

Open Commission Meeting
December 12, 1979
Options Moratorium Discussion
Staff Introductory Statement

A brief sketch of the options moratorium chronology is provided in the public handout. I think that experience is well enough known to those interested in this discussion to be passed over in these introductory remarks.

As the Commission is aware, for the past 10 months the staff has been monitoring closely the work of a joint SRO task force, composed principally of the five options exchanges, the New York Stock Exchange and the NASD. The Task Force has been developing rule proposals, uniform wherever possible, that it believes are responsive to the concerns underlying those recommendations of the Options Study which the Commission requested the SROs to address before any further expansion of the standardized options markets would be permitted. Thus far, we have received rule proposal filings addressing most of these recommendations from each of the SROs participating in the Task Force, and we expect to begin to receive the remaining filings, as well as certain amendments to the proposals already filed, before the end of year. In addition, in accordance with the recommendations of the Options Study, the staff has conducted inspections of the surveillance programs of each of the options exchanges and has received certain undertakings from the SROs regarding their compliance programs.

Shortly after the first of the year, the staff will present to the Commission the SRO responses to the Options Study recommendations for determination whether those responses are sufficient to permit the Commission to terminate the moratorium, at least in part. In order to enable the options markets to begin planning for orderly expansion, we believe it would be appropriate at this time for the Commission to discuss publicly the manner in which expansion should be permitted upon termination of the moratorium, so that such expansion is not unduly delayed at such time the Commission determines that the Options Study recommendations have been addressed adequately by particular SROs.

The primary issues that the Commission must address in determining the manner in which expansion appropriately may occur are the listing of additional put and call classes, and the expansion of multiple trading. As a general matter, the Division believes that once the Commission has determined that the Options Study recommendations have been addressed adequately, the Commission should permit the listing of additional put and call classes by the existing options exchanges, limited only by each exchange's operational and surveillance capabilities. The manner in which additional put and call listings would be selected by the options exchanges, however, necessarily depends upon whether the Commission permits additional multiple trading immediately upon termination of the moratorium.

While the 1975 Amendments express a regulatory preference for multiple trading, there are legitimate concerns that expansion of multiple trading in the current market environment, first, would result in market fragmentation characterized by pricing inefficiency and disparity (which may, on occasion, be significant) and reduced opportunity for best execution and, second, would not provide a fair field of competition among market centers and marketmakers. We, therefore, believe it may be appropriate to delay expansion of multiple trading for some period of time in order to afford the SROs a reasonable opportunity to consider jointly whether, and to what extent, the development of market integration facilities would minimize concerns regarding market fragmentation and maximize competitive opportunities in the marketplace and, if so, to implement such facilities. If this course is pursued, we believe it is imperative that the focus of the SROs deliberations be confined to facilities implementation, and not dissolve into a general debate of the merits of multiple trading. Accordingly, we believe the Commission should ~~negate explicitly~~ any notion that the failure to implement particular facilities (or any facilities at all) would, alone, be sufficient to postpone multiple trading expansion indefinitely.

Commission participation in these deliberations

If the Commission determines to postpone multiple trading expansion temporarily, the staff nonetheless believes that the existing options exchanges should be

permitted to list additional put and call classes upon termination of the moratorium. With regard to the listing of additional puts, the staff believes there are benefits to listing both puts and calls on the same underlying security, and, accordingly, recommends that the Commission permit the listing of additional puts on any security, which underlies an exchange's call classes, limited only by an exchange's surveillance and operational capabilities. With regard to the listing of additional call classes, in view of the limited number of attractive new stocks available for options trading and in the absence of additional multiple trading, it will be necessary to develop a fair and equitable plan to allocate the additional classes among the option exchanges. In this regard, we believe the options exchanges should be afforded an opportunity to develop such a plan for submission to the Commission.

In addition, we believe that any entry to standardized options trading by the New York Stock Exchange or the NASD, even in the absence of immediately expanded multiple trading, requires further Commission consideration. Over-the-counter trading in standardized options for listed stocks, as contemplated by the NASD proposal, raises significantly greater fragmentation, internalization and market surveillance concerns. The New York Stock Exchange proposal would raise the prospect of having the "primary market" for both an option class and its underlying stock integrated in the same market center. That integration ^{even if trading} ~~raises significantly~~ ^{physically} ~~greater concerns~~ ^{separated} regarding misuse of market information and potential for stock/option manipulation. These distinct concerns are exacerbated by the absence of the automated stock audit trail recommended by the Options Study.

Finally, the staff believes that upon termination of the moratorium, the SROs should be permitted to begin to file other types of expansionary proposals to be considered by the Commission on a case by case basis. In view of the Commission's limited resources, however, the SRO's should be encouraged to stagger the filing of such proposals and, to the extent feasible and appropriate, to establish priorities jointly.

Chairman Williams.