GENERAL RULING/ORDER 91-901
RECOGNIZED OPTIONS RATIONALIZATION ORDER

IN THE MATTER OF
THE SECURITIES ACT, 1988, S.S. 1988, c. S-42.2

AND

IN THE MATTER OF
TRADING IN RECOGNIZED OPTIONS CLEARED
THROUGH RECOGNIZED CLEARING ORGANIZATIONS

RULING/ORDER
(Sections 83 and 158)

WHEREAS on September 5, 1991, the Saskatchewan Securities Commission (the "Commission") made General Ruling/Order 3 - Recognized Options Rationalization Order, 1991 ("GRO3") ruling and ordering pursuant to sections 83 and 158 of *The Securities Act, 1988*, S.S. 1988, c. S-42.2 (the "Act") that the provisions of sections 27 and 58 of the Act shall not, subject to certain terms and conditions set out therein, apply to trades in Recognized Options cleared through Recognized Clearing Organizations (both as defined therein) such Ruling/Order being a successor to decisions of the Commission made July 17, 1984 as amended and November 7, 1988;

AND WHEREAS on December 1, 1988, the Ontario Securities Commission (the "OSC") made an Order and Ruling pursuant to sections 73 and 140 of *The Securities Act*, R.S.O. 1980, c. 466, as amended (the "SA") that the provisions of sections 24 and 52 of the SA shall not, subject to certain terms and conditions set out therein, apply to trades in Recognized Options cleared through Recognized Clearing Organizations (both as defined therein) and which Order and Ruling has been amended several times (the "Ontario Order");

AND WHEREAS it is desirable to amend GRO 3 so as to add to the list of Recognized Options in GRO 3 capped index options, capped stock index options and capped international index options (collectively "CIOs");

AND WHEREAS the Commission is of the opinion that it would not be prejudicial to the public interest to amend GRO 3 as set out above and restate it as GRO 91-901 as amended;

IT IS HEREBY ORDERED pursuant to section 83 and subsection 158(3) of the Act that:

1. Section 58 of the Act shall not apply to trades in Recognized Options (as defined herein) cleared through Recognized Clearing Organizations (as defined herein) provided that prior to the making of any such trades by a Recognized Dealer (as defined herein) with a customer, such Recognized Dealer shall have sent by prepaid mail or shall have delivered to the customer:

a. A copy of the Disclosure Statement for Recognized Market Options dated July, 1987, a copy of which is attached hereto as Schedule A, as it may be revised from time to time and approved for distribution by the OSC under the Ontario Order (a copy of which is to be filed with the Commission prior to use in Saskatchewan) (the "Disclosure Statement"); and

b. Where the trade is in capped index options, capped stock index options or capped international index options referred to in subparagraph 3.e. of this Ruling/Order, a copy of the Disclosure Document for Capped Index Options dated February, 1993, a copy of which is attached hereto as Schedule B, as it may be revised from time to time and approved for distribution by the OSC under the Ontario Order (a copy of which is to be filed with the Commission prior to use in Saskatchewan) (the "CIO Disclosure Document");

2. For the purposes of this Ruling/Order, the following are Recognized Clearing Organizations:

a. Trans Canada Options Inc. ("TCO");

b. International Options Clearing Corporation ("IOCC");

c. The Options Clearing Corporation ("OCC");

d. The Intermarket Clearing Corporation ("ICC"); and

e. Such other clearing organizations as are recognized from time to time by the OSC under the Ontario Order;

3. For the purposes of this Ruling/Order, the following are Recognized Options:

a. Equity options currently or in the future traded on one or more of The Toronto Stock Exchange (the "TSE"), the Montreal Exchange (the "ME") and the Vancouver Stock Exchange (the "VSE") and cleared through TCO;

b. Debt options and index options currently traded on one or more of the TSE, the ME and the VSE and cleared through TCO;

c. Debt options and precious metal options currently traded on The Toronto Futures Exchange (the "TFE") and cleared through TCO;

d. Precious metal options and currency options currently traded on one or more of the

