

Accordingly, the Commission finds that good cause exists, consistent with section 6(b)(5)<sup>10</sup> and 19(b)(2)<sup>11</sup> of the Act to accelerate approval of Amendment No. 1 to the proposed rule change.

### III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1, including whether Amendment No. 1 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, in Washington, DC. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-99-38 and should be submitted by May 16, 2000.

### IV. Conclusion

*It Is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-CBOE-99-38), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42693; File No. SR-CBOE-99-03]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Option Exercise Procedures

April 17, 2000.

On January 20, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> In its filing, CBOE proposes to amend Exchange Rules 4.16 and 11.1 relating to option exercise procedures for noncash-settled equity options and American-style, cash-settled index options, as well as to reflect in an Exercise Regulatory Circular the proposed changes to American-style, cash-settled index options, and a change approved in a prior Commission Order relating to those options.<sup>3</sup> On May 10, 1999, the Exchange submitted to the Commission Amendment No. 1 to the proposed rule change.<sup>4</sup> The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on June 1, 1999.<sup>5</sup> The Commission received no comments on the proposal. This Order approves the proposed rule change as amended.

#### I. Description of the Proposal

##### *A. Exercise Procedures for American-Style, Cash-Settled Index Options After Certain Trading Halts and During a Trading Resumption That May Follow Such Trading Halts*

The CBOE proposes to modify its rules governing the exercise of American-style, cash-settled index options during certain trading halts. In addition, if trading resumes following a trading halt (such as by closing

rotation), the Exchange proposes to permit exercises to occur during the resumption of trading and for five minutes after the close of the resumption of trading. In particular, the Exchange proposes to modify CBOE Rules 11.1 and 4.16 to permit the exercise of American-style, cash-settled index options during a trading halt that occurs at or after 3:00 p.m. (Central Time).<sup>6</sup> A number of index options are traded on the Exchange from 8:30 a.m. To 3:15 p.m. (CT),<sup>7</sup> whereas the markets for the equity securities underlying those index options generally close for trading by 3:00 p.m. (CT). CBOE Rule 11.1 governs the exercise of option contracts, including index option contracts, and provides that Exchange members will follow the procedures of the Options Clearing Corporation ("OCC"), as well as those of the Exchange, when exercising option contracts. CBOE Rule 4.16 governs other restrictions on options transactions and exercises. Under CBOE Rule 11.1.05<sup>8</sup> and CBOE Rule 4.16(b), exercises of cash-settled index options are prohibited whenever trading in such options is delayed, halted or suspended, unless otherwise determined by the Exchange's President or his designee.<sup>9</sup> The Exchange has long noted that one of the distinctive characteristics of a cash-settled option is that its exercise is functionally equivalent to trading out of the long position, and, conversely, the assignment of a short option eliminates

<sup>6</sup> Currently, the Exchange trades only one type of standardized American-style, cash-settled index option contract, Standard & Poor's 100 index options ("OEX index options").

<sup>7</sup> CBOE Rule 24.6, *Days and Hours of Business*.

<sup>8</sup> The Exchange is proposing to move the text of CBOE Rule 11.1.05, which relates to the exercise of American-style, cash-settled index options, to proposed CBOE Rule 11.1.03(h) for ease of reference for Exchange members.

<sup>9</sup> The Exchange is also proposing to reflect the Commission's 1999 approved rule changes to CBOE Rule 11.1.05 and CBOE Rule 4.16(b) in an Exercise Regulatory Circular. In 1999, the Commission approved rule amendments to CBOE Rule 11.1.05 and CBOE Rule 4.16(b), which state that with the exception of the last business day prior to expiration, exercises of cash-settled index options will be prohibited during any time when trading in such options is delayed, halted, or suspended, unless otherwise determined by the Exchange's President or his designee. The 1999 rule amendments also stated that, notwithstanding this prohibition, the exercise of a cash-settled index option may be processed and given effect in accordance with and subject to the rules of the OCC while trading in an option is delayed, halted, or suspended if it can be documented that the decision to exercise the option was made during allowable time frames prior to the delay, halt or suspension. The Commission approved these rule amendments in 1999, but the Exchange did not propose, at that time, to reflect those rule amendments in an Exercise Regulatory Circular. See Securities Exchange Act Release No. 40951 (January 15, 1999), 64 FR 4482 (January 28, 1999) (File No. SR-CBOE-98-33).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> The Exchange's Exercise Regulatory Circular sets forth procedures and requirements regarding the exercise of American-style, cash-settled index options. In 1998, the CBOE filed with the Commission the Exercise Regulatory Circular, See Securities Exchange Act Release No. 40334 (August 18, 1998), 63 FR 45275 (August 25, 1998) (File No. CBOE-98-34).

