
SECURITIES ACT OF 1933

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INTERPRETATION RELATING TO THE WRITING OF EXCHANGE-TRADED CALL OPTIONS

The Securities and Exchange Commission today announced that it had authorized the Division of Corporation Finance to issue a letter modifying its previous position regarding the delivery of underlying securities subject to Rules 144 or 145(d) under the Securities Act of 1933 in connection with the writing of exchange-traded call options. As the Commission has previously announced, it is currently engaged in an extensive study of the regulatory questions associated with trading in standardized options. The results of that study may affect the future position of the Division of Corporation Finance with respect to the matters discussed below.

Background

Subject to its provisions, Rule 144 (17 CFR 230.144) under the Securities Act of 1933 (the "Act") (15 U.S.C. 77a et seq.) permits resales of securities owned by affiliates¹ of the issuer and by persons who have acquired restricted securities² of the issuer without

¹Rule 144(a)(1) defines "affiliate" of an issuer as a person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, such issuer.

²Rule 144(a)(3) defines "restricted securities" as securities acquired directly or indirectly from the issuer thereof, or from an affiliate of such issuer, in a transaction or chain of transactions not involving any public offering or from the issuer in a transaction in reliance on Rule 240 under the Act or which were issued by an issuer in a transaction in reliance on Rule 240 and were acquired in a transaction or chain of transactions not involving any public offering.

such persons being deemed to be engaged in a distribution and thus be considered underwriters as defined in Section 2(11) of the Act. Similarly, paragraph (d) of Rule 145 (17 CFR 230.145) under the Act permits resales of securities acquired in business combinations that are subject to that rule to be made by certain persons,³ who might otherwise be considered underwriters or deemed to be engaged in a distribution, provided such resales are made in accordance with certain provisions of Rule 144,⁴ including paragraph (f). Rule 144(f) requires that the securities be sold in "brokers' transactions" (as defined in paragraph (g) of Rule 144) and that the person selling the securities not solicit orders to buy such securities or make any payment in connection with their sale to any person other than the broker who executes the order to sell the securities.

The Division's interpretative letter set forth below relates to the proposed writing of exchange-traded call options on securities subject to the resale provisions of Rule 145(d) and subsequent sale of the underlying securities by delivering them in satisfaction of any exercise notices received on the options. The Division has previously expressed the view⁵ that the writing of call options involves the solicitation of orders to buy the underlying securities and, therefore, does not comply with the provisions of Rule 144(f). Upon reconsideration, because the mechanics of selling call options over national exchanges are similar to those involved in the sale on an exchange of other exchanged-traded securities, the Division's view is that the writing of exchange-traded call options should not be deemed under Rule 144(f) as a solicitation for the purchase of the underlying securities. This view, which is applicable solely to the provisions of Rule 144 and Rule

³Rule 145(c) provides that any party to any transaction subject to Rule 145, other than the issuer, or any person who is an affiliate of such party at the time any such transaction is submitted for vote or consent, who publicly offers or sells securities of the issuer acquired in connection with any such transaction, shall be deemed to be engaged in a distribution and therefore to be an underwriter thereof within the meaning of Section 2(11) of the Act.

⁴The applicable provisions of Rule 144 are paragraphs (c) (Current Public Information), (e) (Limitation of Amount of Securities Sold), (f) (Manner of Sale), and (g) (Brokers' Transactions).

⁵See *Columbia University* letter (pub. avail. February 27, 1976); *Burroughs Corporation* letter (pub. avail. August 9, 1976).

145(d), relates only to the writing of exchange-traded options and does not extend to the writing or sale of options under any other circumstances.

