

INFORMATIONAL

Options Rule

SEC Approves Proposed Changes To NASD Rule 2860

The Suggested Routing function is meant to aid the reader of this document. Each NASD member firm should consider the appropriate distribution in the context of its own organizational structure.

SUGGESTED ROUTING

- Executive Representatives
- Legal & Compliance
- Senior Management
- Trading & Market Making

KEY TOPICS

- Options
- NASD Rule 2860

Executive Summary

On December 13, 2000, the Securities and Exchange Commission (SEC) approved amendments to National Association of Securities Dealers, Inc. (NASD[®]) Rule 2860.¹ The amendments:

- (1) apply the NASD's options position and exercise limits to members that effect trades for non-member brokers and non-member dealers;
- (2) require members to report the options positions that they effect for non-member brokers and non-member dealers where such positions meet the reporting thresholds under NASD rules;
- (3) codify an interpretive position with respect to which firms are required to report standardized options positions under the NASD's options position reporting requirements; and
- (4) clarify that a member may have its clearing firm report options positions to the NASD on the member's behalf.

The amendments become effective on February 15, 2001. The text of the amendments is provided in Attachment A.

Questions/Further Information

Questions concerning this *Notice* may be directed to the NASD Regulation, Inc. Office of General Counsel at (202) 728-8071, or Gary L. Goldsholle, Associate General Counsel, Office of General Counsel, NASD RegulationSM, at (202) 728-8104.

Background And Summary

The NASD's options position limits, exercise limits, and reporting requirements, Rules 2860(b)(3), 2860(b)(4) and 2860(b)(5), respectively, apply to any account in which a member, or any partner, officer, director, or employee of the member has an interest, or for the account of any customer. However, because the NASD's definition of "customer"² excludes a broker or dealer, non-member brokers and non-member dealers have been outside the scope of these rules. As a result, conventional options transactions³ of a non-member broker or non-member dealer that are effected by an NASD member are not subject to any position and exercise limits or options reporting.⁴ The new amendments to Rule 2860 will remedy this gap. Under these amendments, options position and exercise limits and reporting requirements will apply to accounts of non-member brokers and non-member dealers.

The amendments also codify certain options position reporting requirements set forth in *NASD Notice to Members 94-46*. Specifically, the amendments state that the reporting requirements are "applicable to all standardized options positions established by 'access' firms or their customers and all conventional options positions established by members or their customers." Access firms are defined as NASD members that conduct a business in exchange-traded options but are not themselves members of the options exchange upon which such options are listed and traded. Limiting reporting of standardized options positions under NASD

rules to access firms only avoids imposing duplicative reporting requirements on NASD members that are also members of an options exchange, inasmuch as members of an options exchange (i.e., dual members) are required to report positions on standardized options pursuant to the rules of the options exchange(s) of which they are a member.

Finally, the amendments clarify that, consistent with current practices, a member may report positions directly to the NASD or have such positions reported to the NASD by another firm, such as the

member's clearing firm, on behalf of the member. Members should be aware, however, that the amendment does not eliminate a member's ultimate responsibility to ensure that the firm reporting the positions on the member's behalf makes the necessary filings with the NASD, and that such filings are true, accurate, and complete, and submitted on a timely basis.

Endnotes

1 See Exchange Act Release No. 43718 (File No. SR-NASD-00-36) (December 13, 2000), 65 Federal Register 80969 (December 22, 2000).

2 Rule 0120(g) states that the term "customer" shall not include a broker or dealer.

3 A "conventional option" is any option contract not issued, or subject to issuance, by the Options Clearing Corporation. NASD Rule 2860(b)(2)(N).

4 Standardized options transactions of a non-member are subject to position and exercise limits and reporting requirements of the applicable options exchange(s) on which the member of such exchange(s) effects the transaction. A "standardized option" is any options contract issued, or subject to issuance by, the Options Clearing Corporation that is not a FLEX Equity Option. NASD Rule 2860(b)(2)(WW).

ATTACHMENT A

Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

Rule 2860 Options.

(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, non-member broker, or non-member dealer, 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, non-member broker, or non-member dealer, would, acting alone or in concert with others, directly or indirectly, hold or control or be obligated in respect of an aggregate equity options position in excess of:

(4) Exercise Limits

(A) 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 or person associated with a member shall exer-

cise, for any account in which such member or person associated with a member has an interest, or for the account of any partner, officer, director or employee thereof or for the account of any customer, non-member broker, or non-member dealer, any option contract if as a result thereof such member or partner, officer, director or employee thereof or customer, non-member broker, or non-member dealer, acting alone or in concert with others, directly or indirectly, has or will have exercised within any five (5) consecutive business days a number of option contracts of a particular class of options in excess of the limits for options positions in paragraph (b)(3). The Association may institute other limitations concerning the exercise of option contracts from time to time by action of the Association. Reasonable notice shall be given of each new limitation fixed by the Association.

(5) Reporting of Options Positions

(A)(i)a. Conventional Options

Each member shall file or cause to be filed with the Association a report with respect to each account in which the member has an interest, each account of a partner, officer, director or employee or such member, and each customer, non-member broker, or non-member dealer account, which has established an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same

underlying security or index, combining for purposes of this subparagraph long positions in put options with short positions in call options and short positions in put options with long positions in call options.

b. Standardized Options

Each member that conducts a business in standardized options but is not a member of the options exchange upon which the standardized options are listed and traded shall file or cause to be filed with the Association a report with respect to each account in which the member has an interest, each account of a partner, officer, director or employee of such member, and each customer, non-member broker, or non-member dealer account, which has established an aggregate position of 200 or more option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security or index, combining for purposes of this subparagraph long positions in put options with short positions in call options and short positions in put options with long positions in call options.

(ii) The reports required by this subparagraph [Such report] shall identify the person or persons having an interest in such account and shall identify separately the total number of option contracts of each such class comprising the reportable position in such account. The reports shall be in such form as may be prescribed by the Association and shall be filed no later than the close of business on the

next business day following the day on which the transaction or transactions requiring the filing of such report occurred. Whenever a report shall be required to be filed with respect to an account pursuant to this subparagraph, the member filing such shall file with the Association such additional periodic reports with respect to such account as the Association may from time to time prescribe.

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