<sup>4</sup> See Letter from Arthur B. Reinstein, Counsel, CBOE, to Hong-anh Tran, Attorney, Division of Market Regulation ("Division"), SEC, dated May 10, 1999 ("Amendment No. 1").

<sup>5</sup> Securities Exchange Act Release No. 41435 (May 21, 1999), 64 FR 29370 (June 1, 1999) (File No. SR-CBOE-99-03).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 15 U.S.C. 78s(b)(2).

<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).

the position as if it had been closed through a purchase transaction. Absent any restrictions upon exercise, holders of long positions would be able to unwind their positions by exercising their options through the OCC during trading halts and after the close of trading. Because holders of short positions are precluded from unwinding their positions through trading (*i.e.*, sell their options) when trading on the CBOE is closed or halted, they would be at a disadvantage to holders of long positions. These rules were developed to reduce the advantage arising from in long positions over those in short positions during trading halts (on any days other than on the last trading day before expiration Friday).<sup>10</sup>

Since 1991, the Exchange has permitted holders of long index options an additional five minutes subsequent to the close of trading on the CBOE to make their exercise decisions (*i.e.*, generally up to 3:20 p.m. (CT)).<sup>11</sup> The Exchange believed that the five-minute exercise window benefitted options investors generally by fostering higher quality markets. In particular, permitting the exercise of American-style, cash-settled index options up to 3:20 p.m. (CT) allows market participants to make investment decisions based on the evaluation of their final positions after having completed trading for the day. Moreover, the additional five-minute exercise period provides market participants with additional time to evaluate the closing prices of the securities that comprise an index and to determine whether or not to exercise their positions. The Exchange adopted the five-minute exercise window notwithstanding that investors holding short positions in index options would not have the same opportunity to trade (*i.e.*, to unwind their options positions) during this period as would holders of long index positions, who would be able to exercise through the OCC during the same period. In doing so, the Exchange believes that the benefits to the overall American-style, cash-settled index market from the five-minute exercise period exceed any potential harm that might result to holders of short index options.

The Exchange now proposes to amend the Exchange Rules 4.16 and 11.1 relating to exercise restrictions for

American-style, cash-settled index options and to permit holders of long index options to exercise through the OCC during trading halts occurring at or after 3:00 p.m. (CT). As mentioned, the trading markets for the equity securities underlying those index options generally are closed for trading by 3:00 p.m. (CT), and their closing values are generally established by this time. Market participants will seek to exercise their index options by this time. Many participations in the index options market utilize the closing value of the index to make trading and hedging decisions (including transactions in the related futures market) contingent upon exercise of an index option position or expected assignment of a short position. Given this, the Exchange believes that the occurrence of a trading halt at or after 3:00 p.m. (CT) should not fundamentally alter the ability of holders of long index options to exercise their options.<sup>12</sup> While permitting the exercise of American-style, cash-settled index options during trading halts that occur at or after 3:00 p.m. (CT) increases the difference in treatment between holders of short and long positions in American-style, cash-settled index options, the Exchange believes that any increase in the difference of treatment is incremental given that the Exchange currently allows holders of long index options positions an additional five minutes after the close of the Exchange to make their exercise decisions. The Exchange represents that the additional benefits that would be afforded to the index market under the proposed rule amendments outweighs the additional differences in treatment between holders of long and short index options positions.

