MFR 04018717

Memorandum for the Record

Event: Meeting with Options Clearing Corporation (OCC) Personnel
Type of Event: On-the-Record Meeting
Date of Meeting: 4/2/04
Date memo prepared: 4/5/04
Special Access Issues: None
Prepared by: Doug Greenburg
Team Number: 4
Location: OCC Office, Chicago
Classification: Unclassified
Present, non-Commission: OCC Deputy Counsel Jean Cawley; OCC Director, Member Services, David H. Harrison
Participants-Commission: Doug Greenburg and John Roth

On April 2, 2004, we met with the above-referenced OCC personnel. This memorandum provides a summary of the most important points covered in the meeting, but is not a verbatim account. The memorandum is organized by subject and does not necessarily follow the order of the meeting. The witnesses provided all of the information in this memorandum during the interview, except where explicitly stated or noted by square brackets.

The meeting followed recent phone and email conversations between D. Greenburg and J. Cawley concerning the issues of unexercised options, as described in the press, and trading volume in advance of 9/11.

Option Exercise Procedures

Cawley explained that options expire on the Saturday after the third Friday of each month at 11:59 p.m Eastern time. According to OCC Rule 805, any expiring options "in the money" by at least $.25 (for firms or market/makers) or $.75 (for customers) are automatically exercised, unless the broker/dealer specifically directs to the contrary. For example, if a stock closes at $40 on the expiration date, all call options with a strike price of less than $39.75 (for firms or market makers) or $39.25 (for customers) are automatically exercised, unless the OCC is otherwise directed.

Harrison said that when instructions are received to refrain from exercising options that are in the money, Member Services contacts the member providing the instructions to ensure that an error did not take place. In other words, since it would be unusual for a customer to not close out a profitable position, Member Services makes a phone call to make sure that is really the customer's intent. The call is a form of "due diligence." The vast majority of profitable positions are closed out without individually coming to Member Services' attention. Only those rare non-exercised profitable positions are subject to the due diligence check.

Cawley said that records of what, if anything, was subject to the due diligence check in fall 2001, do not exist at the OCC. Harrison said, however, he has no recollection of any positions made profitable by the 9/11 attacks not being closed out in the fall 2001. As the OCC official responsible for making the due diligence calls, he would have been aware of any such positions. Such calls are sufficiently rare that he and others within the organization would have remembered them, especially because they were aware very soon after 9/11 of the rumors of insider trading in advance of the attacks. No one in the organization has any recollection of any such due diligence calls or open positions being allowed to expire. For this reason, Harrison is confident that no substantial profitable options positions remained unexercised after 9/11.

We reviewed with Cawley and Harrison a September 29, 2001 San Francisco Chronicle article, citing the OCC as stating that 2,313 put UAL options remained outstanding. They said this article must be referring to options other than the then-expired September series, which would not have yet expired. Some holders of the October or other UAL put series had apparently not exercised those options by the date of the article, perhaps in hopes that the stock price would continue to fall before the expiration.

Trading Volume

Pursuant to our request, Harrison provided us with the OCC volume figures for UAL and AMR stock options for the period 8/20/01 to 9/10/01. The "records" reflect number of transactions, with the buy and sell side of each transaction reflected separately. Thus, one trade is two records. The quantity reflects puts or calls both bought and sold.

Paper Trail

Cawley and Harrison said that it was impossible to trade options in the U.S. without creating a paper trail. Any options trading could be traced to an account at a broker/dealer. There, the broker/dealer's "know your customer" policies would require information about the end customer. In any event, at a minimum, the paper trail would lead back to the broker/dealer.

Additional Information

The OCC agreed to compile and provide a list breakdown of the UAL and AMR put volumes, reflecting quantity of puts bought, by broker/dealer.