While the matter dealt with in the letter relates to the writing of exchange-traded call options on underlying securities subject to Rule 145(d), the Division's view on solicitation is applicable as well to the writing of exchange-traded options on securities subject to Rule 144. The Commission emphasizes, however, that the Division's views relate only to the manner of sale provision of Rule 144(f) and do not affect the other provisions of that rule. Accordingly, for sales made under Rules 144 and 145(d) through the writing of exchange-traded call options, all of the conditions applicable to those rules must be satisfied both at the time of the writing of the options and the time that the underlying securities are delivered pursuant to exercise notices on the options. With respect to sales made under Rule 144, the notice on Form 144 required by paragraph (h) of that rule would be required to be filed with the Commission and the principal national securities exchange on which the underlying securities are listed at the time the call option is written, and subsequently amended, in the event the option is exercised, at the time of the delivery of such securities.⁶

The Commission reminds affiliates engaging in transactions in exchange-traded options⁷ of the provisions of Section 16 under the Securities Exchange Act of 1934 (the "Exchange Act") (15 U.S.C. 78a et seq.). The reporting obligations of Section 16(a) and Rule 16a-6 (17 CFR 240.16a-6) thereunder would require such persons to report the writing, purchase or sale of put and call options covering equity securities of the issuer at the time of the transaction, and subsequently report the exercise, cancellation or expiration of the options.⁸

⁶Rule 144(h) requires the Form 144 to be filed "concurrently with the placing with a broker of an order to execute a sale." Since the Division deems the writing of the option to be an offer to sell, its view is that the Form must be filed at that time.

⁷Many of the national exchanges currently prohibit their members from accepting orders for the writing of call options from affiliates of the issuer of the underlying securities.

⁸The Commission expresses no view as to the impact of the other provisions of Section 16 to transactions made in such options. Subject to its provisions, Section 16(b) provides that the issuer is entitled to any profit made by a ten percent beneficial owner, officer or director of the

In a related matter, the Commission has recently permitted shareholders to offer and sell securities covered by an effective shelf registration statement⁹ through the writing of exchange-traded call options on such securities and the delivery of those securities upon the exercise of the options. In such circumstances, the Commission believed that the requirements of Section 5 of the Act would be satisfied where: (1) a registration statement is in effect, having a prospectus meeting the requirements of Section 10 of the Act, both at the time the options are written and the underlying securities delivered; (2) copies of such prospectus are delivered, pursuant to Rule 153 (17 CFR 230.153) under the Act, to the exchanges on which the options are written prior to the time the options are written and underlying securities delivered; and (3) such prospectus describes the intended plan of distribution.¹⁰ As indicated, the position taken by the Division relates solely to the question of what is a solicitation for purposes of Rules 144 and 145(d). Any persons considering such trans-

issuer from any combination of purchases and sales of its equity securities within a six-month period. In addition, under Section 16(c), such persons are prohibited from selling any equity security of the issuer if such security is not owned by them.

⁹A shelf registration statement refers to a registration statement used in connection with a deferred or extended offering. For a description of the types of offerings where such registration is permitted or required, see Securities Act Release No. 4936, as amended, (December 9, 1968), (33 Fed. Reg. 18617), Paragraph 4.

¹⁰Under Section 5, it is required that a registration statement be filed with the Commission prior to an offer to sell a security and that a registration statement be in effect, with a prospectus meeting the requirements of Section 10 of the Act, prior to the sale of a security. In the Division's view, the writing of a call option should be considered as an offer to sell the underlying securities, and the delivery of the underlying securities upon the exercise of the option should be considered a sale of those securities. Section 5 would require, therefore, the filing of a registration statement prior to the writing of a call option on the underlying securities being registered and an effective registration statement with a statutory prospectus at the time of the delivery of the underlying securities. Since the terms and conditions of options trading provide that the option is subject to exercise immediately after it is written, as a practical matter in order to avoid violations of Section 5, it would be necessary to have a registration statement in effect and a statutory prospectus delivered to the exchange at the time the call option is written.

actions should first carefully consider the provisions of Rule 10b-6 (17 CFR 240.10b-6) under the Exchange Act.¹¹

As indicated in the Division's letter set forth below, additional restrictions on the writing of options on securities whose sale is subject to the registration requirements of the Act or Rules 144 and 145(d) may be imposed by the national securities exchanges.

The Commission authorized the Division of Corporate Finance to issue the following letter:

"Dear Mr. X:

"In your letter dated August 13, 1976, you request that this Division reconsider the position expressed in its letter of July 9, 1976, in response to your letter of May 13, 1976, concerning the proposed writing by your client, Mr. Y, of exchange-traded call options on all or a portion of his shares of the common stock of _____ (the 'Company'), as more fully described below.