ME, the VSE, the European Options Exchange (the "EOE") and the Australian Stock Exchange (Sydney) and cleared through IOCC or TCO;

e. Equity options, debt options, currency options, index options, stock index options, capped index options, capped stock index options, capped international index options, international index options, Eurodollar time deposit options and gold bullion options currently or in the future traded on one or more of the American Stock Exchange, the Chicago Board Options Exchange, the New York Stock Exchange, the Pacific Stock Exchange, the Amex Commodities Corporation, the Philadelphia Stock Exchange, the Philadelphia Board of Trade, the EOE and the automated quotation system of the National Association of Securities Dealers and cleared through OCC or ICC;

f. Options on participation units currently traded on the TSE and cleared through TCO; and

g. Such other options as are recognized from time to time by the OSC under the Ontario Order;

provided that any Recognized Option shall cease to be a Recognized Option if:

h. It ceases to be a recognized option under the Ontario Order; or

i. A material change shall be made in the contract specifications to such option which the Director of the Commission (the "Director") refuses to accept within ten business days of the filing with the Commission of notice of any material change;

4. Any additional option traded or to be traded on a market and cleared through a Recognized Clearing Organization shall become a Recognized Option for the purposes of this Ruling/Order for such time as it is a recognized option under the Ontario Order;

5. A clearing organization may become a Recognized Clearing Organization for the purposes of this Ruling/Order in accordance with subclause 2.e. of this Ruling/Order;

6. Section 27 of the Act shall not apply to trades in Recognized Options, other than Recognized Options on equities and on other securities for which registration for trading such underlying securities is generally required under the Act, provided that the trades are effected through Recognized Dealers (as defined herein);

7. Section 27 of the Act shall not apply to advice with respect to Recognized Options, other than Recognized Options on equities and on other securities for which registration for trading such underlying securities is generally required under the Act, provided that advice is given through an adviser registered under the Act and policies of the Commission or through a person or

company for whom registration as an adviser is not required to be obtained under the Act and policies of the Commission;

8. Any person trading in and/or rendering advice with respect to Recognized Options, other than Recognized Options on equities and on other securities for which registration for trading such underlying securities is generally required under the Act, as a salesperson, partner or officer of a dealer registered under the Act or as an adviser in the category of investment counsel and portfolio manager registered under the Act and policies of the Commission:

   a. Shall be registered in that capacity under the Act; and

   b. Shall have successfully completed the Canadian Options Course;

9. For the purposes of this Ruling/Order, the following are Recognized Dealers:

   a. Dealers who are registered under the Act, and who are members of a Recognized Self-Regulatory Organization (as defined herein);

   b. Persons or companies who are members of a Recognized Self-Regulatory Organization (as defined herein) which is a market, and who or which are subject to rules and by-laws of that market provided that such persons or companies are effecting trades in Recognized Options solely on behalf of hedgers (as defined herein); and

   c. With respect to options traded on the TFE and cleared through TCO, persons or companies who or which are Restricted Trader Members or who or which are Unrestricted Trader Members of the TFE, as defined in the By-laws of the TFE as they may be amended from time to time, acting in accordance with the By-laws of the TFE;

10. For the purposes of this Ruling/Order a hedger is:

    A person or company who carries on agricultural, mining, forestry, processing, manufacturing or other commercial activities and, as a necessary part of these activities, becomes exposed from time to time to a risk attendant upon fluctuations in the price of an underlying interest and offsets that risk through trading in options for the underlying interest or related underlying interests whether or not any particular trade is effected for that purpose, but a person or company is a hedger only as to trades in options for such underlying interest or related underlying interests;

11. For the purposes of this Ruling/Order the following are Recognized Self-Regulatory Organizations:

a. The Alberta Stock Exchange (the "ASE");

b. The TSE;

c. The TFE;

d. The ME, including the International Options Market and the Mercantile Division;

e. The VSE;

f. The Winnipeg Commodity Exchange (the "WCE"); and

g. The Investment Dealers Association of Canada;