Furthermore, the Exchange proposes that if trading resumes following a trading halt (such as by closing rotation), the Exchange would continue to permit holders of long index options in American-style, cash-settled index options to make their exercise decisions during the resumption of trading and for a five-minute period after the close of the resumption of trading. The Exchange represents that permitting the additional five-minute exercise period after the close of the resumption of trading is consistent with what the Exchange currently permits as the

additional exercise period after the daily close of trading on the Exchange.<sup>13</sup>

The Exchange generally will continue to prohibit American-style, cash-settled index option exercises during any trading halt which occurs before 3:00 p.m., as the length of time required to provide sufficient notice and opportunity equally to all market participants during an intra-day trading halt would unfairly expand the opportunity for holders of long index option positions to exercise when short option holders are prohibited from trading.

#### *B. Exercise Procedures for American-style, Cash-settled Flex Index Options*

The Exchange proposes to amend CBOE Rules 4.16(b) and CBOE Rule 11.1.03 to treat both standardized and FLEX American-style, cash-settled index options in the same manner with respect to exercise restrictions.<sup>14</sup> In particular, the Exchange proposes to amend the language in proposed CBOE Rules 4.16(b) and 11.1.03 to state that if a trading delay, halt, suspension, resumption, closing rotation, or modified trading hours occurs in a standardized index option (either American-style or European-style), then the Exchange will treat the related American-style, cash-settled FLEX Index Option (if any) for purposes of exercise procedures as if that same condition had occurred in the American-style, cash-settled FLEX Index Option. The Exchange would then apply the same exercise procedures to the related American-style, cash-settled FLEX Index Option as established for the standardized index option following the market condition. Although the market condition will be deemed to have taken place in the related American-style, cash-settled FLEX Index Option for the purpose of triggering the same exercise procedures relating to that market condition, the market condition may or may not have actually occurred with respect to the American-style, cash-settled FLEX Index Option.<sup>15</sup>

Thus, for example, if there is a trading halt that occurs before 3:00 p.m. (CT) in standardized Standard & Poor's 500 Index (SPX) options (which are European-style options and which can be exercised only at expiration),

<sup>13</sup> See proposed CBOE Rule 4.16(b)(iii) and proposed CBOE Rule 11.1(h)(iii).

<sup>14</sup> The Exchange also proposes to reflect these rule amendments in an Exercise Regulatory Circular.

<sup>15</sup> Pursuant to a telephone conversation between Arthur B. Reinstein, Counsel, CBOE, and Hong-anh Tran, Attorney, Division, SEC, dated August 30, 1999.

<sup>10</sup> Exercises of expiring American-style, cash-settled index options cannot be restricted in any way on the last business day prior to their expiration. See CBOE Rules 4.16 and 11.1.

<sup>11</sup> See CBOE Rule 11.1.03. See Securities Exchange Act Release No. 29860 (October 25, 1991), 56 FR 56254 (November 1, 1991) (File No. SR-CBOE-91-28).

<sup>12</sup> While implementing the standard five minutes exercise window after a trading halt has been announced would provide floor traders with sufficient opportunity to exercise, such a small window may not provide other market participants with a sufficient opportunity to do so an would add to the increased operational burdens of member firms resulting from the trading halt itself.

exercises of American-style, cash-settled SPX FLEX options would be prohibited during the trading halt. Similarly, if there is a trading halt in the standardized SPX options that occurs at or after 3:00 p.m. (CT), the Exchange would deem that a trading halt has also occurred in the related American-style, cash-settled SPX FLEX options, and would allow exercises of American-style, cash-settled SPX FLEX options to occur through 3:20 p.m. (CT). Additionally, if there was a closing rotation in the standardized SPX options, the Exchange would deem that a closing rotation has occurred in the related American-style, cash-settled SPX FLEX options for the purpose of triggering the exercise procedures relating to that condition, and would allow exercises of American-style, cash-settled SPX FLEX options to occur during the closing rotation for standardized SPX options and for five minutes thereafter.<sup>16</sup>

The Exchange represents that the proposed amendment is consistent with how the Exchange has historically applied the exercise provisions that are applicable in the above market conditions to American-style, cash-settled FLEX Index Options. Hence, the Exchange proposes to codify the Exchange's prior exercise practices as they apply to American-style, cash-settled FLEX Index Options.<sup>17</sup>

### C. Extension of Exercise Notification Deadline and Cut-off-Time

The Exchange proposes to amend the second provision of proposed CBOE Rule 11.1.06(d) to grant the CBOE President or his designee the authority to extend the exercise notification deadline for noncash-settled equity options under unusual circumstances. The Exchange also proposes to amend CBOE Rule 11.1(b) and the first provision within proposed CBOE Rule 11.1.06(d) to grant the President of CBOE or his designee the authority to extend the 4:30 p.m., exercise cutoff time for noncash-settled equity options under unusual circumstances.<sup>18</sup> In such

<sup>16</sup> The Exchange represents that the rule amendments would not actually cause a closing rotation to occur in the American-style, cash-settled SPX FLEX options. Pursuant to a telephone conversation between Arthur B. Reinstein, Counsel, CBOE, and Hong-anh Tran, Attorney, Division, SEC, dated August 30, 1999.

