

whether dollar value volume is an appropriate measure for determining limited volume; and (3) what conditions should apply to such an exemption.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40159; File No. SR-Amex-98-22]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the American Stock Exchange, Inc., Relating to an Increase in Position and Exercise Limits for Standardized Equity Options

July 1, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 24, 1998, the American Stock Exchange, Inc. ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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

The Amex proposes to amend Exchange Rule 904 to increase position and exercise limits for standardized equity options to three times their current levels.

#### 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 Amex is proposing to increase the position and exercise limits for equity options traded on the Exchange to three times their current levels. Currently, Amex Rule 904 subjects equity options to one of the five different position limits depending on the trading volume and outstanding shares for the underlying security. Rule 905 establishes exercise limits for the corresponding options at the same levels.<sup>3</sup> The limits are: 4,500; 7,500; 10,500; 20,000; and 25,000; contracts on the same side of the market. Under the proposed changes the new limits will be: 13,500; 22,500; 31,500; 60,000; and 75,000. The Exchange believes sophisticated surveillance techniques at options exchanges adequately protect the integrity of the markets for the options that will be subject to these increased position and exercise limits.

*Manipulation.* The Amex believes that position and exercise limits, at their current levels, no longer serve their stated purpose. The Commission has stated that:

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market. In addition, such limits serve to reduce the possibility of disruption of the options market itself, especially, illiquid options classes.<sup>4</sup>

On the twenty-fifth anniversary of listed options trading, the Exchange believes that the existing surveillance procedures and reporting requirements

at options exchanges and clearing firms that have been developed over the years are able to properly identify unusual and illegal trading activity. In addition, Amex believes that routine oversight inspections of Amex's regulatory programs by the Commission have not uncovered any material inconsistencies or shortcomings in the manner in which the Exchange's market surveillance is conducted. These procedures entail a daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both the options and underlying stock. Further, the Exchange believes the significant increases in unhedged options capital charges resulting from a September 1997 adoption of risk-based haircuts and the Exchange margin requirements applicable to these products under Exchange rules serves as a more effective protection than position limits.<sup>5</sup>

Further, large stock holdings must be disclosed to the Commission by way of Schedule 13D or 13G.<sup>6</sup> Options positions are part of any reportable positions and cannot be legally hidden. In addition, Exchange Rule 906—which requires members to file reports with the Exchange for any customer who held aggregate long or short positions of 200 or more option contracts of any single class for the previous day—will remain unchanged and an important part of the Exchange's surveillance efforts.

*Position and exercise limits restrict legitimate options use.* In the Exchange's view, equity position limits prevent large customers like mutual funds and pension funds from using options to gain meaningful exposure to individual stocks, resulting in lost liquidity in both the options market and the stock market. The Exchange further believes that equity position limits also act as a barrier to the use of options by corporations wishing to implement options strategies with their own stock. For example, existing equity position limits could restrict the number of put options that could be sold under a corporate buyback program.<sup>7</sup>

*Financial requirements.* The Exchange believes that financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an

<sup>3</sup> Rule 905 states "no member or member organization shall exercise, for any account in which such member or member organization has an interest or for the account of any partner, officer, director or employee thereof or for the account of any customer, a long position in any option contract of a class of options dealt in on the Exchange if as a result thereof such member or member organization, or partner, officer, director or employee thereof or customer acting alone or in concert with others, directly or indirectly has or will have exercised within any five (5) consecutive business days aggregate long positions in excess of: (i) the number of option contracts set forth as the position limit in Rule 904 in a class of options for which the underlying security is a stock. \* \* \*

<sup>5</sup> See Exchange Act Release No. 38248 (February 6, 1997), 62 FR 6474 (February 12, 1997) (adopting Risk Based Haircuts); and Amex Rule 462.

<sup>6</sup> Exchange Act Rule 13d-1.

<sup>7</sup> The Commission notes that issuers would, of course, need to comply with all applicable provisions of the federal securities laws in conducting their share repurchase programs.

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>4</sup> Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998).

inordinately large unhedged position in an equity option. Current margin, and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. It should also be noted that the Exchange has the authority under paragraph (d)(2)(K) of Rule 462 to impose a higher margin requirement upon member or member organization when the Exchange determines a higher requirement is warranted. In addition, the Commission's net capital rule, Rule 15c3-1 under the Exchange Act, imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

*Past increases have had no adverse consequences.* Equity position limits have been gradually expanded from 1,000 contracts in 1973 to the current level of 25,000 contracts for the largest and most active stocks. In 1997, the SEC approved the elimination of position and exercise limits in FLEX Equity options under a two-year pilot program.<sup>8</sup> To date, there have been no adverse effects on the market as a result of the past increases in the limits for equity options or the elimination of position and exercise limits for FLEX Equity options.

*Changes will allow options exchanges to compete more fairly with OTC markets.* The Commission has stated that "limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market."<sup>9</sup> However, in today's market, equity position limits put listed options at a competitive disadvantage to over-the-counter derivatives. OTC dealers can execute options trades through overseas subsidiaries not subject to NASD regulation, and therefore not subject to position limits. As a result, the largest trades can go unobserved and unmonitored for regulatory and oversight purposes. Member firms continue to express concern to the Exchange that position limits on Amex products are an impediment to their business and that they have no choice but to move their business to off-shore

markets where position limits are not an issue.