12. Persons who are not members of a Recognized Self-Regulatory Organization may, with the consent of the Recognized Self-Regulatory Organization, be recognized in writing by the Director as deemed members of that Recognized Self-Regulatory Organization for the purposes of this Ruling/Order;

13. The following rulings and orders of this Commission shall be revoked as and from the date that this Ruling/Order is signed:

a. Order dated July 17, 1984 effective October 30, 1984 as amended - In the Matter of Trading in Recognized Options Cleared Through Recognized Clearing Organizations; and

b. Order and Ruling dated November 7, 1988 - In the Matter of Recognized Options Cleared Through Recognized Clearing Organizations;

14. A Recognized Clearing Organization may appeal any decision of the Director under this Ruling/Order pursuant to the procedures for appeal provided for in the Act;

15. A Recognized Clearing Organization shall provide to the Commission:

a. Initially, its most recent audited financial information and information as to incorporation, principal or registered office, officers, directors and shareholders;

b. Within 150 days of the end of its fiscal year, audited financial information for the most recent fiscal year;

c. Forthwith, and in any event within five days of the approval of a material change to the specifications of any Recognized Option by the governing body of the Recognized Clearing Organization, details of such material change to the specifications of any Recognized Option; and

d. Forthwith, or in any event within five days of the occurrence of a material change to information previously provided to the Commission respecting incorporation, principal or registered office, officers, directors, and shareholders of the Recognized Clearing Organization, details of the material change in that information previously provided to the Commission;

DATED at the City of Regina, in the Province of Saskatchewan, this 5th day of September, 1991.

AMENDED at the City of Regina, in the Province of Saskatchewan, this 16th day of February, 1993.

"*Marcel de la Gorgendière*"
Marcel de la Gorgendière, Q.C.
Chairman

Schedule "A"

No securities commission or similar authority in Canada has in any way passed upon the merits of Options referred to herein and any representation to the contrary is an offence. This document contains condensed information respecting the Options referred to herein. Additional information may be obtained from your broker.

DISCLOSURE STATEMENT

for

Recognized Market Options

A high degree of risk may be involved in the purchase and sale of Options, depending to a large measure on how and why Options are used. Options may not be suitable for every investor. See "Risks in Option Trading" and "Additional Information".

INTRODUCTION

This Disclosure Statement sets forth general information relevant to the purchase and sale of Put and Call Options traded on a recognized market and cleared through a clearing corporation. Information concerning the underlying interests on which Options are traded, the terms and conditions of these Options, the recognized markets on which they trade and the applicable clearing corporations may be obtained from your broker. Information on investment strategies and possible uses of Options may also be obtained from your broker.

This Disclosure Statement refers only to Options and clearing corporations which have been recognized or qualified for purposes of this Disclosure Statement by provincial securities administrators where required. The Options discussed herein trade on markets which, for the purposes of this Disclosure Statement only, are referred to as "recognized markets".

NATURE OF AN OPTION

An Option is a contract entered into on a recognized market between a seller (sometimes known as a writer) and a purchaser where all the terms and conditions of the contract (called the "specifications"), other than the consideration (called the "premium") for the Option, are standardized and predetermined by the recognized market. The premium, paid by the purchaser to the seller, is determined in the market on the basis of supply and demand, reflecting such factors as the duration of the Option, the difference between the exercise price of the Option and the market price of the underlying interest, the price volatility and other characteristics of the underlying interest.

There are two types of Options: Calls and Puts. A Call gives the purchaser a right to buy, and a Put the right to sell, a specific underlying interest at a stated exercise price and within a specified period of time or on a specific date. An Option subjects the seller to an obligation to honour the right granted to the purchaser if exercised by the purchaser. Underlying interests can be shares of a specific corporation, bonds, notes, bills, certificates of deposit, commodities, foreign currency, the cash value of an interest in a stock index or any other interest provided for in the specifications.