<sup>17</sup> The Exchange presently sets forth in the same Exercise Regulatory Circular the exercise procedures relating to standardized and FLEX, American-style, cash-settled index options.

<sup>18</sup> The exercise cutoff time for noncash-settled equity options is 4:30 p.m. (CT) and is in effect on expiration Friday for expiring contracts. Members must not exercise through the OCC past this exercise cutoff time unless one of the three exceptions in CBOE Rule 11.1 applies. Members

case, the deadline for the delivery of an exercise instruction, "contrary exercise advice," and "advice cancel" based on proposed CBOE Rule 11.1.06(d) would be the revised exercise cutoff time designated by the President or his designee. For example, on rare occasions, the closing rotation in an equity option has ended shortly before 4:30 p.m. (CT) (*i.e.*, the normal exercise cutoff time for these options). The exchange believes that a late-ending closing rotation delays a market participant in taking the actions necessary to make and process an exercise decision. This proposal would permit the President or his designee to extend the exercise notification deadline and the exercise cutoff time so that market participants can have adequate time to make informed exercise decisions and to process them under unusual situations.

The Exchange also proposes to permit CBOE's President or his designee to extend the applicable deadline for the delivery of "exercise advice" and "advice cancel" notifications pursuant to CBOE Rule 11.1.03(c) for American-style, cash-settled index options if unusual circumstances are present.<sup>19</sup> CBOE Rule 11.1.03 currently requires members to notify the Exchange by 3:20 p.m. (CT) (or if trading hours are extended or modified in the applicable option class, no later than five minutes after the close of trading on that day) of their exercise decisions with respect to American-style, cash-settled index options and sets forth procedures for providing such notification. The Exchange represents that under certain unusual circumstances, market participants have had difficulty meeting the 3:20 p.m. (CT) notification deadline. For example, on rare occasions, the reporting authority for an index has been late in reporting the closing value for the index. Consequently, market participants have found it difficult on those occasions to make and process exercise decisions before the 3:20 p.m. (CT) deadline. This amendment proposes to amend CBOE Rule 11.1.03(c) to permit the President of CBOE or his designee to extend the applicable deadline for the delivery to the Exchange of "exercise advice" and "advice cancel" notifications for

who violate this rule are subject to disciplinary action, including summary fines under CBOE Rule 17.50(g)(8).

<sup>19</sup> The Exchange has a rule relating to the deadline for the delivery of exercise notifications for American-style, cash-settled index options, but no similar rule relating to the exercise cutoff time for these options. See CBOE Rule 11.1.03.

American-style, cash-settled index options under unusual situations.

Under the Exchange's current rules, there is a time window following the close of trading during which long option holders are permitted to exercise their option positions while at the same time short option holders do not have the ability to trade out of their positions. Accordingly, as discussed above, one of the inherent differences between holding a long or short option position is that there is a disparity between the ability of long and short option holders to take market action following the close of trading. The purpose of the Exchange's exercise deadline for American-style, cash-settled index options and non-cash-settled equity options, as well as the exercise cutoff time for non-cash settled equity options is to restrict this disparity to a limited time period following the close of trading in those situations in which long option holders have the ability to take action through the exercise or non-exercise of an option that can affect their position in the market. Although permitting the President of CBOE or his designee the authority to extend the applicable exercise deadline or cut-off time in unusual circumstances would marginally increase this existing disparity, the Exchange believes that any potential detriment that may result from the implementation of the foregoing rule would be far exceeded by the benefit to the marketplace as a whole that is derived from allowing the President of CBOE or his designee to permit market participants sufficient time to make informed exercise decisions and to process their exercise decisions under unusual circumstances.

