

A holder who plans to exercise a cash-settled index option that settles based on closing prices can minimize this risk by withholding exercise instructions until just before the daily exercise cut-off time fixed by his brokerage firm. However, he may not be able to eliminate it entirely. Daily exercise cut-off times for index options may be earlier than those fixed for other types of options and may occur before definitive exercise settlement values have been determined. In the case of the exercise of a cash-settled index option that settles based on opening prices of the constituent securities, this risk applies if the holder submits exercise instructions before the definitive exercise settlement index value has been announced, which may be different from index levels that are initially disseminated at the time of the opening and which may not be available in some cases until several hours after the opening.

7. Cash-settled index options whose exercise settlement values are based on the opening prices of the constituent securities are not traded on the last scheduled trading day for those securities prior to the option expiration date. An option holder will be able to realize value from his option on that day only if the option is in the money and he exercises it. A writer of this type of option who has not previously closed out his position will be unable to do so on that last trading day for the constituent securities and will be at risk of being assigned an exercise.

8. Current index levels will ordinarily continue to be reported even when trading is delayed or interrupted in some or all of the constituent securities of the index or when the reporting of transactions in those securities has been delayed. In that event, the reported index levels will be based on the most recent reported prices of the constituent securities—whether or not those securities are being currently traded. As a result, reported index levels may at times be based on non-current price information with respect to some or even all of the constituent securities of an index. If this condition existed at the time of determining the exercise settlement value of an exercised option, that exercise would be settled on the basis of an index level that might not reflect current price information with respect to constituent securities accounting for a significant portion of the value of the index. (Indeed, as noted in Chapter IV, an exercise settlement value that is based on the opening prices of the constituent securities may not coincide with, and may diverge substantially from, the index values that are reported at the time of the