An Option transaction is entered into on a recognized market by a purchaser and a seller represented by their respective brokers. When the transaction is concluded it is cleared by a clearing corporation affiliated with the recognized market on which the Option is traded. When an Option transaction is cleared by the clearing corporation it is divided into two contracts with the clearing corporation becoming the seller to the purchaser in the transaction and the purchaser to the seller. Thus on every outstanding Option, the purchaser may exercise the Option against the clearing corporation and the seller may be called upon to perform his obligation through exercise of the Option by the clearing corporation.

Options may also be classified according to delivery requirements: actual delivery and cash delivery. An actual delivery Option requires the physical delivery of the underlying interest if the Option is exercised. A cash delivery Option requires a cash payment of the difference between the aggregate exercise price and the value of the underlying interest at a specified time prior or subsequent to the time the Option is exercised.

Options are issued in series designated by an expiration month, an exercise price, an underlying interest and a unit of trading. At the time trading is introduced in Options with a new expiration month, the recognized market on which the Option is traded establishes exercise prices that reflect the current spot prices of the underlying interest. Generally, three series of Options are introduced with exercise prices at, below and above the current spot price. When the spot price of the underlying interest moves, additional Options may be added with different exercise prices. Options having the same underlying interest and expiration month, but having different exercise prices, may trade at the same time.

SPECIFICATIONS OF OPTIONS

Specifications of Options are fixed by the recognized market on which they are traded. These specifications may include such items as trading units, exercise prices, expiration dates, last day of trading, and the time for determining settlement values.

An Option may be bought or sold only on the recognized market on which the Option is traded. The recognized market and the clearing corporation may each impose restrictions on certain types of transactions, and under certain circumstances may modify the specifications of outstanding Options. In addition, a recognized market or a clearing corporation may limit the number of Options which may be held by an investor, and may limit the exercise of Options under prescribed circumstances.

EXERCISING OPTIONS

An Option may have either an American style exercise or European style exercise irrespective of where the recognized market is located. An American style Option can be exercised by the purchaser at any time before the expiration. To do this, the purchaser notifies the broker through whom the Option was purchased. A purchaser should ascertain in advance from his broker the latest date on which he may give such notice to his broker. A European style Option may only be exercised by the purchaser on a specified date. Upon receiving an exercise notice from the purchaser's broker, the clearing corporation assigns it to a member which may re-assign it to a client on a random or other predetermined selection basis.

Upon assignment, the seller must make delivery of (in the case of a Call) or take delivery of and pay for (in the case of a Put) the underlying interest. In the case of a cash delivery Option, the seller must, in lieu of delivery, pay the positive difference between the aggregate exercise price and the settlement value of the underlying interest (in the case of both a Call and a Put).

A purchaser of an Option which expires loses the premium paid for the Option and his transaction costs. The seller of an Option which expires will have as his gain the premium received for the Option less his transaction costs.

TRADING OF OPTIONS

Each recognized market permits secondary market trading of its Options. This enables purchasers and sellers of Options to close out their positions by offsetting sales and purchases. By selling an Option with the same terms as the one purchased, or buying an Option with the same terms as the one sold, an investor can liquidate his position (called an "offsetting transaction"). Offsetting transactions must be made prior to expiration of an Option or by a specified date prior to expiration. Offsetting transactions must be effected through the broker through whom the Option was initially sold or purchased.

Price movements in the underlying interest of an Option will generally be reflected to some extent in the secondary market value of the Option and the purchaser who wishes to realize a profit will have to sell or exercise his Option during the life of the Option or on the specified date for exercise, as the case may be.

COSTS OF OPTIONS TRADING

Margin Requirements

Prior to trading Options, a seller must deposit with his broker cash or securities as collateral (called "margin") for the obligation to buy (in the case of a Put) or sell (in the case of a Call) the underlying interest if the Option should be exercised. Minimum margin rates are set by the recognized market on which the Option trades. Higher rates of margin may be required by the seller's broker.

