

Options Position and Exercise Limits

Extension of Pilot Program Increasing Position and Exercise Limits for Stock Options

Executive Summary

SEC amendments to NASD Rule 2860 extend until March 1, 2008, a pilot program increasing certain stock options position and exercise limits. The pilot program was scheduled to expire on September 1, 2007.

The rules, as amended, are set forth in Attachment A. The amendments become effective September 1, 2007.

Questions concerning this *Notice* may be directed to Gary L. Goldsholle, Vice President and Associate General Counsel, Office of General Counsel (OGC), at (202) 728-8104; or James L. Eastman, Assistant General Counsel, OGC, at (202) 728-6961.

Background and Discussion

On July 31, 2007, FINRA filed for immediate effectiveness with the Securities and Exchange Commission (SEC) amendments to NASD Rule 2860 extending until March 1, 2008, a pilot program increasing certain stock options position and exercise limits ("Pilot Program").¹ The Pilot Program was scheduled to expire on September 1, 2007.² FINRA extended the Pilot Program to allow it to continue without interruption.

August 2007

Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Institutional
- Legal
- Options
- Senior Management
- Trading
- Training

Key Topic(s)

- Exercise Limits
- Options
- Position Limits

Referenced Rules & Notices

- NASD Rule 2860
- NTM 06-46
- NTM 06-09
- NTM 05-56
- NTM 05-31

NASD Rule 2860(b)(3)(A) 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.³ The rule provides that the position limits for stock options are determined according to a five-tiered system in which more actively-traded stocks with larger public floats are subject to higher position limits.

Pursuant to the Pilot Program, which began March 30, 2005, and now ends March 1, 2008, unless extended ("Pilot Period"), the limits for each of the tiers remains increased as follows:

- (a) 13,500 contracts has been increased to 25,000 contracts;
- (b) 22,500 contracts has been increased to 50,000 contracts;
- (c) 31,500 contracts has been increased to 75,000 contracts;
- (d) 60,000 contracts has been increased to 200,000 contracts; and
- (e) 75,000 contracts has been increased to 250,000 contracts.

These tiers apply to both conventional and standardized options. Options exercise limits, which are set forth in NASD Rule 2860(b)(4), and which incorporate by reference the position limits in NASD Rule 2860(b)(3), also have been increased during the Pilot Period.

Endnotes

- 1 Securities Exchange Act Release No. 56265 (August 15, 2007), 72 FR 47102 (August 22, 2007) (SR-FINRA-2007-002).
- 2 See Securities Exchange Act Release No. 55225 (February 1, 2007), 72 FR 6634 (February 12, 2007) (SR-NASD-2007-007); Securities Exchange Act Release No. 54334 (August 18, 2006), 71 FR 50961 (August 28, 2006) (SR-NASD-2006-097) (extending Pilot Program); *NASD Notice to Members 06-46* (August 2006); Securities Exchange Act Release No. 53346 (February 22, 2006), 71 FR 10580 (March 1, 2006) (SR-NASD-2006-025) (extending Pilot Program); *NASD Notice to Members 06-09* (March 2006); Securities Exchange Act Release No. 52271 (August 16, 2005), 70 FR 49344 (August 23, 2005) (SR-NASD-2005-097) (extending Pilot Program); *NASD Notice to Members 05-56* (August 2005); Securities Exchange Act Release No. 51520 (April 11, 2005), 70 FR 19977 (April 15, 2005) (SR-NASD-2005-040) (establishing Pilot Program); *NASD Notice to Members 05-31* (April 2005).
- 3 A “standardized equity option” is an equity options contract issued, or subject to issuance by, The Options Clearing Corporation that is not a FLEX Equity Option. NASD Rule 2860(b)(2)(VV). A “conventional option” is an option contract not issued, or subject to issuance by, The Options Clearing Corporation. NASD Rule 2860(b)(2)(O). The limits on standardized equity options in NASD Rule 2860 are applicable only to those FINRA member firms that are not also members of the exchange on which the option is traded; the limits on conventional options are applicable to all FINRA member firms. NASD Rule 2860(b)(1)(A).

©2007. FINRA. All rights reserved. *Regulatory Notices* attempt to present information to readers in a format that is easily understandable. However, please be aware that, in case of any misunderstanding, the rule language prevails.

ATTACHMENT A

New text is underlined; deletions are in brackets.

2800. SPECIAL PRODUCTS

2860. Options

(a) No Change.

(b) Requirements.

(1) and (2) No Change.

(3) Position Limits

(A) Stock Options—Except in highly unusual circumstances, and with the prior written approval of NASD 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:

(i) 13,500 (or 25,000 during the pilot period from March 30, 2005 through [September 1, 2007]March 1, 2008 (“Pilot Period”)) option contracts of the put class and the call class on the same side of the market covering the same underlying security, combining for purposes of this position limit long positions in put options with short positions in call options, and short positions in put options with long positions in call options;

(ii) through (viii) No Change.

(B) through (D) No Change.

(4) through (24) No Change.