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Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39417; File No. SR-NASD-97-80]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to Options Position Limits

December 9, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),<sup>1</sup> notice is hereby given that on October 30, 1997, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

NASD Regulation is proposing to amend Rule 2860 of the Conduct Rules of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), to exempt conventional equity option transactions that are intermediated by a member pursuant to Exchange Act Rule 15a-6(a)(3) from options position limits provided that the member reports such transactions to the Association in accordance with the options position reporting requirements. Below is the text of the proposed rule change. Proposed new language is italicized.

#### 2860. Options

##### (b)(3) Position Limits;

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of the Association pursuant to the Rule 9600 Series for good cause shown in each instance, no member shall effect for any account in which such member has an interest, or for the account of any partner, officer, director or employee thereof, or for the account of any customer, an opening transaction through Nasdaq, the over-the-counter

market or on any exchange in a stock option contract of any class of stock options if the member has reason to believe that as a result of such transaction the member or partner, officer, director or employee thereof, or customer would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate position in excess of:

\* \* \* \* \*

*(E) Conventional equity option transactions effected by a member pursuant to Exchange Act Rule 15a-6(a)(3) shall not be subject to position limits set forth in this subparagraph, provided that such conventional equity option transactions are reported to the Association in accordance with the requirements of subparagraph (5).*

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### 1. Purpose

The proposed rule change would exempt conventional equity option transactions in which members act as agent or intermediary pursuant to Exchange Act Rule 15a-6(a)(3) from options position limits provided that such conventional equity option transactions are reported to the Association pursuant to Rule 2860(b)(5). NASD Rule 2860(b)(3) establishes limits on the number of options contracts that a member, a customer, or a group of investors acting in concert can write or hold. Specifically, Rule 2860(b)(3) provides that "no member shall effect \* \* \* for the account of any customer, an opening transaction through Nasdaq, the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the \* \* \* customer would \* \* \* hold or control or be obligated in respect to an aggregate position in excess of [certain prescribed

limits]."<sup>2</sup> Members have expressed uncertainty as to whether U.S. broker/dealers that intermediate conventional equity option transactions between their affiliated foreign broker/dealers and U.S. institutional investors and major U.S. institutional investors pursuant to Rule 15a-6(a)(3), and that do not carry such options positions, are subject to the limits of the Rule. The NASD's options position limits apply to both conventional and standardized equity options. The proposed rule change, however, would affect only transactions in conventional equity options intermediated by a member pursuant to Rule 15a-6(a)(3). Position limits for all other conventional equity options transactions, as well as for standardized options, would remain unchanged.

NASD Regulation believes that Rule 2860 is ambiguous as to whether the limits specified in the Rule apply to option position transactions intermediated by a member firm under Rule 15a-6(a)(3),<sup>3</sup> and understands that industry practice in this respect is inconsistent. NASD Regulation is filing this proposed rule change in order to provide clarity and consistency of treatment for all member firms participating in transactions with foreign broker/dealers under Rule 15a-6(a)(3), and also to ensure that such transactions are reported under paragraph (b)(5) of the Rule.

NASD Regulation proposes amending Rule 2860(b)(3) to expressly exempt conventional equity option transactions intermediated by U.S. broker/dealers pursuant to Rule 15a-6(a)(3), provided that the member report to the Association such transactions which establish an aggregate position of 200 or more option contracts pursuant to Rule 2860(b)(5). Exchange Act Rule 15a-6(a)(3) provides that a foreign broker or dealer may, without registering under the Securities Exchange Act of 1934, induce or attempt to induce the

<sup>2</sup> On September 5, 1997, the NASD filed a proposed rule change to Rule 2860(b) to disaggregate conventional equity options from exchange-traded equity options for position limit purposes and to amend the OTC Collar Exemption to provide that the exemption may be utilized with respect to an entire conventional equity option position, not just that portion that was established pursuant to the NASD's position limit hedge exemption rule. SR-NASD-97-67. This proposed rule change is currently pending with the Commission.

<sup>3</sup> In NASD Notice to Members 94-46, the NASD answered common questions concerning position limits, and included the following:

Question #5: Do the NASD options rules apply to conventional option transactions effected abroad by an NASD member or a foreign branch of an NASD member?