Margin requirements of various recognized markets may differ. In addition, they are subject to change at any time and such changes may apply retroactively to Option positions previously established.

Commission Charges

Commissions are charged by brokers on the purchase or sale of Options as well as on the exercise of Options and the delivery of underlying interests.

RISKS IN OPTIONS TRADING

Options can be employed to serve a number of investment strategies including those concerning investments in or related to underlying interests. SOME STRATEGIES FOR BUYING AND SELLING OPTIONS INVOLVE GREATER RISK THAN OTHERS.

The following is a brief summary of some of the risks connected with trading in Options:

(i) Because an Option has a limited life, the purchaser runs the risk of losing his entire investment in a relatively short period of time. If the price of the underlying interest does not rise above (in the case of a Call) or fall below (in the case of a Put) the exercise price of the Option plus premium and transaction costs during the life of the Option, or by the specified date for exercise, as the case may be, the Option may be of little or no value and if allowed to expire will be worthless.

(ii) The seller of a Call who does not own the underlying interest is subject to a risk of loss should the price of the underlying interest increase. If the Call is exercised and the seller is required to purchase the underlying interest at a market price above the exercise price in order to make delivery, he will suffer a loss.

(iii) The seller of a Put who does not have a corresponding short position (that is an obligation to deliver what he does not own) in the underlying interest will suffer a loss if the price of the underlying interest decreases below the exercise price, plus transaction costs minus the premium received. Under such circumstances, the seller of the Put will be required to purchase the underlying interest at a price above the market price, with the result that any immediate sale will give rise to a loss.

(iv) The seller of a Call who owns the underlying interest is subject to the full risk of his investment position should the market price of the underlying interest decline during the life of the Call, or by the specified date for exercise, as the case may be, but will not share in any gain above the exercise price.

(v) The seller of a Put who has a corresponding short position in the underlying interest is subject to the full risk of his investment position should the market price of the underlying interest rise during the life of the Put, or by the specified date for exercise, as the case may be, but will not share in any gain resulting from a decrease in price below the exercise price.

(vi) Transactions for certain Options may be carried out in a foreign currency. Accordingly, purchasers and sellers of these Options using Canadian dollars will be exposed to risks from fluctuations in the foreign exchange market as well as to risks from fluctuations in the price of the underlying interest.

(vii) There can be no assurance that a liquid market will exist for a particular Option to permit an offsetting transaction. For example, there may be insufficient trading interest in the particular Option; or trading halts, suspensions or other restrictions may be imposed on the Option or the underlying interest; or some event may interrupt normal market operations; or a recognized market could for regulatory or other reasons decide or be compelled to discontinue or restrict trading in the Option. In such circumstances the purchaser of the Option would only have the alternative of exercising his Option in order to realize any profit, and the seller would be unable to terminate his obligation until the Option expires or until he performed his obligation upon being assigned an exercise notice.

(viii) The seller of an American style Option has no control over when he might be assigned an exercise notice. He should assume that an exercise notice will be assigned to him in circumstances where the seller may incur a loss.

(ix) In unforeseen circumstances there may be a shortage of underlying interests available for delivery upon exercise of actual delivery Options, which could increase the cost of or make impossible the acquisition of the underlying interests and cause the clearing corporation to impose special exercise settlement procedures.

(x) In addition to the risks described above which apply generally to the buying and selling of Options, there are timing risks unique to Options that are settled by the payment of cash.

The exercise of Options settled in cash results in a cash payment from the seller to the purchaser based on the difference between the exercise price of the Option and the settlement value. The settlement value is based on the value of the underlying interest at a specified time determined by the rules of the recognized market. This specified time could vary with the Option. For example, the specified time could be the time for establishing the closing value of the underlying interest on the day of exercise or in the case of some Options based on a stock index the time for establishing the value of the underlying interest which is based on the opening prices of constituent stocks on the day following the last day of trading. Options for which the settlement value is based on opening prices may not, unless the applicable recognized market announces a rule change to the contrary, trade on that day.

