

Chapter 25

Options On Contracts Of Sale On Hard Winter Wheat Futures Contracts

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Chapter 25

Options On Contracts Of Sale On Hard Winter Wheat Futures Contracts

2500.00 Options On Contracts Of Sale On Hard Winter Wheat Futures Contract. This chapter is limited in application to trading "put" and/or "call" options on the Hard Winter Wheat Futures Contracts traded on The Board of Trade of Kansas City, Missouri, Inc. (KCBT). The procedures for exchange government, rule enforcement, membership and other rights with privileges and obligations for trading options hereunder, and the procedures for trading, clearing, delivery, and settlement and all other matters not specifically covered herein shall be governed by and be subject to the general rules, regulations and resolutions of the KCBT or such other rules hereafter adopted by the Board of Directors ("Board") pertaining thereto. Whenever the rules of other chapters use words such as "grain," "wheat," or "commodity," those rules shall be deemed to refer to this Contract as well, if and as the context indicates. However, if there is any conflict between this chapter and the general rules and regulations of the KCBT, the provisions of this chapter shall take precedence.

2501.00 Additional Rules. The Board of Directors ("Board") of the KCBT has the authority to adopt additional rules and regulations, and alter existing rules and regulations, including the rules of this chapter, on ten (10) hours' notice, subject to Commodity Futures Trading Commission approval, if required. Changes which materially alter the rights of the parties with open contracts must be delayed until there are no open contracts, except in the event of a market emergency.

2502.00 Options. Options may be written and traded in the "Hard Winter Wheat Futures Contract" pursuant to Chapter 20 of the KCBT Rules and Regulations as they exist or are amended from time to time.

2503.00 Transfer, Assignment Or Disposal Of Options. Options shall not be transferred, assigned or otherwise disposed of other than on or subject to the rules of the KCBT, the Commodity Exchange Act and the rules and regulations of the Commodity Futures Trading Commission and may be exercised only by the establishment, by book entry, in the Clearing Corporation of positions in the underlying futures contracts.

2503.01 Limitations On Option Transactions. No person shall solicit or accept orders (other than in a clerical capacity) for the purchase or sale of the option contract, or to supervise any person so engaged, unless that individual meets the requirements of 17 C.F.R. 33.3 (b) (1).

2503.02 Prohibition On Order Acceptance. Futures Commission Merchants (FCM) members of the KCBT (or others who may trade the option contract pursuant to rule 2503.01) are prohibited from accepting customer orders from another FCM or introducing broker which does not qualify to trade the option contract as prescribed in rule 2503.01.

2505.00 Option Trading Hours. The trading hours are 9:30 A.M. to 1:15 P.M. local time. The trading hours may be varied by the Board of Directors.

2506.00 Location. Trading will occur on the trading floor of the Kansas City Board of Trade at a place designated by the Board of Directors.

2507.00 Option Trading Months. Options shall be listed for trading in the following months:

- a. For options months in the ordinary cycle of the underlying futures contract (i.e., July, September, December, March and May), the number of months listed shall be the same as the underlying futures contract, provided, however, that a new option contract based on the ordinary cycle will be introduced the day after trading has commenced in the underlying futures pursuant to Rule 2511.02.
- b. For options months outside the ordinary cycle (i.e., August, October, November, January, February, April and June, hereinafter referred to as "serial" months), the number of months listed shall be established by the Board. However, no serial months shall be listed outside of the months listed pursuant to subsection (a) above.

2507.01 Underlying Futures Contract. For options that expire in the ordinary cycle (i.e., July, September, December, March and May), the underlying futures contract is the futures contract corresponding to the option expiration month. For serial options (options outside the ordinary cycle), the underlying futures contract is the next futures contract in the ordinary cycle nearest the option expiration month. For example, the underlying futures contract for an option contract expiring in October or November is the December futures contract.

2508.00 Futures Contract Size. The size of the unit of trading in the options contract shall be five thousand (5,000) bushels, the same size as the underlying futures contract.

