

February 13, 1998

Katherine A. England
Assistant Director
Division of Market Regulation
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549
Mail Stop 2-2/Room 2097

Re: **File No. SR-NASD-98-15**
Amendment to Rule 2860(b) Concerning Position and Exercise Limits for
FLEX Equity Options

Dear Ms. England:

Pursuant to Rule 19b-4, enclosed herewith is the above-numbered rule filing. Also enclosed is a 3-1/2" disk containing the rule filing in WordPerfect 5.1 to facilitate production of the Federal Register release.

In submitting this rule filing, we are withdrawing SR-NASD-97-67, which was filed with the Securities and Exchange Commission on September 5, 1997.

If you have any questions, please contact Gary L. Goldsholle, Office of General Counsel, NASD Regulation, Inc., at (202) 728-8104; e-mail goldshog@nasd.com. The fax number of the Office of General Counsel is (202) 728-8264.

Very truly yours,

Alden S. Adkins
Senior Vice President and General Counsel

Attachment

File No. SR-NASD-98-15
Consists of 17 Pages

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C.

File No. SR-NASD-98-15

Form 19b-4

Proposed Rule Change

by

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.

Pursuant to Rule 19b-4 under the
Securities Exchange Act of 1934

1. Text of Proposed Rule Change

(a) Pursuant to the provisions of Section 19(b)(1) under the Securities Exchange Act of 1934 ("Act"), NASD Regulation, Inc. ("NASD Regulation") is filing with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to amend Rule 2860(b) of the National Association of Securities Dealers, Inc. ("NASD" or "Association") to establish that NASD member firms and their customers shall have the same position and exercise limits for FLEX Equity Options as the firms that are members of the exchange on which such FLEX Equity Options trade. Below is the text of the proposed rule change. Proposed new language is underlined; proposed deletions are in brackets.

Rule 2860. Options

* * *

(b) Requirements

(1) General

(A) Applicability--This Rule shall be applicable (i) to the trading of options contracts issued by The Options Clearing Corporation and displayed on The Nasdaq Stock Market and to the terms and conditions of such contracts; (ii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members who are not members of an exchange on which the option executed is listed; (iii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the

execution of transactions, and the handling of orders in conventional options; and (iv) other matters related to options trading.

Unless otherwise indicated herein, subparagraphs (3) through (12) shall apply only to options displayed on Nasdaq and standardized and conventional on common stock and subparagraphs (13) through (24) shall apply to transactions in all options as defined in paragraph (a), including common stock. The position and exercise limits for FLEX Equity Options for members who are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded.

* * *

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

* * *

(W) FLEX Equity Option -- The term “FLEX Equity Option” means any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contract is traded.

(X)-(ZZ) Redesignated accordingly.

* * *

(b) Not applicable.

(c) Not applicable.

2. Procedures of the Self-Regulatory Organization

(a) The proposed rule change was approved by the Board of Directors of the Nasdaq Stock Market, Inc. on November 6, 1996, which authorized this filing with the Commission. The Board of Governors of the NASD declined to call the proposed rule changes for review at its meeting on December 12, 1996. No other action by the NASD is necessary for the filing of the rule change. Pursuant to the Plan of Allocation and Delegation of Functions by NASD to Subsidiaries, Nasdaq staff has provided an opportunity for staff of NASD Regulation, Inc. to consult with it concerning the proposed rule change.

(b) Questions regarding this rule filing may be directed to Gary L. Goldsholle, Senior Attorney, NASD Regulation, Office of General Counsel, at (202) 728-8104.

3. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

(a) **Purpose**

On September 5, 1997, The Nasdaq Stock Market, Inc. ("Nasdaq") filed a proposed rule change with the Commission to: (1) amend NASD Rule 2860(b) to disaggregate conventional equity options from exchange-traded equity options for position limit purposes; (2) amend the NASD's OTC Collar Aggregation Exemption to provide that the exemption may be utilized with respect to an entire conventional equity options position, not just that portion of the position that was established pursuant to the NASD's Equity Option Hedge

Exemption; and (3) eliminate position and exercise limits on FLEX Equity Options. Shortly thereafter, on September 9, 1997,¹ the Commission approved a two-year pilot program (“Pilot Program”) to eliminate position and exercise limits for FLEX Equity Options, which are traded on the American Stock Exchange, Inc. (“AMEX”), the Chicago Board Options Exchange, Inc. (“CBOE”), and the Pacific Stock Exchange, Inc. (“PCX”) (collectively “Options Exchanges”).² In light of the adoption of the Pilot Program, NASD Regulation seeks to amend its rules to be consistent with the rules of the Options Exchanges. The NASD is withdrawing its proposed rule change dated September 5, 1997, and intends to refile shortly a proposed rule change addressing items (1) and (2) described above. The NASD has determined to make the instant rule filing concerning FLEX Equity Options separately in order to obtain expedited approval, which is necessary to avoid inconsistencies between the rules of the NASD and the Options Exchanges.

The NASD’s option position and exercise limits apply, among other things, to “the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members who are not members of an exchange on which the option executed is listed.”³ As currently written, the NASD’s position limits do not provide any exemption for FLEX Equity Options. Consequently, NASD member firms who are not members of an Options Exchange and who effect proprietary or customer FLEX Equity Options through

¹ See 62 FR 48683 (September 16, 1997).

² FLEX Equity Options, are exchange-traded options issued by The Options Clearing Corporation that give investors the ability, within specified limits, to designate certain terms of the option (i.e., the exercise price, exercise style, expiration date, or option type).

³ NASD Rule 2860(b)(1)(A).

members of the Options Exchanges are subject to options position and exercise limits. By contrast, the Options Exchange member firms executing such orders in FLEX Equity Options are not subject to options position and exercise limits. NASD Regulation does not believe that NASD and Options Exchange member firms and their customers should be subject to different position and exercise limits with respect to FLEX Equity Options.

To reconcile the NASD rules with those of the Options Exchanges, the proposed rule change provides that the position and exercise limits for FLEX Equity Options⁴ for NASD members who are not members of an Options Exchange shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded. Moreover, since the proposed rule change incorporates the position and exercise limits for FLEX Equity Options established by the Options Exchanges, the elimination of position and exercise limits for FLEX Equity Options will continue only as long as the Pilot Program remains in effect, subject, of course, to extensions by the Commission or the adoption of a rule permanently eliminating position and exercise limits for FLEX Equity Options.

Finally, although the proposed rule change does not specify any of the reporting, margin and capital charge requirements of the Pilot Program, NASD members and their customers will be effectuating such requirements through the Options Exchange member effecting the FLEX Equity Option transaction.

⁴ The proposed rule change defines FLEX Equity Options as any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contracts is traded.

(b) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act, which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that amending its rules to incorporate changes in the position and exercise limits for FLEX Equity Options as a result of the Pilot Program achieves these purposes.

4. Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

5. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

6. Extension of Time Period for Commission Action

NASD Regulation does not consent at this time to an extension of the time period for Commission action specified in Section 19(b)(2) of the Act.

7. Basis for Summary Effectiveness Pursuant to Section 19(b)(3) or for Accelerated Effectiveness Pursuant to Section 19(b)(2)

NASD Regulation requests the Commission to find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after its publication in

the Federal Register. The proposed rule change conforms the NASD's rules concerning position and exercise limits for FLEX Equity Options with those of the Options Exchanges, as amended by the Pilot Program announced by the Commission on September 9, 1997.

Specifically, the proposed rule change provides that the position and exercise limits for FLEX Equity Options for NASD members who are not members of an Options Exchange shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded. NASD Regulation believes that good cause exists to accelerate approval of the proposed rule change because equalizing the position and exercise limits for FLEX Equity Options between NASD and Options Exchange member firms will avoid the inequitable treatment faced by NASD member firms and their customers with respect to FLEX Equity Options.