The settlement value for Options, futures contracts and futures options may not be calculated in the same manner even though each may be based on the same underlying interest.

Where the settlement value of a cash delivery Option is determined after the exercise period, the purchaser who exercises such Option will suffer from any unfavourable change in the value of the underlying interest from the time of his decision to exercise to the time settlement value is determined. With actual delivery Options, this risk can be covered by a complementary transaction in the actual market for the underlying interest.

The seller of a cash delivery Option is not informed that he has been assigned an exercise notice until the business day following exercise, at the earliest, and the seller will suffer from any unfavourable change in the value of the underlying interest from the time of determination of the settlement value to the time he learns that he has been assigned. Unlike the seller of an actual delivery Option, the seller of a cash delivery Option cannot satisfy his assignment obligations by delivery of the lower valued underlying interest, but must pay cash in an amount determined by the settlement value.

The type of risk discussed above makes spreads and other complex option strategies involving cash delivery Options substantially more risky than similar strategies involving actual delivery Options.

TAX CONSEQUENCES

The income tax consequences of trading in Options are dependent upon the nature of the business activities of the investor and the transaction in question. Investors are urged to consult their own professional advisers to determine the consequences applicable to their particular circumstances.

ADDITIONAL INFORMATION

Before buying or selling an Option an investor should discuss with his broker:

* His investment needs and objectives
* The risks he is prepared to take
* Commission rates
* Margin requirements
* Any other matter of possible concern

Specifications for each Option are available on request from your broker and from the recognized market on which the Option is traded. Should there be any difference in interpretation between this document and the specifications for a given Option, the specifications shall prevail.

July, 1987

Schedule "B"

No securities commission or similar authority in Canada has in any way passed upon the merits of Options referred to herein and any representation to the contrary is an offence. This document contains condensed information respecting the Options referred to herein. Additional information may be obtained from your broker.

D I S C L O S U R E D O C U M E N T

for

Capped Index Options

INTRODUCTION

This document relates to "capped" (or "capped-style") standardized index options. This document supplements and is intended to be read in conjunction with the Disclosure Statement for Recognized Market Options, which is available from brokers and the exchanges on which standardized options are traded. This document presumes that the reader has read and is familiar with that Disclosure Statement. If that is not the case, the reader should obtain and read that Disclosure Statement befor placing an order for, or effecting a transaction in, any standardized option.

A capped index option is an Index option that is automatically exercised prior to expiration if, as determined by the exchange on which the option is traded, the "exercise settlement value" for the option on any trading day equals or exceeds (in the case of a call) or equals or is less than (in the case of a put) the "cap price" for the option. (This is sometimes described in this document by saying that the automatic exercise feature of a capped index option is "triggered" if the exercise settlement value "hits the cap Price.) The holder of a capped index option also has the right, like the holder of a European-style option, to exercise the option during a specified period immediately prior to the expiration of the option.

Because the automatic exercise feature of capped index options makes them different from American-style and European-style index options, capped options are treated as constituting a different "style of option," and put and call options may therefore be categorized as American-style, European-style or "capped-style." Just as it has previously been essential for holders and writers of index options to know whether their options are American-style or European-style, it is now essential for holders and writers to know whether their options are American-style, European-style or capped-style.

The terms of a particular capped index option (contract size, exercise price, expiration date, cap price, time of day at which the exercise settlement value is determined, etc.) are fixed by the market on which that option trades. Capped index options having the same underlying index and other identical contract terms may be traded in more than one market.

CAPPED INDEX OPTION TERMINOLOGY

CAPPED and CAPPED-STYLE-A capped or capped-style, index option is an index option that (1) will be automatically exercised prior to expiration if the exchange on which the option is traded determines that the exercise settlement value for the option on any trading day has hit the cap price for the option and (2) may, as in the case of a European-style index option, be exercised by it holder in the holder's discretion, during a period (of a duration specified by the exchange on which the option is traded) immediately prior to its expiration.