In addition, the Commission has recently approved the NASD's proposed rule change to raise position limits for conventional equity options (*i.e.*, those options not issued, or subject to issuance by the Options Clearing Corporation) to three times their current levels (which is the same as three times the levels established by current Exchange rules for standardized options).<sup>10</sup>

Because conventional options often have nearly the identical terms as standardized, Exchange-traded options, the Exchange believes the position limits for standardized options should be at least as high as those for conventional options. The proposed rule changes should help to attract business back to the Exchange where the trades will be subject to reporting requirements and surveillance. In its release approving the elimination of FLEX equity option limits for a two-year pilot period, the Commission states that the elimination of position limits will allow the listed options markets to better compete with the OTC market.<sup>11</sup>

[The elimination of position and exercise limits for FLEX equity options allows the Exchanges to better compete with the growing OTC market in customized equity options, thereby encouraging fair competition among brokers and exchange markets. The attributes of the Exchanges' options markets versus an OTC market include, but are not limited to, a centralized market center, an auction market with posted transparent market quotations and transaction reporting, parameters and procedures for clearance and settlement, and the guarantee of the OCC for all contracts traded on the Exchanges.<sup>12</sup>

It should also be noted that individual stocks are not subject to position limits. Investors can theoretically hold 100% of a company's shares outstanding as long as they file the appropriate Schedule 13D or 13G. The Exchange believes the increase in the position and exercise limits will better enable the Exchange to compete against the OTC markets and is an appropriate and responsible increase given the nature of the Exchange's surveillance.

<sup>10</sup> Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998). The NASD's position limit filing established position and exercise limits for conventional equity options identical to those being proposed by Amex in this filing.

<sup>11</sup> Exchange Act Release No. 39032 (September 9, 1997), 62 FR 48683 (September 16, 1997).

<sup>12</sup> *Id.* at 48685. The Commission notes that approval of the elimination of position and exercise limits for FLEX equity options was granted for a two-year pilot period and was based on several other factors including, in large part, additional safeguards adopted by the exchanges to allow them to monitor large options positions.

## 2. Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)<sup>13</sup> of the Act, in general, and furthers the objectives of Section 6(b)(5),<sup>14</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, to protect investors and the public interest 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 Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments on the proposed rule change were neither solicited nor received.

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

Within 35 days of the date of 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 such 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, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>8</sup> Exchange Act Release No. 39032 (September 9, 1997), 62 FR 48683 (September 16, 1997).

<sup>9</sup> See H.R. Rep. No. IFC-3, 96th Cong., 1st Sess. At 198-91 (Comm. Print 1978).

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 in the Commission's Public Reference Room, located at the above address. Copies of such filing will also be available for inspection and copying at the principal office of the self-regulatory organization. All submissions should refer to File No. SR-Amex-98-22 and should be submitted by July 30, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40158; File No. SR-CBOE-98-23]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to the Elimination of Position and Exercise Limits for Options on Broad-Based Indexes

July 1, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 11, 1998, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") 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

The CBOE proposes to eliminate position and exercise limits for broad-based index options. The current

reporting procedures, with slight modifications, which serve to identify large option holdings and hedging information, will remain in place.

The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

#### 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 CBOE is proposing the elimination of position and exercise limits for broad-based index options for the reasons detailed below. The Exchange will, however, still require that member organizations file reports with the Exchange in the event that they maintain proprietary or customer positions in excess of Exchange established reporting thresholds in the different broad-based index option products.

**Manipulation.** The CBOE believes that position and exercise limits in broad-based index options no longer serve their stated purpose. The Commission has stated that:

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market. In addition such limits serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.<sup>3</sup> On the fifteenth anniversary of listed index options trading, the Exchange

believes that the size of the market underlying broad-based index options is so large as to dispel any concerns regarding market manipulation. To date, there has not been a single disciplinary action involving manipulation in any broad-based index product listed on the Exchange. The Exchange believes that its fifteen years of experience conducting surveillance of index options and program trading activity is sufficient to identify improper activity. The CBOE believes that routine oversight inspections of CBOE's regulatory programs by the Commission have not uncovered any inconsistencies or shortcomings in the manner in which index option surveillance is conducted. These procedures entail a daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both the options and underlying stock basket components. Moreover, the CBOE believes that current NYSE Market on Open and Market on Close procedures facilitate the orderly unwinding of large index program trades.<sup>4</sup> Further, the significant increases in unhedged options capital charges resulting from the September 1997 adoption of risk-based haircuts and the high margin requirements applicable to these products under Exchange rules serves as a more effective protection than position limits ever have or ever could.<sup>5</sup>

**Competition.** The Commission has stated that "limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market."<sup>6</sup> However, in today's market, the Exchange believes that position and exercise limits severely hamper CBOE's ability to compete with the OTC and futures markets. Investors who trade listed options on the CBOE are placed at a serious disadvantage in comparison to the OTC market where index options and other types of index based derivatives (e.g., forwards and swaps) are not subject to position and exercise limits. Member firms continue to express concern to the Exchange that position limits on CBOE products are an impediment to their business and that they have no choice but to move their

<sup>4</sup> See NYSE Informational Memo Number 96-34 (November 8, 1996).

<sup>5</sup> See Exchange Act Release No. 34-38248 (February 6, 1997), 62 FR 6474 (February 12, 1997) (adopting Risk-Based Haircuts); and CBOE Rule 24.11 Margins.

<sup>6</sup> See H.R. Rep. No. IFC-3, 96th Cong., 1st Sess. At 189-91 (Comm. Print 1978).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998) (SR-CBOE-97-11) (order approving an increase in OEX position and exercise limits).