

III. 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 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 changes that are filed with the Commission, and all written communications relating to the proposed rule changes 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 at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filings also will be available for inspection and copying at the principal offices of the Exchanges. All submissions should refer to File Nos. SR-NYSE-95-31, SR-PSE-95-25, SR-Amex-95-42, and SR-Phlx-95-71, and should be submitted by November 21, 1995.

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Changes

A. Description and Background

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of large options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations¹³ and for corners or squeezes of the underlying market. In addition, they serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.

In establishing position and exercise limits, the Commission has been careful to balance two competing concerns. First, the Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market for the underlying security by acquiring and exercising a number of

¹³ Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established derivatives position.

options contracts disproportionate to the deliverable supply and average trading volume of the underlying security. At the same time, the Commission has realized that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.¹⁴

In October 1980, the Commission approved proposed rule changes by several options exchanges to increase position and exercise limits from 1,000 to 2,000 contracts for all individual equity options classes.¹⁵ In conjunction with the approval, the Commission received commitments from the options exchanges to study the effects of the increased limits. The Commission indicated that the experience gained under the increased limits, if coupled with adequate monitoring and surveillance procedures, could serve as a basis for considering further position and exercise limit modifications.

In July 1983, the Commission approved a further increase in position and exercise limits for individual stock options based on a tiering approach.¹⁶ Limits for options on stocks with the greatest trading volume and public float were increased to 4,000 contracts and limits on all other options classes were increased to 2,500 contracts.¹⁷ In approving the increased limits under a two-tiered framework, the Commission noted that tiering was consistent with the gradual, evolutionary approach that the Commission and the exchanges have adopted in increasing position and exercise limits.

In 1985, the Commission approved a further increase in position and exercise limits for individual equity options. This approval extended the tiering approach commenced by the options

¹⁴ See H.R. Rep. No. IFC-3, 96th Cong., 1st Sess. at 189-91 (Comm. Print 1978) ("Options Study").

¹⁵ See Securities Exchange Act Release No. 17237 (October 22, 1980), 45 FR 71454 (October 28, 1980) (order approving File Nos. SR-PSE-80-15, SR-Amex-80-23, and SR-Phlx-80-21) ("1980 Release").

¹⁶ See Securities Exchange Act Release No. 19975 (July 15, 1983), 48 FR 33389 (July 21, 1983) (order approving File Nos. SR-PSE-83-09, SR-Amex-83-05, and SR-Phlx-83-04) ("1983 Release").

¹⁷ To be eligible for the 4,000 contract limit an underlying security was required to have had either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 60 million shares currently outstanding. All other options not meeting these requirements were subject to the 2,500 contract limits.

exchanges in 1983.¹⁸ The Commission noted in the 1985 Release that liberalizing position and exercise limits would further increase the potential depth and liquidity of the individual stock options markets without significantly increasing concerns regarding intermarket manipulations or disruptions of the market for the options or underlying securities.

Lastly, in December 1993, the Commission approved the Exchanges' existing position and exercise limit framework for individual equity options.¹⁹ Depending on certain criteria related to the trading volume of the underlying stock or a combination of both the trading volume and the number of shares outstanding of the underlying stock, the Exchanges' current position and exercise limits were established at levels of 10,500 contracts, 7,500 contracts, and 4,500 contracts.²⁰

The Exchanges proposed to add two position and exercise limit tiers at 25,000 and 20,000 contract levels. As stated above, the criterion to qualify for

¹⁸ See Securities Exchange Act Release No. 21907 (March 29, 1985), 50 FR 13440 (April 4, 1985) (order approving File Nos. SR-PSE-85-01, SR-Amex-84-30, and SR-Phlx-84-25) ("1985 Release"). The 1985 Release created a three-tiered system of position and exercise limits of 8,000, 5,500, and 3,000 contracts. To be eligible for the 8,000 contract limit an underlying security was required to have had either (i) trading volume of at least 40 million shares during the most recent six month trading period; or (ii) trading volume of at least 30 million shares during the most recent six month trading period and at least 120 million shares currently outstanding. To be eligible for the 5,500 contract limit an underlying security was required to have had either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 40 million shares currently outstanding. All other options not meeting these requirements were subject to the 3,000 contract limits.

¹⁹ See Securities Exchange Act Release Nos. 33284 (December 3, 1993), 58 FR 65215 (December 13, 1993) (order approving File No. SR-NYSE-93-41); 33282 (December 3, 1993), 58 FR 65218 (December 13, 1993) (order approving File No. SR-PSE-92-38); 33285 (December 3, 1993), 58 FR 65201 (December 13, 1993) (order approving File No. SR-Amex-93-27); and 33288 (December 3, 1993), 58 FR 65221 (December 13, 1993) (order approving File No. SR-Phlx-93-07) (collectively "1993 Release").

²⁰ To be eligible for the 10,500 contract limit an underlying security must have either (i) trading volume of at least 40 million shares during the most recent six month trading period; or (ii) trading volume of at least 30 million shares during the most recent six month trading period and at least 120 million shares currently outstanding. To be eligible for the 7,500 contract limit an underlying security must have either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 40 million shares currently outstanding. All other options not meeting these requirements are subject to the 4,500 contract limits.