2509.00 Deep-Out-Of-The-Money Options.

1. A deep out-of-the-money option is defined as an out-of-the-money option whose strike price is more than X strike prices distant from the strike price closest to the settlement price of the underlying futures contract, where X equals two (2) plus the number of calendar months remaining until option expiration;
2. However, the Board may impose additional criteria as appropriate;
3. No member commission merchant shall accept an order for a deep out-of-the-money option without providing the customer with an explanation of the nature and the risks of the option prior to the transaction.

2510.00 Option Premium — Definition. The "option premium" shall be the sum paid to the writer of a call option who agrees to deliver the underlying futures contracts against payment of the exercise price upon being assigned an exercise notice. The premium with respect to the writer of a put option is the sum paid to the writer of the put option who agrees to purchase the underlying futures contract on which the put is written at the exercise price upon being assigned an exercise notice. Both put options and call options may be written.

2510.01 Option Premium Payment. The Clearing Corporation must receive from each of its clearing members, and each clearing member must receive from each other party for whom it clears commodity option transactions, and each futures commission merchant must receive from each of its option customers, the full amount of each option premium at the time the option is purchased, or within a reasonable time thereafter.

2511.00 Strike Price. The strike price is the price at which a party may purchase or sell the underlying futures contract upon exercise of an option. The strike price will be determined as follows:

2511.01 Strike Price Interval. Trading shall be conducted for options with strike prices in interval multiples of \$.10 per bushel.

At the commencement of trading a new option month, the following strike prices shall be listed: the strike price closest to the previous day's settlement price of the underlying futures contract, the next thirty (30) higher and the next thirty (30) lower strike prices; provided, however, that no strike price shall be listed below the \$1.00 strike price level.

If the previous day's settlement price is midway between two strike prices, the closest price shall be the larger of the two. (For example - new futures month closes at 3.75, closest price is 3.80.) The Board of Directors, or a Committee designated by the Board, may modify the procedures for the introduction of strikes as it deems appropriate in order to respond to market conditions.

2511.02 New Options. A new option based on a futures month within the ordinary cycle will be introduced the day after trading has commenced in the underlying futures contract for that contract month, (for example — if on February 1, the December futures contract had traded for the first time, then on February 2, an option month for the December futures contract is listed, having strike prices as specified in Rule 2511.01). A new option based on a serial month (a month outside of the ordinary cycle) will automatically be introduced the day following the expiration of a serial month, so as to at all times have available for trading the number of serial months established by the Board for trading, (for example, if the Board has authorized the listing of three serial months, and those months currently traded are January, February and April, then the serial contract month of June will automatically be listed for trading the day following the expiration of the January contract month).

2511.03 New Strike Price. Any close which causes there to be less than the number of strike prices prescribed by Rule 2511.01 will cause new strike prices to be added the next day in order to have at least the number of strike prices pursuant to Rule 2511.01 available for trading.

2511.04 Horizontal Option Strike Price. Reserved.

2511.05 Limit On New Strike Prices. No new strike prices may be introduced during the last six (6) trading days of the expiring option.

2511.06 Delisting. An option having a particular strike price shall be delisted if for ten consecutive trading days no transaction is made, and there is no open position in such strike price; provided, however, that no option shall be delisted if it has a strike price which is required by Rules 2511.01, 2511.03, or 2511.04.

2511.07 Relisting. Any strike price which has been delisted under Rule 2511.06 shall thereafter be relisted at any time any such option has a strike price required by Rules 2511.01, 2511.03 or 2511.04.

2511.08 Price Display And Dissemination. Each series of options and prices opened for trading shall be displayed on the price display system on the KCBT floor and disseminated in such other manner as deemed appropriate by the Board of Directors.

2512.00 Bids And Offers. Bids and offers for options shall be measured and expressed in increments of 1/8¢ per bushel. However, for options valued at less than 1/8¢, the option premium may range from \$1.00 to \$5.00 in \$1.00 increments per option contract.

2513.00 Margin Requirements. The Margin requirements will be set by Resolution of the Board of Directors, and may be changed from time to time in like manner. Note: See Resolution 11-1160.00-1.

