

Options Moratorium

REQUEST FOR EXPEDITED COMMISSION DECISION

REQUEST: That the Commission authorize the Division to send the attached letter to those exchanges which presently trade standardized options, containing the proposed guidelines for the replacement of involuntarily delisted options class during the voluntary moratorium.

SERIAM CONSIDERATION

(X) Pursuant to the provisions of 17 CFR 200.41(a), the Chairman or the undersigned member of the Securities and Exchange Commission, acting as Duty Officer of the Commission, is of the opinion that joint deliberation among the members of the Commission upon the above matter is unnecessary in light of the nature of the matter, impracticable, or contrary to the requirements of agency business but is of the view that such matter should be the subject of a vote of the Commission

DUTY OFFICER CONSIDERATION*

() Pursuant to the provisions of 17 CFR 200.42(b)

EMERGENCY CALENDAR CONSIDERATION

()

REASON EXPEDITED DECISION IS REQUIRED:

In its June 22 letter to seven self-regulatory organizations requesting continuation of the options expansion moratorium on a voluntary basis, the Commission indicated that the proposed guidelines for the replacement of involuntarily delisted options classes during the voluntary moratorium would be sent during the week of June 26, 1978. In view of this deadline, calendar procedures are not feasible.

Andrew M. Kle...

Requesting Division Director

Chairman

George A. F...
Secretary
John P. Brown
Duty Officer Commissioner
Date: *June 30, 1978*

COMMISSION ACTION

- Chairman Williams
- Commissioner Loomis
- Commissioner Evans
- Commissioner Pollack
- Commissioner Karmel

Approved*
[Handwritten signatures]

Deferred for
Regular Calendar

Date of Action: *6/30/78*

* Staff memorandum requesting affirmation by the full Commission is due in the Secretary's Office within three business days if item is approved by Duty Officer Only.

M E M O R A N D U M

June 30, 1978

TO: The Commission

FROM: Division of Market Regulation

SUBJECT: Letter to Options Exchanges Regarding Guidelines for Replacement of Involuntarily Delisted Options Classes During the Voluntary Moratorium

RECOMMENDATION:

(1) That the Commission authorize the Division to send the attached letter (Exhibit A) to the American Stock Exchange, Inc. ("Amex"), Chicago Board Options Exchange, Incorporated ("CBOE"), Midwest Stock Exchange, Incorporated ("MSE"), Pacific Stock Exchange Incorporated ("PSE"), and Philadelphia Stock Exchange, Inc. ("PHLX"), setting forth the staff's proposed guidelines for the replacement of involuntarily delisted options classes during the voluntary moratorium; and

(2) That, in view of the interest expressed by some members of the press in these guidelines, the Commission issue a release announcing that the letters have been sent and setting forth the text of the letters (Exhibit B).

NOVEL, UNIQUE OR
COMPLEX ISSUES:

Whether to permit the options exchanges to replace an involuntarily delisted call options class with a puts options class.

OTHER DIVISIONS AND
OFFICES CONSULTED:

Options Study

RESPONSIBLE STAFF
MEMBER:

Gene E. Carasick - X57913

ACTION REQUESTED:

Seriatum Vote on June 30, 1978

I. Introduction

In its June 22, 1978 letter requesting that the self-regulatory organizations continue to honor the Commission's July 18, 1977 request 1/ for a voluntary moratorium on

1/ Securities Exchange Act Release No. 13760 (July 18, 1977), 42 FR 38035 (July 26, 1977)).

further expansion of standardized options trading programs, the Commission stated that it would send to each self-regulatory organization, during the week of June 26, 1978, proposed guidelines for the replacement of involuntarily delisted options classes. 2/ We have attached to this memorandum a draft letter containing those proposed guidelines. The letter will be sent today to each of the five exchanges which presently trade standardized options, with copies to the New York Stock Exchange, Inc. and the National Association of Securities Dealers, Inc. We have drafted the letter for the Division Director's signature, and have described the guidelines as a staff proposal, in order to enable the Commission to retain as much flexibility as possible in considering any revisions to the guidelines which the self-regulatory organizations may suggest.