The Exchange further notes that the President or his designee will only exercise this authority in unusual circumstances and thus that extensions in the applicable exercise deadline or cut-off time will not occur often. The Exchange represents that the President or his designee would in no event extend the applicable exercise deadline or cutoff time beyond the exercise cutoff time required by the OCC.<sup>20</sup>

### D. Documentation Evidencing Timely Exercise Determinations Made Prior to a Trading Delay, Halt or Suspension

As discussed above, Exchange members are expected from the general prohibition on exercising American-style, cash-settled index options during trading halts, delays, or suspensions

<sup>20</sup> The OCC has separate rules regarding the cutoff time by which exercise notices must be delivered to the OCC by the clearing members. See OCC Chapter VIII, (Exercise and Assignment).

provided they can document that the decision to exercise was made prior to the trading halt, delay, or suspension. Currently, the Exchange accepts as evidence of timely exercises internal exercise memoranda prepared by CBOE members, a copy of "exercise advices" transmitted electronically to OCC via OCC's Clearing Management and Control System (C/MAS), or a member's "exercise advice" previously submitted to the Exchange.

The Exchange now believes that it would be preferable to rely on, and encourage the most objective evidence available as to, the timing of an exercise decision. For this reason, the Exchange proposes to no longer ordinarily accept internal exercise memoranda prepared by CBOE members. The Exchange will continue to accept "exercise advices" transmitted via C/MAS, or a member's copy of an exercise advice previously submitted to the Exchange as evidence of timely exercise decisions made prior to a trading delay, or suspension.<sup>21</sup>

## II. Discussion

After careful consideration, the Commission has determined to approve the Exchange's proposal, finding that it is consistent with Section 6(b)(5) of the Act.<sup>22</sup> Section 6(b)(5) provides that the rules of an exchange be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information regarding the exercise of outstanding option contracts, to remove impediments to and perfect the mechanisms of a free and open market, to promote just and equitable principles of trade, and to protect investors and the public interest.<sup>23</sup>

### *A. Exercise Procedures for American-Style, Cash-Settled Options After Certain Trading Halts and During a Trading Resumption That May Follow Such Trading Halt*

First, the Commission believes that the proposal relating to the ability of market participants to exercise American-style, cash-settled index options during a trading halt occurring at or after 3:00 p.m. (CT) is appropriate based on the reasons set forth below.

The Commission believes that the occurrence of a trading halt at or after 3:00 p.m. (CT) should not fundamentally alter the ability of holders of long index options to exercise through the OCC. As discussed above, the trading markets for the equity

securities underlying index options generally are closed for trading by 3:00 p.m. (CT), thereby establishing the value of a given index. By this time, market participants are already watching the market for opportunities to exercise their index options. Many participants in the index options market use the closing value of the index to make trading and hedging decisions (including transactions in the related futures market) contingent upon exercise of an index option position or the expected assignment of a short position. Thus, the Exchange believes that the occurrence of a trading halt at or after 3:00 p.m. (CT) should not fundamentally alter the ability of holders of long index options to exercise their options.

Because the Exchange currently allows its members an additional five minutes after the close of trading for the holders of long index options to make their exercise decisions, the Commission believes that the implementation of the above rule amendment would only marginally increase the exercise time period for holders of long index options to exercise through the OCC. The Commission believes that permitting holders of long positions in an American-style, cash-settled index, option to submit their exercise decisions during a trading halt occurring at or after 3:00 p.m. (CT) would remove the impediments to, and perfect the mechanism of, a free and open market during such a halt.

The Commission also believes that the proposed amendment to permit exercise of standardized American-style, cash-settled index options during a trading resumption (such as a closing rotation) following a trading halt occurring at or after 3:00 p.m. (CT), and for a five minute period thereafter, is appropriate because it will promote just and equitable principles of trade. First, the Commission believes that the proposed amendment will reduce potential confusion among CBOE members and customers during a trading resumption that may follow a trading halt occurring at or after 3:00 p.m. (CT). Second, the Exchange presently permits an additional five-minute window after the close of options trading on the Exchange for market participants to make exercise decisions. The Commission believes that the proposed amendment, which will also permit the additional five-minute window after the close of a trading resumption following a late trading halt, will maintain consistency among the rules of the Exchange, and will promote just and equitable principles of trade.