2514.00 Last Day Of Trading And Expiration.

- a. For options months in the ordinary cycle; no trades in options expiring in the current month shall be made after 1:15 p.m. on the last Friday which precedes by at least 2 business days, the first notice day for the corresponding futures contract.
- b. For serial options months (months outside the ordinary cycle); no trades shall be made after 1:15 p.m. on the Friday which precedes by at least 2 business days, the last business day of the calendar month immediately preceding the option serial month, (for example, for November serial options contracts, the last trading day is the Friday which precedes by at least 2 business days, the last business day in October). If such Friday is not a business day, the last day of trading shall be the business day prior to such Friday. The option shall expire at 10:00 a.m. on the first Saturday following the option's last day of trading.

2514.01 Settlement Price Procedure. The settlement price of the option contract shall be determined using a computer model to calculate each settlement based on consensus input in satisfaction of the model variables, provided such settlement does not violate an existing bona-fide CTI type 2 or 4 order. The information input should yield a settlement that reflects the average of the fair value bid/ask for each strike. If technical problems preclude the use of the computer model, the settlement price of the option shall be determined by the same procedure used to determine the settlement price of the hard winter wheat futures contract.

2514.02 Settlement Of Trades. Trades made in put and call options shall be settled at the end of each day's trading. Positions in the underlying futures contracts as a result of the exercise of options shall be made by book entry in the books of the Clearing Corporation.

2515.00 Exercise. Options are exercisable at any time prior to the expiration thereof by giving notice of exercise to the Clearing Corporation by 4:00 p.m. on any trading day, up to and including the last trading day. The KCBT reserves the right by Board action to extend the time by which options can be exercised under emergency situations.

2515.01 Allocation Of Exercise Notices By Clearing Corporation. The Clearing Corporation shall assign an exercise notice to the clearing member's account which the clearing company selected on a random non-preferential basis (as is determined by the Clearing Corporation) from among all clearing member accounts reflecting the writing of options of the same maturity month and strike price as the exercised option. The Clearing Corporation shall notify the clearing member to whose account the exercised notice is assigned by 9:00 a.m. on the next business day. The writer of a call option is assigned a short Hard Winter Wheat Futures position at the striking price of the option. The writer of a put option is assigned a long Hard Winter Wheat Futures position at the striking price of the option. If the exercise notice was assigned to the clearing member's customer account, the clearing member in turn shall allocate the assignment to one of its customers who is a writer of options of the same maturity and strike price as the exercised option. Such allocation shall be made on a random, non-preferential basis. The clearing member should make an attempt in good faith to promptly notify any customer who has been allocated an option assignment.

2515.02 Allocation Of Exercise Notices By Members. Members must implement fair non-preferential procedures for the allocation of exercise notices among their accounts and accounts they carry. Such procedures must be in writing. Such allocation is subject to review by the KCBT.

2515.03 Automatic Exercise. On the last trading day of the expiring option, all open long positions in expiring wheat options for which the exercise price is less, in the case of call options, or greater, in the case of put options, than the settlement price of the underlying futures contract shall be automatically exercised unless instructions to the contrary are delivered to the KCBT Clearing Corporation by 4:00 p.m. on such last trading day.

2515.04 Due Diligence In Exercise Procedures. KCBT member FCM's shall exercise due diligence in monitoring accounts of its customers trading in the options contract to ensure that in the case of options in-the-money by less than the firm's commission charges for exercising such options, instructions have been given to the KCBT Clearing Corporation so that such options are not automatically exercised pursuant to Rule 2515.03 unless it is the customer's explicit intention to exercise such options.

2515.05 Notice To Customers. FCM members shall use their best efforts to promptly notify customers of exercise notices.

2515.06 Clearing Corporation To Monitor Delivery Procedures. The KCBT and Clearing Corporation shall monitor the delivery procedure to ensure proper exercise of the options.

2516.00 Failure To Perform. If the clearing member with a delivery commitment fails to perform all acts required by this chapter, then that clearing member shall be deemed in default, which may be punishable as a major violation. In the event of default, any defaulting party shall be liable for damages and any loss sustained as a result of the default, if any, by the Clearing Corporation, an FCM, or any other FCM or customer thereof, plus a penalty of not less than \$500 per defaulted contract. An additional fee or penalty may also be imposed through KCBT disciplinary procedures. The defaulting party may petition the Board of Directors for reconsideration of any penalty so assessed. Whenever, in the judgment of the Board of Directors, upon consideration, the default was not due to the fault of the appealing party, or for other good cause shown, the Board of Directors may, in its discretion, waive or reduce the penalty.