8. Proposed Rule Change Based on Rules of Another Self-Regulatory Organization or of the Commission

The proposed rule change is based upon the recent amendments to rules of the Options Exchanges concerning the Pilot Program relating to the elimination of position and exercise limits for FLEX Equity Options.⁵ The proposed rule change establishes that NASD member firms and their customers shall have the same position and exercise limits for FLEX Equity Options as the firms that are members of the Options Exchange on which such FLEX Equity Options trade. Although the proposed rule change does not directly impose reporting, margin and capital requirements on NASD member firms, the NASD member firms and their customers will be effectuating the reporting, margin and capital requirements of the Pilot

Program through the Options Exchange member effecting the FLEX Equity Options transaction.

9. Exhibits

1. Completed notice of proposed rule change for publication in the Federal Register.

Pursuant to the requirements of the Securities Exchange Act of 1934, NASD Regulation has duly caused this filing to be signed on its behalf by the undersigned thereunto duly authorized.

NASD REGULATION, INC.

BY: _____

Alden S. Adkins,
Senior Vice President and General Counsel

Date: February 13, 1998

⁵ See 62 FR 48683.

EXHIBIT 1

SECURITIES AND EXCHANGE COMMISSION

(Release No. 34- ; File No. SR-NASD-98-15)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Elimination of Position and Exercise Limits for FLEX Equity Options

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on , NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by NASD Regulation. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change.

I. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE TERMS OF SUBSTANCE OF THE PROPOSED RULE CHANGE

NASD Regulation is proposing to amend Rule 2860(b) of the National Association of Securities Dealers, Inc. ("NASD" or "Association"), to establish that NASD member firms and their customers shall have the same position and exercise limits for FLEX Equity Options as the firms that are members of the exchange on which such FLEX Equity Options trade.

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

Rule 2860. Options

* * *

(b) Requirements

(1) General

(A) Applicability--This Rule shall be applicable (i) to the trading of options contracts issued by The Options Clearing Corporation and displayed on The Nasdaq Stock Market and to the terms and conditions of such contracts; (ii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members who are not members of an exchange on which the option executed is listed; (iii) to the extent appropriate unless otherwise stated herein, to the conduct of accounts, the execution of transactions, and the handling of orders in conventional options; and (iv) other matters related to options trading.

Unless otherwise indicated herein, subparagraphs (3) through (12) shall apply only to options displayed on Nasdaq and standardized and conventional on common stock and subparagraphs (13) through (24) shall apply to transactions in all options as defined in paragraph (a), including common stock. The position and exercise limits for FLEX Equity Options for members who are not also members of the exchange on which FLEX Equity Options trade shall be the same as the position and exercise limits

as applicable to members of the exchange on which such FLEX Equity Options are traded.

* * *

(2) Definitions

The following terms shall, unless the context otherwise requires, have the stated meanings:

* * *

(W) FLEX Equity Option -- The term “FLEX Equity Option” means any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contract is traded.

(X)-(ZZ) Redesignated accordingly.

* * *

II. SELF-REGULATORY ORGANIZATION'S STATEMENT OF THE PURPOSE OF, AND STATUTORY BASIS FOR, THE PROPOSED RULE CHANGE

In its filing with the Commission, NASD Regulation 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. NASD Regulation 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**

On September 5, 1997, The Nasdaq Stock Market, Inc. (“Nasdaq”) filed a proposed rule change with the Commission to: (1) amend NASD Rule 2860(b) to disaggregate conventional equity options from exchange-traded equity options for position limit purposes; (2) amend the NASD’s OTC Collar Aggregation Exemption to provide that the exemption may be utilized with respect to an entire conventional equity options position, not just that portion of the position that was established pursuant to the NASD’s Equity Option Hedge Exemption; and (3) eliminate position and exercise limits on FLEX Equity Options. Shortly thereafter, on September 9, 1997,¹ the Commission approved a two-year pilot program (“Pilot Program”) to eliminate position and exercise limits for FLEX Equity Options, which are traded on the American Stock Exchange, Inc. (“AMEX”), the Chicago Board Options Exchange, Inc. (“CBOE”), and the Pacific Stock Exchange, Inc. (“PCX”) (collectively “Options Exchanges”).² In light of the adoption of the Pilot Program, NASD Regulation seeks to amend its rules to be consistent with the rules of the Options Exchanges. The NASD is withdrawing its proposed rule change dated September 5, 1997, and intends to refile shortly a proposed rule change addressing items (1) and (2) described above. The NASD has determined to make the instant rule filing concerning FLEX Equity Options separately in

¹ See 62 FR 48683 (September 16, 1997).