Answer: Yes. If the option is booked and carried with an NASD member, it is subject to the NASD position-limit rule.

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

purchase or sale of any security by a U.S. institutional investor or major U.S. institutional investor so long as a registered U.S. broker/dealer intermediates such transaction.<sup>4</sup> By intermediating transactions, the U.S. broker/dealer is responsible for: (1) Effecting the transactions, other than negotiating their terms; (2) issuing all required confirmations and statements; (3) extending or arranging any credit to the U.S. institutional investor or major U.S. institutional investor in connection with the transactions; (4) maintaining required books and records relating to the transactions; (5) complying with the net capital requirements of Exchange Act Rule 15c3-1 with respect to the transactions; and (6) receiving, delivering, and safeguarding funds and securities in connection with the transactions on behalf of the U.S. institutional investor or the major U.S. institutional investor in compliance with Exchange Act Rule 15c3-3. While the responsibilities of a U.S. broker/dealer under Rule 15a-6(a)(3) may be significant, they do not otherwise change what is essentially a foreign transaction between a U.S. institutional customer and a foreign broker/dealer. Further, as a jurisdictional matter, the NASD's options position limits do not apply to transactions that occur directly between a U.S. customer and a foreign broker/dealer.

The proposed rule change would require Rule 15a-6(a)(3) conventional equity option transactions to be reported to the NASD in accordance with the reporting requirements for large options positions generally. Rule 2860(b)(5)(ii) imposes reporting obligations on "each account in which the member has an interest \* \* \* and each customer account, which has established an aggregate position of 200 or more option contracts \* \* \*." Under the proposed rule change, conventional equity option transactions intermediated by a member pursuant to Rule 15a-6(a)(3) that establish an aggregate position of 200 or more option contracts would be reported to the Association. Although an institutional investor entering into an option transaction with a foreign broker/dealer that is booked with a member

pursuant to Rule 15a-6(a)(3) is a customer of the foreign broker/dealer, and not the member, the proposed rule change would require the member to report the identity of the person or persons having an interest in an option position and the total of number of contracts in accordance with Rule 2860(b)(5)(ii). The information reported to the Association would be used by the NASD Regulation Market Regulation staff as part of their ongoing market surveillance operations and should minimize the risk of any market manipulation or disruption related to the accumulation or disposition of large options positions.

The proposed rule change may raise concerns that it could motivate members to move their existing conventional equity options business to off-shore broker/dealer affiliates to avoid position limits entirely. In response to these concerns, NASD Regulation notes that the proposed rule change is limited to transactions "effected pursuant to Exchange Act Rule 15a-6(a)(3)"—i.e., trades negotiated between a foreign broker/dealer and a U.S. institutional investor or major U.S. institutional investor for which the U.S. broker/dealer is acting solely in the limited capacity prescribed by Rule 15a-6(a)(3). The proposed rule change would *not* allow a member to negotiate an option transaction with a U.S. institutional customer and then book such transaction with a foreign broker/dealer affiliate and thereby avoid position limits because such transaction would not be "effected pursuant to Exchange Act Rule 15a-6(a)(3)."

## 2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act<sup>5</sup> in that it promotes just and equitable principles of trade, removes impediments to and perfects the mechanism of a free and open market and a national market system, and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

## B. Self-Regulatory Organization's Statement on Burden on Competition

The Association does not believe that the proposed rule change will impose any inappropriate burden on competition.

## C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve the proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NASD-97-80 and should be submitted by January 6, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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<sup>4</sup> In a no-action letter dated April 9, 1997, 1997 SEC No-Act. LEXIS 525, the Commission expanded the exemption under Rule 15a-6 to include transactions with any entity that owns or controls in excess of \$100 million in aggregate financial assets and modified the clearance and settlement requirements of an intermediating U.S. broker/dealer with respect to foreign securities and U.S. Government securities. Additionally, the no-action letter expanded the range of permissible contacts between foreign broker/dealers and U.S. institutional investors.

<sup>5</sup> 15 U.S.C. § 78o-3.

<sup>6</sup> 17 CFR 200.30-3(a)(12).