

Options Position and Exercise Limits Increase

FINRA Announces Amendments to Make Permanent the Pilot Program Increasing Positions and Exercise Limits for Stock Options

Effective Date: February 28, 2008

Executive Summary

On February 28, 2008, amendments to NASD Rule 2860 (Options) made permanent a pilot program increasing position and exercise limits for stock options. The amendments also revised the examples in NASD IM-2860-1 (Position Limits) that illustrate the operation of position limits.¹ The amended rules are set forth in Attachment A.

Questions regarding 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 Kathryn M. Moore, Assistant General Counsel, OGC, at (202) 974-2974.

Background and Discussion

NASD Rule 2860(b)(3)(A) imposes a ceiling or position limit on the number of standardized and conventional 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. The Rule provides that the position limits for equity 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. Options exercise limits, which are set forth in NASD Rule 2860(b)(4), incorporate by reference the position limits in NASD Rule 2860(b)(3).

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Notice Type

- Rule Amendment

Suggested Routing

- Compliance
- Institutional
- Legal
- Operations
- Options
- Senior Management

Key Topic(s)

- Exercise Limits
- Options
- Position Limits

Referenced Rules & Notices

- NASD Rule 2860
- NASD IM-2860-1

FINRA has amended the options position and exercise limits in NASD Rule 2860 to make permanent a pilot program that increases position and exercise limits for both standardized and conventional stock options.² Below are the original, pre-pilot limits and new permanent limits.

Original Limits	New Permanent Limits
13,500 contracts	25,000 contracts
22,500 contracts	50,000 contracts
31,500 contracts	75,000 contracts
60,000 contracts	200,000 contracts
75,000 contracts	250,000 contracts

In addition, FINRA amended NASD IM-2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the permanent position limits.

Endnotes

- ¹ See Securities Exchange Act Release No. 34-57413 (March 3, 2008), 73 FR 12487 (March 7, 2008) (Notice of Filing and Immediate Effectiveness of SR-FINRA-2008-007).
- ² The original pilot program became effective on March 30, 2005, and has continued uninterrupted until becoming permanent on February 28, 2008. See Securities Exchange Act Release No. 51520 (April 11, 2005) 70 FR 19977 (April 15, 2005) (Notice of Filing and Immediate Effectiveness of SR-NASD-2005-040 establishing the pilot program).

ATTACHMENT A

New language is underlined, deletions are in brackets.

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Rule 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 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 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; or

(ii) [22,500 (or)50,000 [during the Pilot Period]]option contracts of the put class and the call class on the same side of the market covering the same underlying security, provided that the [22,500 (or)50,000 [during the Pilot Period]]contract position limit shall only be available for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of [22,500 (or)50,000 [during the Pilot Period]]option contracts; or

(iii) [31,500 (or)75,000 [during the Pilot Period]]option contracts of the put class and the call class on the same side of the market covering the same underlying security provided that the [31,500 (or)75,000 [during the Pilot Period]]contract position limit shall only be available for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of [31,500 (or)75,000 [during the Pilot Period]]option contracts; or

(iv) [60,000 (or)200,000 [during the Pilot Period]]option contracts of the put and the call class on the same side of the market covering the same underlying security, provided that the [60,000 (or)200,000 [during the Pilot Period]]contract position limit shall only be available for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of [60,000 (or)200,000 [during the Pilot Period]]option contracts; or

(v) [75,000 (or)250,000 [during the Pilot Period]]option contracts of the put and the call class on the same side of the market covering the same underlying security, provided that the [75,000 (or)250,000 [during the Pilot Period]]contract position limit shall only be available for option contracts on securities that underlie exchange-traded options qualifying under applicable rules for a position limit of [75,000 (or)250,000 [during the Pilot Period]]option contracts; or

(vi) through (vii) No Change.

(viii) Conventional Equity Options

a. For purposes of this paragraph (b), standardized equity option contracts of the put class and call class on the same side of the market overlying the same security shall not

be aggregated with conventional equity option contracts or FLEX Equity Option contracts overlying the same security on the same side of the market. Conventional equity option contracts of the put class and call class on the same side of the market overlying the same security shall be subject to a position limit equal to the greater of:

1. the basic limit of [13,500 (or)25,000 [during the Pilot Period]] contracts, or
2. any standardized equity options position limit as set forth in paragraphs (b)(3)(A)(ii) through (v) for which the underlying security qualifies or would be able to qualify.

b. In order for a security not subject to standardized equity options trading to qualify for an options position limit of more than [13,500 (or)25,000 [during the Pilot Period]] contracts, a member must first demonstrate to NASD's Market Regulation Department that the underlying security meets the standards for such higher options position limit and the initial listing standards for standardized options trading.

Provided, however, that for certain securities in an index designated by NASD, a member may claim such higher position limit as permitted in accordance with the volume and float criteria specified by NASD; provided further, that a member claiming a higher position limit under this subparagraph must notify NASD's Market Regulation Department in writing in such form as may be prescribed by NASD and shall be filed no later than the close of business day on the next business day following the day on which the transaction or transactions requiring such limits occurred; and provided further, that the member must agree to reduce its position in the event that NASD staff determines different position limits should apply.

(B) through (D) No Change.

(4) through (24) No Change.

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IM-2860-1. Position Limits

The following examples illustrate the operation of position limits established by NASD Rule 2860(b)(3) (all examples assume a position limit of [4,500]25,000 contracts and that the options are standardized options):

(a) Customer A, who is long [4,500]25,000 XYZ calls, may at the same time be short [4,500]25,000 XYZ calls, since long and short positions in the same class of options (i.e., in calls only, or in puts only) are on opposite sides of the market and are not aggregated for purposes of paragraph (b)(3).

(b) Customer B, who is long [4,500]25,000 XYZ calls, may at the same time be long [4,500]25,000 XYZ puts. Paragraph (b)(3) does not require the aggregation of long call and long put (or short call and short put) positions, since they are on opposite sides of the market.

(c) Customer C, who is long [1,700]20,000 XYZ calls, may not at the same time be short more than [2,800]5,000 XYZ puts, since the [4,500]25,000 contract limit applies to the aggregation of long call and short put positions in options covering the same underlying security. Similarly, if Customer C is also short [1,600]20,000 XYZ calls, he may not at the same time be long more than [2,900]5,000 puts, since the [4,500]25,000 contract limit applies separately to the aggregation of short call and long put positions in options covering the same underlying security.

(d) Customer D, who is short [900,000]2,000,000 shares of XYZ, may be long up to [4,500]45,000 XYZ calls, since the “hedge” exemption contained in paragraph (b)(3)(A)(vii) permits Customer D to establish an options position up to [4,500]25,000 contracts in size. In this instance, [4,500]25,000 of the [13,500]45,000 contracts are permissible under the basic position limit contained in paragraph (b)(3)(A)(i) and the remaining [9,000]20,000 contracts are permissible because they are hedged by the [900,000]2,000,000 short stock position.

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