CAP INTERVAL - This is a value established by the exchange on which a series of capped options is traded. The exercise price for a capped option plus the cap interval (in the case of a call), or minus the cap interval (in the case of a put), is equal to the cap price for the option.

CAP-PRICE - The cap price is the value of the index underlying a series of capped index options at which the options in the series will be automatically exercised. The cap price of an option is above (in the case of a call) or below (in the case of a put) the exercise price of the option.

EXAMPLE: A capped call option on the ABC Index has an exercise price of 360 and a cap interval of 30. The call option has a cap price of 390.

EXAMPLE: A capped put option on the XYZ Index has an exercise price of 310 and a cap Interval of 20. The put option has a cap price of 290.

CASH SETTLEMENT AMOUNT - This is a term that is used to refer to the cash amount that the holder of any index option is entitled to receive upon the exercise of the option. In the case of a capped index option that is automatically exercised, the cash settlement amount is equal to the cap interval times the multiplier for the option, even if the exercise settlement value on the day that the automatic exercise feature is triggered actually exceeds (in the case of a call) or is less than (in the case of a put) the cap price. If the capped option is exercised at the discretion of its holder in the period immediately prior to expiration, the cash settlement amount is determined in the same manner as for an American-style or European-style index option, i.e., the cash settlement amount is equal to the difference between the exercise settlement value on the day of the exercise and the exercise price of the option, multiplied by the multiplier. If the day on which the option is exercised is not a trading day, then the cash settlement amount is determined as of the most recent trading day.

EXAMPLE: A capped call option on the ABC Index has an exercise price of 360, a cap interval of

30, and a multiplier of 100. The exercise settlement value of the ABC Index is 396 on a particular trading day. The call option is automatically exercised, and the cash settlement amount is $3000 (equal to the cap interval of 30 times the multiplier of 100).

EXAMPLE: A capped call option on the ABC Index has an exercise price of 360, a cap interval of 30, and a multiplier of 100. The exercise settlement value of the ABC Index never equals or exceeds 390 during the life of the option, and is 367 on the final trading day. The holder is able to exercise the option and receive a cash settlement amount of $700 (equal to the multiplier of 100 times the difference between the final exercise settlement value of 367 and the exercise price of 360).

EXERCISE SETTLEMENT VALUE - The exercise settlement value is a value of the index underlying a series of index options, determined for each trading day as of the close of trading, or as of another time of the day specified by a rule of the exchange on which the series of options is traded.

EXAMPLE: A capped put option on the XYZ Index has an exercise price of 310 and a cap Interval of 20, and therefore has a cap price of 290. The exercise settlement value for options on the XYZ Index is determined as of the close of trading on each trading day. The value of the Index reaches a low of 289 during a particular trading day, but closes at 291. The exercise settlement value has not hit the cap price and the automatic exercise feature of the option is not triggered.

RISKS OF BUYING CAPPED INDEX OPTIONS

Holders of capped-style options are subject to the risks of buying Index options. In addition, holders should take the following into account.

1. The automatic exercise feature of capped-style index options limits the maximum value that a buyer or holder of the options can receive. This is because the maximum cash settlement amount that a holder can receive is equal to the cap interval times the multiplier for the option. Even if a holder of a capped index option expects the exercise settlement value for the option to continue to move in a direction favourable to the holder (i.e. up in the case of a call, or down in the case of a put) prior to the expiration date of the option, the automatic exercise feature will prevent the holder from realizing any additional gain from the option.

2. Like a European-style index option, a capped-style index has no intrinsic or in-the-money value prior to the period when the option may be exercised in the direction of its holder. That is, prior to the period when a capped-style option may be exercised in the discretion of its holder, the only means through which the holder can realize value from the option (unless the option is automatically exercised, which the holder cannot control) is to sell it at its then market price in the secondary market. Although an American-style option may be exercised ordinarily to trade for no less than its intrinsic value prior to its expiration, the same may not be true for a capped-

style option, just as it may not be true for a European-style option.