II. Discussion

A. The Guidelines

The guidelines are substantially the same as those set forth in the Division's June 21, 1978, memorandum to the Commission, "Outline of Points of Agreement for Continuation of Options Moratorium on a Voluntary Basis," with some minor changes, as follows:

1. In the introductory paragraph to the guidelines, a definition of "involuntarily delisted options classes" has been added to make clear that only those options classes

on underlying securities which fail to meet the minimum maintenance requirements for options trading set forth in the rules of each options exchange, may be replaced during the voluntary moratorium.

The Division believes that this addition is necessary in view of an inquiry made by Dennis Carlton of the PSE staff 3/ concerning whether the PSE would be permitted to include options on the common stock of Texas Oil and Gas as an involuntarily delisted options class. The PSE had commenced trading in Texas Oil and Gas call options on Monday, July 18, 1977, before it received notice of the Commission's request for a voluntary moratorium. Although the Division had contacted the Amex on Friday evening, July 15, 1977, to request that it not go forward with its plans to begin trading in certain call options classes on Monday, July 18 (a request to which the Amex acceded), the Division apparently did not contact the PSE until the morning of July 18. By that time, the PSE already had commenced trading in Texas Oil and Gas options. 4/ The Division informed the PSE that it could not continue to trade the options during the voluntary moratorium since they had not been traded on July 15. Subsequently, the PSE broke all trades effected in Texas Oil and Gas during the morning of July 18, 1977, and ceased further trading in that class. Notwithstanding these unfortunate circumstances,

3/ Telephone conversation between Gene Carasick of the Division's staff and Dennis Carlton of the PSE (June 28, 1978).

4/ Telephone conversation between Frank Moore, the former member of the Division's staff who was responsible for options matters in July 1977 and Kathryn McGrath and Gene Carasick of the Division's staff.

the Division does not believe that Texas Oil and Gas properly can be considered an involuntarily delisted options class for purposes of the voluntary moratorium. If the Commission were to accede to the PSE's request, we think it would be difficult to deny a similar request from the Amex regarding those options classes which it had intended to begin trading on July 18, 1977.

We have also added the phrase "with options classes of the same type (i.e., put or call)" and an accompanying footnote to clarify that involuntarily delisted classes must be replaced with classes of the same type and where an exchange involuntarily delists an option upon which both puts and calls were traded, the puts class may be replaced with another puts class, provided the puts class is not traded on another exchange. As a practical matter, the underlying securities upon which both puts and calls are traded are generally high quality issues, which are unlikely to be involuntarily delisted.

2. A sentence has been added to paragraph 2 of the guidelines stating that the Commission will act upon replacement applications at the time it approves, pursuant to Securities Exchange Act Rule 12d2-2(c), an exchange's application to strike the involuntarily delisted class from listing and registration.

3. In paragraph 4 of the guidelines, the phrase "delisting proceeding" has been replaced by the word "phaseout". This was done in order to avoid confusion

among the exchanges between the date upon which a replacement application may be filed with the Commission (i.e., when the exchange notifies The Options Clearing Corporation that it will phase out an options class for which the underlying security no longer meets the exchange's minimum maintenance requirements) and the date upon which the Commission approves, pursuant to Rule 12d2-2(c), the exchange's application to strike the involuntarily delisted class from listing and registration, and also acts upon its application for a replacement class.

B. Replacement of Involuntarily Delisted Call Options Classes with Puts Options Classes

On June 28, 1978, Mr. Burton Rissman, outside counsel to the CBOE, raised in a discussion with the staff the possibility of permitting put option classes as replacements for involuntarily delisted call option classes. Mr. Rissman explained that the CBOE believes that there presently are not a sufficient number of securities which meet current listing criteria which, for a variety of business reasons, would be attractive as replacements for involuntarily delisted call option classes, particularly in light of the fact that the Commission is not permitting any additional

dual trading. Apparently, the CBOE believes that there may be only three or four "quality" candidates out of approximately twenty-two underlying securities which would presently qualify for options listing. It is now generally known that at least three exchanges eventually will be eligible to apply to the Commission for the replacement of a total of five involuntarily delisted classes (PSE and PHLX are eligible now for one and two replacements, respectively; CBOE will not become eligible until the fall, when it will need two replacements). The CBOE is concerned that it is likely to be the last in line to replace its involuntarily delisted classes under whatever guidelines the Commission develops, and fears that there will be no "quality" classes left for it to choose. 5/ Mr. Rissman therefore suggested, on behalf of the CBOE, that, in order to expand the number of attractive listings from which to choose a replacement, the Commission consider permitting the exchanges to replace involuntarily delisted call options classes with classes of put options. 6/

