

Notice to Members

SEPTEMBER 2006

SUGGESTED ROUTING

Legal and Compliance
Institutional
Senior Management
Operations
Trading
Options

KEY TOPICS

Contrary Exercise Advice
Exercise-by-Exception
Exercise Procedures
Options
Rule 2860
Rule 11850

GUIDANCE

Options

Amendments to Option Exercise Procedures in Rule 2860;
Effective Date: October 12, 2006

Executive Summary

On August 10, 2006, NASD filed with the Securities and Exchange Commission (SEC) for immediate effectiveness a rule change to amend Rule 2860(b)(23) (Tendering Procedures for Exercise of Options) to: (1) simplify the manner in which a Contrary Exercise Advice (CEA) is submitted; (2) extend by one hour the cut-off time by which members must submit CEA notices; (3) add procedures for exercising a standardized equity option when a modified close of trading is announced; and (4) consolidate all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) instead of having additional and overlapping provisions in Rule 11850 (Tendering Procedures for Exercise of Options).¹

Rule 2860 and Rule 11850, as amended, are set forth in Attachment A of this *Notice*. The implementation date of the amendments is October 12, 2006.

Questions/Further Information

Questions regarding this *Notice* may be directed to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel, Regulatory Policy and Oversight (RPO), at (202) 728-8104, or Kathryn M. Moore, Assistant General Counsel, Office of General Counsel, RPO, at (202) 974-2974.

Background and Discussion

Rule 2860(b)(23) and Rule 11850 set forth the procedures to exercise options, including procedures that address The Options Clearing Corporation's (OCC) exercise-by-exception procedure (Ex-by-Ex) for standardized options. The Ex-by-Ex procedure in OCC Rule 805 provides for the automatic exercise of certain options that are in-the-money by a specified amount. Under the Ex-by-Ex procedure, option holders with an option contract that is in-the-money by the requisite amount and who wish to have their contracts automatically exercised need to take no further action. However, under OCC Rule 805, option holders who do not want their options automatically exercised, or who want their options to be exercised under different parameters than that of the Ex-by-Ex procedure, must file a CEA and instruct OCC of their "contrary intention." The option exercise procedures and CEA delivery requirements contained in the analogous rules of the Options Exchanges² have recently been amended³ and NASD has made the conforming changes to its rules.

The amendments to Rule 2860(b)(23) modify CEA delivery requirements, add exercise procedures for standardized equity options in the event of a modified close of trading and consolidate all provisions pertaining to the exercise of standardized options contracts into Rule 2860(b)(23) from Rule 11850.

Rule 2860(b)(23)(A)(i) was amended to mirror the provisions of Rule 11850(a)(1) and provides that members may establish fixed procedures as to the latest time they will accept exercise instructions from customers for tender to OCC.

Rule 2860(b)(23)(A)(ii) was amended to integrate the provisions of Rule 11850(b)(1)(A) regarding the cut-off time to submit final exercise decisions. In order to conform to similar amendments to the rules of the Options Exchanges, NASD has extended the cut-off time for members to submit CEAs to the appropriate venue from 5:30 pm ET to 6:30 pm ET. Please note, however, that option holders continue to be required to submit exercise decisions to members no later than 5:30 pm ET. This one-hour extension applies only to members submitting CEAs for customer accounts and non-customer accounts where the member employs an electronic procedure with time stamp recording for the submission of exercise instructions by options holders. Members must establish fixed procedures to ensure secure time stamps in connection with the utilization of the electronic stamp provision for their non-customer accounts. If a member does not employ an electronic time stamp and appropriate procedures to ensure secure time stamps, the member will have to submit CEAs for non-customer accounts by 5:30 pm ET.

Rule 2860(b)(23)(A)(iii) was amended to incorporate the provisions of Rule 11850(b)(1)(A) and contains the particulars of the Ex-by-Ex procedure, including when and where exercise notices and CEAs must be filed, together with conforming language and definitional changes to harmonize the rule with the rules of the Options Exchanges.

A new subparagraph (iv) was added to Rule 2860(b)(23)(A), which includes provisions parallel to the provisions of Rule 11850(b)(1)(B) and details the procedures to be followed in the event the Ex-by-Ex procedure has been waived. New subparagraph (iv) also tracks the amended rules of the Options Exchanges that provide that when the Ex-by-Ex procedure has been waived, no CEA is required to be filed if the option holder does not wish to exercise the expiring standardized equity option.

Rule 2860(b)(23)(A)(v) provides (as previously provided in Rule 11850(b)(1)(C)) that members that maintain proprietary or public customer positions in expiring standardized equity options must take necessary steps to ensure that final exercise decisions are properly indicated to the relevant national options exchange with respect to such positions. In addition, members that have accepted the responsibility to indicate final exercise decisions on behalf of another member also must take necessary steps to ensure that such decisions are properly indicated to the relevant national options exchange.