2517.00 Procedure For Customer Complaints. Each futures commission merchant who is a member of the KCBT and engages in the offer or sale of commodity options shall, with respect to all written option customer complaints, comply with Rules 2517.01 through 2517.03.

2517.01 Complaints. Retain all such written complaints.

2517.02 Records. Make and retain a record of the date the complaint was received, the associated person who serviced the account, or the introducing broker who introduced the account, and a general description of the matter complained of, and what, if any, action was taken by the FCM in regard to the complaint; and

2517.03 Copies. Immediately send a copy of any such complaint to the FCM's "Designated Self-Regulatory Organization" (DSRO) and, upon final disposition thereof, immediately send a copy of the record of such disposition to the DSRO.

2518.00 Futures Commission Merchants. Each FCM who is eligible to trade options pursuant to Rule 2503.01 shall comply with the following:

2518.01 Written Procedures. Adopt and enforce written procedures pursuant to which it will be able to supervise adequately each option customer's account, including but not limited to the solicitation of any such account, provided that "option customer" does not include another futures commission merchant; and

2518.02 Written Record. Immediately upon the receipt of a customer's order, prepare a written record of the order. Said order shall be dated and time stamped to the nearest minute when the order is received and shall show the account designation. In addition, such written record also shall show the time to the nearest minute the order is transmitted for execution; and

2518.03 Notification. Give immediate written notification to the FCM's "Designated Self-Regulatory Organization" (DSRO) of any disciplinary action taken against the futures commission merchant or any of its associated persons by the commission or by another self-regulatory organization; and

2518.04 Disclosure. Each member FCM which engages in the offer or sale of commodity options shall enforce the disclosure requirements set forth in CFTC Regulation Section 33.7.

2518.05 Option Promotional Material. Each FCM which engages in the offer or sale of option contracts traded on this Exchange shall submit promptly to the member's Designated Self-Regulatory Organization (DSRO) all promotional material pertaining to trading in such options. For the purposes of this rule, the term "promotional material" shall include those items described in CFTC Regulations 33.1 (b).

2518.06 Discretionary Accounts. With respect to option customer accounts for which discretion is given for option trading:

- (i) Provide the option customer with an explanation of the nature and risks of the strategy or strategies to be used in connection with the option customer's account; and
- (ii) Require an officer, general partner, sole proprietor, or branch office manager of the FCM (other than any individual authorized to exercise discretion in trading the account) to approve, in writing, the discretionary authority prior to any trading for the account involved; and
- (iii) Identify as discretionary each order for a discretionary account on the order at the time of entry and an officer, general partner, sole proprietor, or branch office manager of the FCM (other than any individual authorized to exercise discretion in trading the account) must approve, initial, and date all orders for a discretionary account; and

- (iv) Review frequently discretionary accounts pursuant to Commodity Futures Trading Commission rules and regulations.

Provided that the provisions of Rule 2518.06 shall not apply to any option customer account: (A) of a commodity pool, the operator of which is registered with the Commission as a commodity pool operator; (B) where the person who has the discretionary authority is the spouse, parent, or child of the option customer, or (C) which is an omnibus account of another futures commission merchant.

2518.07 Prohibition. Shall not engage in fraudulent or high pressure sales communications relating to the offer or sale of option contracts; and

2518.08 Sales Practice Audits. Comply with KCBT procedures and permit the KCBT or its agent to conduct sales practice audits of member futures commission merchants which engage in the offer or sale of the options contracts. The sales practice audits with which FCM must comply will be those in effect by the KCBT from time to time as adopted by the Board of Directors of the KCBT; and

2518.09 Applicable CFTC Rules. Comply with all applicable regulations and rules of the Commodity Futures Trading Commission, and the National Futures Association applicable from time to time to trading in the options governed by this contract.