5/ In an informal survey of the PHLX, PSE, and Amex made by the Division, we have learned that both the CBOE and the PSE would like to list call options on the common stock of Lockheed as a replacement for an involuntarily delisted class. Under the proposed guidelines PSE would have priority in selecting Lockheed since the PSE notified OCC of the commencement of a phaseout of its involuntarily delisted classes before the CBOE did so. (PHLX is most interested in relisting the options classes which it previously involuntarily delisted: Braniff and Marriott Corporation).

6/ Mr. Rissman also suggested that the Commission hold a lottery instead of establishing, as we recommend, a "first out, first in" system. We doubt that such a system would work, do not think it would be fair, and, in any event, would not consider the CBOE eligible to participate in any such lottery until this fall.

The Division believes, however, that it would not be appropriate or consistent with the purposes of the options moratorium to permit the replacement of involuntarily delisted call options classes with classes of put options. 7/ In Securities Exchange Act Release No. 13401 (March 23, 1977) the Commission announced its determination to approve, on a pilot basis, proposed rule changes by all the options exchanges to list and trade put options. The Commission stated that "the size of the initial puts pilot should be more limited than has been proposed and that, to the maximum effort feasible, experience should be gained prior to further expansion," and limited the puts pilot programs

7/ As noted supra, at 5, however, the proposed guidelines would permit to list and trade both puts and calls in a replacement class, if both puts and calls were traded in the involuntarily delisted class.

of each exchange to five puts classes. The Commission also stated that it expected to review, by November 7, 1977, the "experience of each of the options exchanges commencing puts pilots and the progress each makes in substantially resolving the concerns the Commission has with respect to the surveillance and other regulatory efforts of the respective options exchanges." Most importantly, the Commission stated: "At such time and upon satisfaction of those concerns, the Commission will consider a further expansion of each of the puts pilots." The Commission, of course, has never conducted the review of the puts pilots which it expected to complete by November 7, 1977, since, by that time, the voluntary moratorium was already in effect and the puts question had been merged into the Options Study.

In light of the concerns which the Commission expressed when it permitted the puts pilots, and which the Commission stated would have to be resolved before any further expansion of the puts pilots could be permitted, the Division does not believe that it would be consistent with the purposes of the voluntary moratorium to permit the puts pilot programs to expand at this time, through the use of puts to replace involuntarily delisted call options classes. In addition, if replacements of calls with puts were permitted, those exchanges which utilized puts as replacements for involuntarily delisted call options classes would receive an unfair advantage in expanding their puts pilot programs

over those exchanges which do not have any involuntarily delisted classes. Finally, the Division is concerned that if puts replacements were permitted, such action on the part of the Commission could be interpreted as a determination that the expansion of puts trading at this time is consistent with the purposes of the Act, and that the Commission's regulatory concerns with respect to the expansion of puts trading have been substantially resolved. The Division believes that the Commission is not able to make that determination at this time and should avoid giving the appearance of doing so. 8/

III. Recommendation

The Division recommends that the Commission not permit the replacement of involuntarily delisted classes with put option classes, and accordingly, recommends that the Commission authorize the Division to send the attached letter to the Amex, CBOE, MSE, PHLX, and PSE containing the proposed "Guidelines for the Replacement of Involuntarily Delisted Classes" (Exhibit A). In light of

8/ Of course, should the self-regulatory organizations make a more persuasive case for the proposal to allow puts to be used as replacements for calls in their comments on the proposed guidelines, the Commission could amend the guidelines to permit this before they are adopted in final form.