### *B. Options Exercise Procedures for American-Style, Cash-Settled Flex Index Options*

The Commission also believes that the proposed amendment to treat all American-style, cash-settled index options (standardized and FLEX) in the same manner with regard to exercise procedures is reasonable because it promotes just and equitable principles of trade. In particular, CBOE's Exercise Regulatory Circular, which the Exchange filed with the Commission in 1998,<sup>24</sup> currently sets forth the policies regarding exercise procedures and requirements for all American-style, cash-settled index options. The Exchange has always treated all American-style, cash-settled index options in the same manner with respect to exercise procedures. However, certain rules relating to FLEX options would make it impossible for all American-style, cash-settled index options to be treated the same for exercise procedure purposes. For example, the CBOE cannot apply to American-style, cash-settled FLEX Index Options its proposed rule regarding exercise procedures during a closing rotation and for five minutes thereafter such rotation because CBOE Rule 24A.3 currently does not permit opening or closing rotations to be conducted in FLEX options. Accordingly, the CBOE is proposed to change CBOE Rules 4.16(b) and 11.1.03<sup>25</sup> to deem, for purposes of the exercise procedures, a trading delay, halt, suspension, resumption, closing rotation, or modified trading hours to take place in the American-style, cash-settled FLEX Index Options, anytime the same condition occurs in the related American-style, cash-settled standardized index option (either American-style or European-style). The Commission believes that the proposal is appropriate and necessary to ensure that equal treatment of two similar options products.

<sup>24</sup> See Securities Exchange Act Release No. 40334 (August 18, 1998), 63 FR 45275 (August 25, 1998) (SR-CBOE-98-34).

<sup>25</sup> The Commission also notes that the Exchange is moving the text of CBOE Rule 11.1.05 (which related to the procedures for exercise of American-style, cash-settled index options) to proposed CBOE Rule 11.1.03(h). CBOE Rule 11.1.03 sets forth the exercise procedures and requirements of American-style, cash-settled index options. The Commission believes that these changes do not substantially alter the meaning of, and will make it easy for Exchange members to refer to these rules because all the provisions relating to the exercise procedures for American-style, cash-settled index options will be set forth under the same rule.

<sup>21</sup> See Exercise Regulatory Circular, Section 11.

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation 15 U.S.C. 78c(f).

### *C. Extension of Exercise Notification Deadline and Exercise Cutoff*

The Commission notes that the purpose of the Exchange's exercise notification deadline<sup>26</sup> for American-style, cash-settled index options, and noncash-settled equity options, as well as the exercise cutoff time for noncash-settled equity options is to limit the differences in the ability of long options holders as compared to short options holders to offset their positions through exercise following the close of trading. The Commission recognizes that permitting the President or his designee to extend the applicable exercise deadline or cut-off time in unusual circumstances will marginally increase this existing disparity. The Commission, however, believes that any potential detriment that may result from increasing the disparity between long and short options holders will be exceeded by the benefit of allowing the President or his designees to give market participants additional time in which to make and process exercise decisions under unusual circumstances.

Furthermore, the Commission believes that the proposed rule change will promote efficient exercise procedures for both equity and index options by permitting market participants the opportunity to make informed decisions before exercising their options under unusual circumstances. For example, it would be an unusual circumstance if the reporting authority was late in reporting the closing value of an American-style, cash-settled index option, or if there were not enough time to process an exercise decision for a noncash-settled equity option due to a late closing rotation that ended just before the normal deadline for submitting the exercise notice to the Exchange. These provisions will also promote just and equitable principles of trade because public customers or Exchange members should not have to make exercise decisions based on incomplete information about the index value (in the case of index options) and should have time to process their exercise decisions (in the case of equity options). The Commission also notes that the Exchange represents that its President or his designee will only exercise this authority in unusual circumstances, and that extensions in the applicable exercise deadline or cutoff time will not occur often. The Exchange further represents that the Exchange's President or his designee will in no event extend

<sup>26</sup> See Securities Exchange Act Release No. 40334 (August 18, 1998), 63 FR 45275 (August 25, 1998) (SR-CBOE-98-34).

the applicable exercise deadline or cut-off time beyond the time required by the OCC for submission of exercise instructions by its clearing members.