2519.00 Advertising Guidelines. Advertising, market letters, and similar information issued by the KCBT, its members, and their associates should not be false or misleading.

2519.01 File Copies. All members, clearing members, commodity representatives, and other employees of members must file within seven (7) days after publication copies of all promotional material including prepared radio or television scripts, prepared lectures, mail solicitations, and market letters relating to commodities traded on the KCBT with the KCBT.

2520.00 Contract Fee. A KCBT contract fee will be set by resolution of the Board of Directors to cover KCBT expenses. The Board of Directors may change the fee at any time on at least thirty (30) days' notice, such changes to be effective on the first of a month.

2521.00 Position Reporting Limits. Members shall comply with all applicable position limits adopted by Resolution of the Board of Directors or by the CFTC.

2521.01 Compliance With CFTC Regulation 16. Each clearing member and each FCM member that has customers trading options shall provide such information as the KCBT shall require to comply with the requirements that the CFTC may require of the KCBT pursuant to Part 16 of the Regulations of the CFTC.

2522.00 Option Daily Price Limits. Option daily price limits shall be identical to that of the underlying Futures Contract.

2523.00 Recording Options Orders. Each member who, on the floor of the KCBT receives an order from an options customer, including an options customer who is another floor trader or floor broker, which is not in the form of a written record showing the account identification, order number and the date and time, to the nearest minute such order was transmitted or received on the floor of the KCBT, shall immediately upon receipt thereof prepare a written record of such order, including an account identification and order number and shall record thereon the date and time to the nearest minute the order is received.

2523.01 Timing Requirements. Effective October 1, 1986, the method of time recording of option transactions by pit brokers and traders on their trading cards will be the recording of the time of execution to the nearest minute. Failure to record the time shall constitute a violation of the rules of the KCBT.

Note: Approved by Board of Director's action August 26, 1986, see page 1092 of Board minutes.

2524.00 Trading Ahead of Customer. Each floor broker is prohibited from trading ahead of a customer order:

- a. **Own Account; No Purchasing.** Each floor broker is prohibited from purchasing any commodity for future delivery, purchasing any call commodity option or selling any put commodity option for the broker's own account, or for any account in which such broker has an interest, while holding an order of another person for (1) the purchase of any future, (2) purchase of any call commodity option, or (3) sale of any put commodity option, in the same commodity which is executable at the market price or at the price such purchase can be made for the broker's own account or the account in which such broker has an interest.
- b. **Own Account; No Selling.** Each floor broker is prohibited from selling any commodity for future delivery, selling any call option commodity, or purchasing any put commodity option, for the broker's own account or for any account in which such broker has an interest, while holding an order of another person for (1) the sale of any future, (2) the sale of any call option commodity, or (3) the purchase of any put option commodity, in the same commodity, which is executable at the market price or at the price at which such sale can be made for the broker's own account or the account in which such broker has an interest.

Resolutions

RES 25-2518.01 Introducing Brokers — Options Sales Practices

Resolved that each KCBT rule and regulation pertaining to the options sales practices of members or their employees shall apply with equal force and in effect to the options sales practices of introducing brokers who are operating pursuant to a guarantee agreement with a member FCM and such member FCM shall be fully responsible therefore and that this resolution shall remain in effect until rescinded by a vote of the Board of Director, or until such time as the National Futures Association or other registered futures association adopts rules which are approved by the CFTC to govern the commodity option related activity of such guaranteed introducing brokers.

RES 25-2521.01 Position Limits — Wheat Futures Options

Position Limits for wheat futures options shall be those limits currently in effect pursuant to Part 150 of the Regulations of the Commodity Futures Trading Commission.

RES 25-2521.02 Reportable Positions — Wheat Futures Options

- (a) **Definition.** A "reportable position" shall be a position of 50 or more put or call options on the KCBT, long or short, in any one month, which is owned, controlled or carried by any person.

- (b) **Reporting of Reportable Positions.** Every member, registered partnership or registered corporation shall report reportable positions as defined in subsection (a) of this Resolution to the Department of Audits and Investigations at such times and in such form and manner as shall be prescribed.