3. The automatic exercise feature of a capped-style index option may cause the option to be automatically exercised at a time that is not optimal from the point of view of the holder.

4. A buyer of capped index options bears the risk that an exercise settlement value for the index underlying a series of capped index options will be reported erroneously by the official source of the index and that, as a consequence, the exchange on which the options are traded will not determine on a timely basis that the automatic exercise feature has been triggered. In that event, the capped index options will not be automatically exercised unless the exchange determines that the exercise settlement value for the options has on a subsequent trading day hit the cap price.

5. The Broker acting on behalf of a holder of a capped index option that has its automatic exercise feature triggered on any trading day other than the trading day immediately preceding expiration will receive the cash settlement amount for the exercise on the second business day after the exercise feature is triggered. In contrast, the Broker acting on behalf of a holder of (a) an exercised non-capped index option, (b) a capped index option that is exercised by its holder during the period immediately prior to its expiration in which such exercise is permitted or (c) a capped index option that has the automatic exercise feature triggered on the trading day immediately preceding expiration, will receive the cash settlement amount on the next business day. A holder of a capped index option that has its automatic exercise feature triggered on any trading day other than the trading day immediately preceding expiration therefore cannot expect to receive the cash settlement amount for the exercise from the holder's broker as quickly as a holder can expect to receive the cash settlement amount for the other index option exercises.

RISKS OF WRITING CAPPED INDEX OPTIONS

Writers of capped index options are subject generally to the risks of writing index options. In addition, writers should take the following into account.

1. A sudden development may cause a sharp upward or downward "spike" in the value of the index underlying a capped index option. Such a spike could cause the option to be automatically exercised, and writers of the option to become obligated to pay the cash settlement amount, even if the effect of the development on the value of the index completely disappears on the day after the automatic exercise is triggered.

2. The index underlying a capped index option may not reflect the true state of the market, if, for example, trading in one or more of the securities comprising the index has been halted. A capped index option would nevertheless be subject to automatic exercise if the exercise

settlement value for the option hits the cap price for the option.

3. The markets on which capped index options are traded do not intend to restrict the automatic exercise of capped index options. Moreover, with respect to capped index options traded on the United States Exchanges, the clearing house has no authority to restrict the automatic exercise. It is therefore possible that automatic exercise of a capped index option could occur on a day when the clearing house or a market has imposed restrictions on the exercise of other index options. It is also possible that automatic exercise of a capped index option could occur on a day when the market has suspended trading in the option. Either of these possibilities could limit the ability of a writer to take action to limit the cost to the writer of the automatic exercise.

4. Like a writer of American-style index options (and unlike a writer of European-style index options), a writer of capped-style index options is exposed to a risk of "early exercise," since the capped options will be automatically exercised prior to expiration if the exercise settlement value on any trading day hits the cap price for the option. However, the likelihood of early exercise for a capped-style index option is somewhat more predictable than it is for an American-style option. On the one hand, early exercise of the capped option can occur only if the exercise settlement value reached or exceed the cap price. On the other hand, if the exercise settlement value for a series of capped options hits the cap price, a writer of a capped option in the series is certain to be assigned an exercise, because all long positions in the series would be automatically exercised and each short position in the series would be assigned an exercise.

5. A writer of capped index options bears the risk that an exercise settlement value for the index underlying a series of capped index options will be reported erroneously by the official source of the index and that, as a consequence, the exchange on which the options are traded will determine that the automatic exercise feature has been triggered. If the exchange makes such a determination and does not correct it on a timely basis, the options will be automatically exercised and, as described in the preceding paragraph, the short positions of all writers will be assigned the exercise.

6. A writer of capped index options has somewhat less financial exposure than a writer of other index options does. This is because the writer of an index option other that a capped index option has an exposure that is unlimited (in the case of a call) or limited only by the value of the underlying index (in the case of a put), whereas the capped option writer has a maximum exposure equal to the maximum possible cash settlement amount for the option, which is the product of the cap interval for the option times the multiplier for the option.

February, 1993