)(23)(A), the terms "customer account" and "non-customer account" shall have the meanings as defined in The Options Clearing Corporation By-laws. Contrary Exercise Advices and/or Advice Cancels may be submitted by any member to:

[1]a. a place designated for that purpose by any national options exchange of which it is a member and where the standardized equity option is listed;

[2]b. a place designated for that purpose by any national options exchange that lists and trades the standardized equity option via a member of such exchange if the member is not a member of such exchange;

[3]c. any national options exchange of which it is a member and where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation; or

[4]d. any national options exchange where the standardized equity option is listed via The Options Clearing Corporation in a form prescribed by The Options Clearing Corporation, provided the member is a member of The Options Clearing Corporation.

[(iv)] (v) In those instances when The Options Clearing Corporation has waived the Ex-by-Ex procedure for an options class, members must either:

- a. submit to any of the places listed in subparagraphs [(iii)]b.1. through 4.] (iv)a. through d. above, a Contrary Exercise Advice, within the time limits specified in subparagraph [(ii)](iv) above if the holder intends to exercise the standardized equity option, or
- b. take no action and allow the standardized equity option to expire without being exercised.

The applicable underlying security price in such instances will be as described in The Options Clearing Corporation Rule 805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the Ex-by-Ex procedure has been waived for an options class, The Options Clearing Corporation rules require that members wanting to exercise such options must submit an affirmative Exercise Notice to The Options Clearing Corporation, whether or not a Contrary Exercise Advice has been filed.

[(v)](vi) Members that maintain proprietary or public customer positions in expiring standardized equity options shall take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. Members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also shall take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange. Members may establish a processing cut-off time prior to FINRA's exercise cut-off time at which they will no longer accept final exercise decisions in expiring standardized equity options from customers.

~~[(vi)]~~(vii) Members may effect or amend exercise decisions for standardized equity options after the exercise cut-off time (but prior to expiration) under the following circumstances:

- a. in order to remedy mistakes or errors made in good faith;
- b. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or
- c. where extraordinary circumstances restricted a customer's or member's ability to inform the respective member of such decisions (or a member's ability to receive such decisions) by the cut-off time.

The burden of establishing an exception for a proprietary or customer account of a member rests solely on the member seeking to rely on such exception.

~~[(vii)]~~ (viii) In the event a national options exchange or The Options Clearing Corporation provides advance notice on or before 5:30 p.m. ET on the business day immediately prior to the last business day before the expiration date indicating that a modified time for the close of trading in standardized equity options on such last business day before expiration will occur, then the deadline for an option holder to make a final decision to exercise or not exercise an expiring option shall be 1 hour ~~[28]~~ 30 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph ~~[(ii)]~~(iii) above. However, members have until 7:30 p.m. ET to ~~[may]~~ deliver a Contrary Exercise Advice or Advice Cancel to the places specified in paragraphs ~~[(iii)b.1. through 4.]~~(iv)a. through d. above ~~[within 2 hours 28 minutes following the time announced for the close of trading in standardized equity options on that day instead of the 6:30 p.m. ET deadline found in paragraph (ii) above]~~ for customer accounts and non-customer accounts where such member firm employs an electronic submission procedure with time stamp for the submission of exercise instructions. For non-customer accounts, members that do not employ an electronic procedure with time stamp for the submission of exercise instructions are required to manually deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and

[28] 30 minutes following the time announced for the close of trading on that day instead of the 5:30 p.m. ET deadline found in paragraph [(ii)] (iv) above.

[(viii)](ix) The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel required by subparagraph (A) hereof does not serve as a substitute to the effective notice required to be submitted to The Options Clearing Corporation for the exercise or non-exercise of expiring standardized equity options.

[(ix)](x) Submitting or preparing an exercise instruction after the exercise cut-off time in any expiring standardized equity option on the basis of material information released after the exercise cut-off time is activity inconsistent with just and equitable principles of trade.

[(x)](xi) The exercise cut-off requirements contained in this subparagraph (A) do not apply to any currency option or standardized index option products listed on a national options exchange.

(B) through (D) No Change.

(24) No Change.

(c) No Change.

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