

NASD Notice to Members 98-92

NASD Regulation Articulates Position On The Application Of NASD Rule 2680 To U.S. Broker/Dealers That Intermediate Transactions Pursuant To Exchange Act Rule 15a-6(a)(3)

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Executive Summary

Through this *Notice*, NASD Regulation, Inc. (NASD RegulationSM) is establishing an interpretation that National Association of Securities Dealers, Inc. (NASD[®]) Rule 2860(b)(3) options position limits apply with respect to options transactions that are intermediated by member firms pursuant to Exchange Act Rule 15a-6(a)(3). Members are also reminded of the reporting obligations under Rule 2860(b)(5) with respect to such Rule 15a-6(a)(3) transactions.

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Assistant General Counsel, NASD Regulation, at (202) 728-8104.

Discussion

NASD Rule 2860(b)(3) imposes a ceiling or position limit on the number of conventional and standardized equity options contracts in each class on the same side of the market (*i.e.*, aggregating long calls and short puts or long puts and short calls) that can be held or written by a member, a person associated with a member, a customer, or a group of customers acting in concert. Specifically, Rule 2860(b)(3) provides that “no member shall effect for any account in which such member has an interest, . . . or for the account of any customer, an opening transaction through . . . the over-the-counter market or on any exchange in a stock option contract of any class of stock options if the member . . . or customer would . . . hold or control or be obligated in respect of an aggregate equity options position in excess of [certain prescribed limits].”

Exchange Act Rule 15a-6(a)(3) permits a foreign broker/dealer, without registering as a broker/dealer in the United States, to induce or attempt to induce the purchase or sale of any security by a U.S.

institutional investor or major U.S. institutional investor if the resulting transactions are effected through a registered broker/dealer as specified in Rule 15a-6(a)(3). Among the requirements of Rule 15a-6(a)(3) are that the U.S. broker/dealer issues all required confirmations and statements to the institutional investors and maintains the required books and records relating to the transaction.

Member firms have expressed uncertainty as to the application of Rule 2860(b)(3) to Rule 15a-6(a)(3) transactions. Some members have taken the position that options transactions that are intermediated by U.S. member firms pursuant to Rule 15a-6(a)(3), but are not carried on their books for capital purposes, are not subject to the limits of Rule 2860(b)(3). Other members have taken the position that Rule 2860(b)(3) would apply to such transactions.

Through this *Notice*, NASD Regulation is issuing an interpretation to establish consistent application of Rule 2860(b)(3). NASD Regulation staff believes that NASD member firms that intermediate transactions under Rule 15a-6(a)(3) are “effecting” such transactions within the meaning of Rule 2860(b)(3) and that position limits should apply. We believe that the use of the term “effect” in this context, given its ordinary meaning, would apply to the functions that U.S. registered broker/dealers are required to perform under Rule 15a-6(a)(3). In this regard, subparagraph (iii)(A) of Rule 15a-6(a)(3) provides that the registered broker/dealer must be responsible for “effecting the transactions conducted under paragraph (a)(3)” We note that this interpretation is consistent with the overall purpose of Rule 2860(b)(3), which is to prevent the establishment of options positions

that can, or may provide incentive to, manipulate or disrupt the underlying market. These concerns exist with respect to options positions that are maintained at both NASD member firms and their foreign affiliates. Further, because the NASD member firm is required to record each options transaction that is effected under Rule 15a-6(a)(3), the member has the practical ability to enforce compliance with limits for positions that are maintained on its books.

NASD Regulation expects that member firms that are parties to

transactions under Rule 15a-6(a)(3) that would cause them to exceed the position limits of Rule 2860(b)(3) should restructure their positions as soon as practicable to meet the applicable limits. In restructuring options positions, members should be mindful of the exercise limits imposed by Rule 2860(b)(4).

Finally, members are reminded of their reporting obligations under Rule 2860(b)(5), which apply to "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 (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 . . ." Consistent with the interpretation described above, this requirement applies to intermediated transactions pursuant to 15a-6(a)(3).

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