### *D. Documentation Evidencing Timely Exercise Determinations Made Prior to a Trading Delay, Halt, or Suspension*

Finally, the Commission believes that it is reasonable for the Exchange to no longer ordinarily accept internal exercise memoranda prepared by CBOE members as evidence of timely exercise determinations of American-style, cash-settled (standardized, or FLEX) index options made prior to a trading delay, halt, or suspension. The Commission believes that by allowing only objective evidence to indicate timely exercise determinations, the proposal promotes the ability of the Exchange to verify the authenticity of the exercise documents.

### III. Conclusion

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-CBOE-99-03) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00-10262 Filed 4-24-00; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42704; File No. SR-DTC-00-04]

### Self-Regulatory Organizations; the Depository Trust Company; Order Granting Approval of a Proposed Rule Change Relating to the Profile Modification Feature of the Direct Registration System

April 19, 2000.

On February 28, 2000, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act or 1934 ("Act"),<sup>1</sup> a proposed rule change. Notice of the proposal was published in the **Federal Register** on March 15, 2000.<sup>2</sup> The Commission received five comment letters in response to the proposed rule change.<sup>3</sup>

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> Securities Exchange Act Release No 42504 (March 8, 2000), 65 FR 14003.

<sup>3</sup> Letters from Stephen J. Dolmatch, Executive Vice President, General Counsel, and Secretary,

The Commission is publishing this order to grant approval of the proposed rule change.

### I. Description

The Profile Modification System ("Profile"), a feature of the Direct Registration System ("DRS"), is an electronic messaging system that allows a DTC participant (*i.e.*, generally a broker-dealer) or a DRS limited participant (*i.e.*, a transfer agent)<sup>4</sup> to submit instructions to transfer investors' book-entry position from one to the other.<sup>5</sup> The primary purpose of DTC's filing is to modify Profile by incorporating the use of an electronic screen-based indemnification. As described more fully below, the inclusion of the electronic indemnification in Profile enables DTC to make DRS fully operational and available for use by qualified issuers, DTC participants, and DRS limited participants. DTC's filing also establishes the procedures governing the use of Profile in the Participant Terminal System ("PTS")<sup>6</sup> and specifies the fees connected with the use of Profile.

#### A. Background

Since 1996 when the New York Stock Exchange, Inc. ("NYSE") and the National Association of Securities

Chase Mellon Financial Group (April 3, 2000); John Cirrito, Chief Operating Officer and Managing Director, ING Barings (April 5, 2000); William Talbot, Vice President, Pershing (April 5, 2000); Jerome Clair, Chairman, Securities Industry Association ("SIA") Operations Committee, SIA (April 6, 2000); Larry E. Thompson, Managing Director and Deputy General Counsel, DTC (April 7, 2000); Charles V. Rossi, Division President, EquiServe Limited Partnership (April 19, 2000).

<sup>4</sup> For a description of DRS limited participants, refer to Securities Exchange Act Release No. 37931 (November 7, 1996), 61 FR 58600 (November 15, 1996).

<sup>5</sup> For a description of DRS and Profile, see Securities Exchange Act Release No. 35038 (December 1, 1994), 59 FR 63652 (concept release relating to DRS); Securities Exchange Act Release No. 41862 (September 10, 1999), 64 FR 51162 (September 21, 1999) (order approving implementation of the Profile Modification feature of DRS); Securities Exchange Act Release No. 42366 (January 28, 2000), 65 FR 5714 (February 4, 2000) (order approving an interpretation of an existing rule pertaining to DRS).

<sup>6</sup> DTC's procedures governing the use of Profile in PTS are attached as Exhibits 3 and 4 to DTC's filing. Copies of DTC's proposed rule change and the attached exhibits are available at the Commission's Public Reference Section or through DTC. In addition, DTC understands that the DRS Committee is developing guidelines to the use of DRS. When such guidelines have been approved by the DRS Committee, DTC will work with the DRS Committee to implement the guidelines. Members of the DRS Committee include representatives from the American Society of Corporate Secretaries, Corporate Transfer Association, Securities Industry Association, Securities Transfer Association, and DTC.