Rule 2860(b)(23)(A)(vi) retains the provision (as previously provided in Rule 2860(b)(23)(A)(ii) and Rule 11850(b)(2)) that allows members to make final exercise decisions after the exercise cut-off time, but before expiration of the standardized equity option, subject to the same exceptions as Rule 11850 previously provided, which are also consistent with the rules of the Options Exchanges. Specifically, exercise decisions may be effected after the exercise cut-off time: (1) in order to remedy mistakes or errors made in good faith; (2) to take appropriate action as the result of a failure to reconcile unmatched option transactions; or (3) 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. Rule 2860(b)(23)(B) also retains the requirements for reporting and record keeping obligations when a member relies on these exceptions and incorporates provisions from Rule 11850(b)(3) that require members to submit to NASD a copy of the memorandum describing the circumstances that gave rise to any exception.

NASD also added to Rule 2860, in subparagraph (vii), a similar provision as found in the rules of the Options Exchanges that addresses when a national options exchange or OCC establishes a different time for the close of trading.⁴ Under such circumstances, the deadline for making a final decision to exercise or not to exercise will be one hour and 28 minutes following the time announced for the close of trading. With respect to the submission of a CEA by members, the cut-off time will be two hours and 28 minutes after the close of trading for customer accounts and non-customer accounts where the member firm employs an electronic procedure with time stamp for the submission of exercise instructions. Members that do not employ an electronic submission procedure for exercise instructions will be required to submit a CEA within one hour and 28 minutes after the close of trading for non-customer accounts.

New subparagraphs (viii), (ix) and (x) of Rule 2860(b)(23)(A), wholly incorporate the provisions previously contained in Rule 11850(b)(4), (5) and (6), respectively. Specifically, subparagraph (viii) provides that the filing of a final exercise decision, exercise instruction, exercise advice, CEA or Advice Cancel does not serve as a substitute to the effective notice required to be submitted to OCC for the exercise or non-exercise of expiring standardized equity options. Subparagraph (ix) provides that 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. Subparagraph (x) provides that the exercise cut-off requirements do not apply to any currency option or standardized index option products listed on a national options exchange.

Finally, paragraphs (C) and (D) of Rule 2860(b)(23) govern the allocation of exercise assignment notices and delivery and payment, respectively, which are the same as the corresponding provisions in Rule 11850(c) and (d). Accordingly, these provisions are deleted from Rule 11850.

The implementation date of the amendment is October 12, 2006.

Endnotes

- 1 See Exchange Act Release No. 54313 (August 14, 2006), 71 FR 47850 (August 18, 2006) (Notice of Filing and Immediate Effectiveness of SR-NASD-2006-099). Under Section 19(b) of the Securities Exchange Act of 1934, the SEC has the authority to summarily abrogate this type of rule change within 60 days of filing.
- 2 See Rule 980 of the AMEX; Rule 1042 of the PHLX; Rule 6.24 of the NYSE Arca (formerly the PCX); Rule 11.1 and related Regulatory Circulars RG03-41 and RG 03-54 of the CBOE; Rule 1100 of the ISE; and Chapter VII Section 1 of the BOX (collectively referred to as the Options Exchanges).
- 3 See Exchange Act Release No. 47885 (May 16, 2003), 68 FR 28309 (May 23, 2003) (Approval Order of SR-AMEX-2001-92); Exchange Act Release No. 48639 (October 16, 2003), 68 FR 60764 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PHLX-2003-65); Exchange Act Release No. 48640 (October 16, 2003), 68 FR 60757 (October 23, 2003) (Notice of Filing and Immediate Effectiveness of SR-PCX-2003-47); Exchange Act Release No. 49275 (February 18, 2004), 69 FR 8713 (February 25, 2004) (Notice of Filing and Immediate Effectiveness of SR-CBOE-2003-47); Exchange Act Release No. 48505 (September 17, 2003), 68 FR 55680 (September 26, 2003) (Notice of Filing and Immediate Effectiveness of SR-ISE-2003-20) and Exchange Act Release No. 49191 (February 4, 2004), 69 FR 7055 (February 12, 2004) (Notice of Filing and Immediate Effectiveness of SR-BSE-2004-04).
- 4 See *id.*

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ATTACHMENT A

New language is underlined; deletions are in brackets.

2860. Options

(a) No Change.

(b) Requirements

(1) through (22) No Change.