² FLEX Equity Options, are exchange-traded options issued by The Options Clearing Corporation that give investors the ability, within specified limits, to designate certain terms of the option (i.e., the exercise price, exercise style, expiration date, or option type).

order to obtain expedited approval, which is necessary to avoid inconsistencies between the rules of the NASD and the Options Exchanges.

The NASD's option position and exercise limits apply, among other things, to "the conduct of accounts, the execution of transactions, and the handling of orders in exchange-listed options by members who are not members of an exchange on which the option executed is listed."³ As currently written, the NASD's position limits do not provide any exemption for FLEX Equity Options. Consequently, NASD member firms who are not members of an Options Exchange and who effect proprietary or customer FLEX Equity Options through members of the Options Exchanges are subject to options position and exercise limits. By contrast, the Options Exchange member firms executing such orders in FLEX Equity Options are not subject to options position and exercise limits. NASD Regulation does not believe that NASD and Options Exchange member firms and their customers should be subject to different position and exercise limits with respect to FLEX Equity Options.

To reconcile the NASD rules with those of the Options Exchanges, the proposed rule change provides that the position and exercise limits for FLEX Equity Options⁴ for NASD members who are not members of an Options Exchange shall be the same as the position and exercise limits as applicable to members of the exchange on which such FLEX Equity Options are traded. Moreover, since the proposed rule change incorporates the position and exercise

³ NASD Rule 2860(b)(1)(A).

⁴ The proposed rule change defines FLEX Equity Options as any options contract issued, or subject to issuance by, The Options Clearing Corporation whereby the parties to the transaction have the ability to negotiate the terms of the contract consistent with the rules of the exchange on which the options contracts is traded.

limits for FLEX Equity Options established by the Options Exchanges, the elimination of position and exercise limits for FLEX Equity Options will continue only as long as the Pilot Program remains in effect, subject, of course, to extensions by the Commission or the adoption of a rule permanently eliminating position and exercise limits for FLEX Equity Options.

Finally, although the proposed rule change does not specify any of the reporting, margin and capital charge requirements of the Pilot Program, NASD members and their customers will be effectuating such requirements through the Options Exchange member effecting the FLEX Equity Option transaction.

(2) Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁵ which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. NASD Regulation believes that amending its rules to incorporate changes in the position and exercise limits for FLEX Equity Options as a result of the Pilot Program achieves these purposes.

(B) Self-Regulatory Organization's Statement on Burden on Competition

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

(C) Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

Written comments were neither solicited nor received.

III. DATE OF EFFECTIVENESS OF THE PROPOSED RULE CHANGE AND TIMING FOR COMMISSION ACTION

NASD Regulation has requested that the Commission find good cause pursuant to Section 19(b)(2) for approving the proposed rule change prior to the 30th day after publication in the Federal Register. The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to the NASD and, in particular, the requirements of Section 15A and the rules and regulations thereunder. The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of notice of filing thereof in that accelerated approval will conform the NASD rules concerning position and exercise limits for FLEX Equity Options with those of the Options Exchanges. Moreover, the Commission finds that good cause exists to accelerate approval of the proposed rule change because the current rules have the effect of placing NASD member firms and their customers at a competitive disadvantage to Options Exchanges member firms with respect to FLEX Equity Options position and exercise limits.

IV. SOLICITATION OF COMMENTS

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the

⁵ 15 U.S.C. 78f(b)(5).

Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C.

20549. Copies of the 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. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days from the date of publication].

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁶ that the proposed rule change be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Jonathan G. Katz
Secretary

⁶ 15 U.S.C. 78s(b)(2).

⁷ 17 CFR 200.30-3(a)(12).