"You state that Mr. Y acquired all of his 8,580 shares of the Company's common stock on January 23, 1976, pursuant to a merger of Z Corporation into a wholly-owned subsidiary of the Company. In connection with the above-described merger, you indicate that the Company filed a registration statement on Form S-14 under the Securities Act of 1933 (the 'Act') covering shares issued pursuant to the merger, including the 8,580 shares issued to Mr. Y (the 'Y shares'). You further indicate that Mr. Y formerly served as a director of Z Corporation. Accordingly, you represent that sales of the Y shares are required to be effected in accordance with the provisions of Rule 145(d) under the Act. You further state that Mr. Y is not an officer, director or ten percent shareholder of the Company.

"You indicate that Mr. Y proposes to write exchange-traded call options on the Company's common stock (which options are listed and traded on the American Stock Exchange ('Amex') and the Chicago Board Options Exchange ('CBOE')) in unsolicited brokerage

transactions. In the event that an exercise notice is subsequently assigned against his option account, you state that Mr. Y proposes to satisfy his obligations thereunder by delivering the requisite number of the Y shares of the Company's common stock, provided, of course, that such shares can lawfully be sold at that time.

"In your letter of May 13, 1976, you state that, in your opinion, sales by Mr. Y of the Y shares in response to an exercise notice would comply with the provisions of Rule 145(d) under the Act. In our letter of July 9, 1976, we stated that this Division was unable to concur with your opinion because the proposed writing of call options for the Company's stock and the subsequent sale of the Y shares to exercising holders of the options would involve the solicitation of orders to buy the common stock of the Company and, accordingly, would not be in compliance with the requirement of paragraph (f) of Rule 144 that the Y shares be sold in 'broker's transactions', as defined in that rule.

"Pursuant to your request for reconsideration, and after further evaluation of the facts and representations contained in your previous letters, the Commission has directed this Division to inform you that sales of the Y shares by your client in response to the receipt of an exercise notice from a holder of a call option for the Company's stock, in the manner described above, would not involve the solicitation of an order to purchase those shares and, therefore, would not be in violation of Rule 144(f). Accordingly, this Division withdraws the position with respect to Rule 144 previously taken in its letter of July 9, 1976. We wish to emphasize, however, that the foregoing position is based upon your representation that all of the conditions of Rule 145(d) (pursuant to which the Y shares are required to be sold in accordance with certain enumerated provisions of Rule 144) shall be satisfied at the time the call options are written and the Y shares sold in the manner described above.

"Notwithstanding the views expressed herein with respect to Rule 145(d) under the Act, the Division of Market Regulation has requested that we inform you that the rules of certain exchanges may impose restrictions on the delivery of underlying securities in satisfaction of option exercise notices. Specifically, your attention is directed to Amex Option Rule 928, which provides, *inter alia*, that members and member organizations may not accept shares of an underlying security 'which may not be sold by the holder thereof except upon registration thereof pursuant to the provisions of the Securities Act of 1933 or pursuant to SEC rules promulgated under the Securities Act of 1933. . . . for the purpose of satisfying an exercise notice assigned against an option contract.

¹¹Rule 10-6 prohibits, subject to certain specifically enumerated exceptions, underwriters and prospective underwriters, issuers, selling shareholders and broker-dealers who are participating, directly or indirectly, in a distribution of securities to bid for or purchase any securities which are the subject of the distribution or any securities of the same class and series or any right to purchase such securities until after such persons have completed their respective participations in the distribution.

"The Division of Market Regulation has further requested that we direct your attention to certain additional exchange rules as well as various rules of the Federal Reserve Board ('FRB') which may have general application to the proposed transactions including, but not limited to, Amex Rule 462, Amex Options Rules 928 and 940, CBOE Rule 12.1 et seq., and FRB Rules promulgated pursuant to Section 7(a) of the Securities Exchange Act of 1934 (12 CFR 220 et seq.). Responsibility for ensuring that the proposed sale of the Y shares are effected in compliance with the foregoing rules and any other applicable rules must, of course, rest with your client."

By the Commission.

George A. Fitzsimmons
Secretary