(23) Tendering Procedures for Exercise of Options

(A) Exercise of Options Contracts

(i) Subject to the restrictions established pursuant to paragraph (b)(4) and (b)(8) hereof and such other restrictions that may be imposed by [the Association]NASD, The Options Clearing Corporation or an options exchange pursuant to appropriate rules, an outstanding option contract issued by The Options Clearing Corporation may be exercised during the time period specified in the rules of The Options Clearing Corporation by the tender to The Options Clearing Corporation of an exercise notice in accordance with rules of The Options Clearing Corporation. An exercise notice may be tendered to The Options Clearing Corporation only by the clearing member in whose account the option contract is carried. [Exercise instructions of their customers relating to exchange listed option contracts shall not be accepted by members after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract. Exercise instructions in respect of such option contracts carried in any proprietary account of a member shall similarly not be accepted by any other member with which such member maintains an account after 5:30 p.m. (Eastern Time) on the business day immediately prior to the expiration date of any option contract.]Members may establish fixed procedures as to the latest time they will accept exercise instructions from customers.

[(ii) Notwithstanding the provisions of subparagraph (A)(i) hereof, members may receive and act on exercise instructions after the cut-off time for the acceptance of exercise instructions but prior to 5:00 p.m. (Eastern Time) on the expiration date of an option contract:]

[a. in the case of option contracts carried in an account maintained for another member in which only positions of customers of such other member are carried;]

[b. in order to remedy mistakes or errors made in good faith;]

[c. to take appropriate action as the result of a failure to reconcile unmatched option transactions; or]

[d. where extraordinary circumstances relating to a public customer's ability to communicate exercise instructions to the member (or the member's ability to receive exercise instructions) prior to such cut-off time warrant such action.]

[(iii) This subparagraph (A) is intended as a means of providing for relatively uniform procedures in respect of exercise instructions and not to alter or affect in any way the expiration times for an option which are fixed in accordance with the rules of The Options Clearing Corporation or any other provisions of an options contract, and the exercise prior to expiration of an option contract in contravention of this subparagraph (A) shall neither affect the validity of such exercise nor modify or otherwise affect any right or obligation of any holder or writer of any option contract of such series of options.]

[(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 2860(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) 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 NASD 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. A Contrary Exercise Advice is a form approved by the national options exchanges, NASD 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 in paragraph (ii) above. Contrary Exercise Advices and/or Advice Cancels may be submitted by any member to:

1. 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. 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. 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. 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) 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 paragraphs (iii)b.1. through 4. above, a Contrary Exercise Advice, within the time limits specified in paragraph (ii) 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) 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 NASD's exercise cut-off time at which they will no longer accept final exercise decisions in expiring standardized equity options from customers.

(vi) 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:

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- 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) 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 to make a final decision to exercise or not exercise an expiring option shall be 1 hour 28 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) above. However, members may deliver a Contrary Exercise Advice or Advice Cancel to the places specified in paragraphs (iii)b.1. through 4. 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 deliver a Contrary Exercise Advice or Advice Cancel within 1 hour and 28 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) above.

(viii) The filing of a final exercise decision, exercise instruction, exercise advice, Contrary Exercise Advice or Advice Cancel required by paragraph (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) 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) The exercise cut-off requirements contained in this paragraph (A) do not apply to any currency option or standardized index option products listed on a national options exchange.

(B) [Each member shall prepare a memorandum of every exercise instruction received from a customer showing the time such instruction was received. Such memoranda shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b) under the Act.] In the event a member receives and acts on an exercise instruction (for its own proprietary account or on behalf of a customer's account) pursuant to an exception set forth in subparagraphs a, b., or c. of subparagraph (A)[~~(ii)~~](vi) hereof, the member shall maintain a memorandum setting forth the circumstances giving rise to such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or NASD's Market Regulation Department if it is not a member of such exchange, no later than 12:00 p.m., ET on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b). [If the member is relying on subparagraph b. or subparagraph d. as the basis for an exception, it shall promptly file a copy of the memorandum with the Association.]

(C) through (D) No Change.

(24) No Change.

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[11850. Tendering Procedures for Exercise of Options]

[(a) Exercise of Option Contracts]

[(1) Subject to the restrictions established pursuant to Rule 2860 of the Association's Rules, and such other restrictions which may be imposed by the Association, the Options Clearing Corporation (OCC) or an options exchange pursuant to appropriate rules, an outstanding exchange listed option contract may be exercised during the time period specified in the OCC rules by the tender to OCC of an exercise notice in accordance with OCC rules. An exercise notice may be tendered to OCC only by the clearing member in whose account the option contract is carried. Members may establish fixed procedures as to the latest time at which they will accept exercise notices from their customers.]

[(b) Exercise Cut-Off for Expiring Equity Options]

[(1)(A) Final exercise decisions of options holders to either exercise or not to exercise an expiring 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 on the business day immediately prior to the expiration date ("the exercise cut-off time") in either of the following manners:]

[(i) take no action and allow exercise determinations to be made in accordance with OCC's Rule 805 exercise-by-exception procedure where applicable; or]

[(ii) submit a Contrary Exercise Advice. A Contrary Exercise Advice is a form approved by the national options exchanges and the Association for use by a member to submit a final exercise decision committing an options holder to not exercise an option position which would automatically be exercised pursuant to OCC's exercise-by-exception procedure, or to exercise an equity option position which would not automatically be exercised pursuant to OCC's exercise-by-exception procedure. Contrary Exercise Advices may be submitted by any member:]

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

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

[c. to any national options exchange of which they are a member and where the equity option is listed via OCC in a form prescribed by OCC; or]

[d. to any national options exchange where the equity option is listed via OCC in a form prescribed by OCC, provided the member is a member of OCC.]

[(B) In those instances when OCC has waived the exercise-by-exception procedure, a Contrary Exercise Advice is still required to be submitted by members wanting to exercise an option that would not have been automatically exercised, or not to exercise an option that would have been automatically exercised, had the exercise-by-exception procedure been in effect. The applicable underlying security price in such instances will be as described in OCC Rule 805(1), which is normally the last sale price in the primary market for the underlying security. In cases where the exercise-by-exception procedure has been waived for an options class, OCC rules require that OCC members and member organizations wanting to exercise such options must submit an affirmative Exercise Notice to OCC, whether or not a Contrary Exercise Advice has been filed.]

[(C) Members that maintain proprietary or public customer positions in expiring 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 who 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 the Association's exercise cut-off time at which they will no longer accept final exercise decisions in expiring options from customers.]

[(2) 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.]

[(3) In the event a member makes a final exercise decision (for its own proprietary account or on behalf of a customer's account) after the exercise cut-off time pursuant to an exception set forth in clauses (A), (B), or (C) of paragraph (b)(2) hereof, the member shall maintain a

memorandum setting forth the circumstances regarding such exception and shall file a copy of the memorandum with the Market Regulation Department of the national options exchange trading the option, if it is a member of such exchange, or the Association's Market Regulation Department if it is not a member of such exchange, no later than 12:00 p.m., Eastern Time on the business day following that expiration. Such memorandum must additionally include the time when such final exercise decision was made or, in the case of a customer, received, and shall be subject to the requirements of SEC Rules 17a-3(a)(6) and 17a-4(b).]

[(4) The filing of a final exercise decision required by paragraph (b)(1) hereof does not serve as a substitute to the effective notice required to be submitted to OCC for the exercise or non-exercise of expiring options.]

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

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

[(c) Allocation of Exercise Assignment Notices]

[(1) Each member shall establish fixed procedures for the allocation to customers of exercise notices assigned in respect of a short position in option contracts in such member's customer accounts. Such allocation shall be on a "first in - first out" or automated random selection basis that has been approved by the Association or on a manual random selection basis that has been specified by the Association. Each member shall inform its customers in writing of the method it uses to allocate exercise notices to its customer's accounts, explaining its manner of operation and the consequences of that system.]

[(2) Each member shall report its proposed method of allocation to the Association and obtain the Association's prior approval thereof, and no member shall change its method of allocation unless the change has been reported to and been approved by the Association. The requirements of this paragraph shall not be applicable to allocation procedures submitted to and approved by another self-regulatory organization having comparable standards pertaining to methods of allocation.]

[(3) Each member shall preserve for a three-year period sufficient workpapers and other documentary materials relating to the allocation of exercise assignment notices to establish the manner in which allocation of such exercise assignment notices is in fact being accomplished.]

[(d) Delivery and Payment]

[Delivery of the shares of an underlying security upon the exercise of an option contract and payment of the aggregate exercise price in respect thereto, shall be effected in accordance with the rules of the Options Clearing Corporation. As promptly as practicable after the exercise of an option contract by a customer, the member shall require the customer to make full cash payment of the aggregate exercise price in the case of a call option contract or to deposit the underlying stock in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereto if such transaction is effected in a margin account, in accordance with the applicable regulations of the Federal Reserve Board and Rule 2520 of the Association's Conduct Rules. As promptly as practicable after the assignment to a customer of an exercise notice, the member shall require the customer to deposit the underlying stock in the case of a call option contract if the shares of the underlying security are not carried in the customer's account, or to make full cash payment of the aggregate exercise price in the case of a put option contract, or, in either case, to make the required margin deposit in respect thereof, if such transaction is effected in a margin account, in accordance with Rule 2520 and the applicable regulations of the *Federal Reserve Board*.]

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