

UNITED STATES OF AMERICA
before the
SECURITIES AND EXCHANGE COMMISSION

Securities Exchange Act of 1934
Release No. 18371 / December 23, 1981

In the Matter of

American Stock Exchange, Inc.
86 Trinity Place
New York, New York 10006

Chicago Board Options Exchange, Incorporated
LaSalle at Jackson
Chicago, Illinois 60604

File Nos. SR-Amex-81-1
SR-CBOE-81-27

NOTICE OF AMENDMENTS TO PROPOSED RULE CHANGES AND
ORDER APPROVING PROPOSED RULE CHANGES

I. Introduction

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, 15 U.S.C. 78s(b)(1) (the "Act"), and Rule 19b-4 thereunder, the American Stock Exchange, Inc. ("Amex") and the Chicago Board Options Exchange, Incorporated ("CBOE") have filed with the Commission proposed rule changes to modify their rules to accommodate the listing and trading of standardized put and call options contracts on securities issued by the United States Department of the Treasury ("Treasury options"). 1/ The exchanges also have designated the specific Treasury bond, note and bill

1/ Amex's Treasury options proposal initially was filed on March 4, 1981 and amended on July 13, 1981, November 12, 1981 and December 9, 1981. Notice of the initial filing and all but the latter set of amendments thereto was given by Securities Exchange Act Release Nos. 17632 (March 16, 1981), 17944 (July 16, 1981) and 18266 (November 17, 1981), and by publication in the Federal Register (46 FR 17936 (March 20, 1981), 46 FR 37582 (July 21, 1981) and 46 FR 57795 (November 25, 1981)). See File No. SR-Amex-81-1. The latter set of amendments relate to such matters as member firm supervision of accounts, position and exercise limits and reporting requirements. Since public comment on these matters already has been solicited extensively, the Commission believes there is good cause for approval prior to the thirtieth day after publication of notice thereof. See p. 17-18, infra.

options contracts in which they propose to commence options trading. 2/

Because of the significance of the proposals and the possible impact of Treasury options trading on related markets, public comment has been solicited extensively. To supplement the initial publication of notice of the filing of the individual proposals, the Commission on May 11, 1981, issued a release discussing various aspects of the proposals and inviting commentators to address a number of specific issues. 3/ In

(Footnote continued)

CBOE's initial proposal to trade options on Treasury notes and bonds was filed April 17, 1980 and amended on August 8, 1980 and August 12, 1981. Notice of the foregoing amendments to the proposed rule change was given by Securities Exchange Act Release Nos. 17325 (November 21, 1980) and 18039 (August 17, 1981), and by publication in the Federal Register (45 FR 79612 (December 1, 1980) and 46 FR 42390 (August 20, 1981)). See File No. SR-CBOE-80-8. The proposal was expanded to include market basket Treasury bond options contracts by a filing submitted on August 21, 1981, on which notice was given by Securities Exchange Act Release No. 18090 (September 10, 1981) and by publication in the Federal Register (46 FR 47335 (September 25, 1981)). See File No. SR-CBOE-81-18. The proposal was expanded to include Treasury bill options contracts by a filing submitted on November 20, 1981, on which notice was given by Securities Exchange Act Release No. 18293 (November 30, 1981) and by publication in the Federal Register (46 FR 59682 (December 7, 1981)). See File No. SR-CBOE-81-25. The foregoing filings were consolidated in the subject proposed rule change submitted on December 8, 1981, which also includes certain amendments similar to the Amex' most recent amendments. See File No. SR-CBOE-81-27. On this basis, the foregoing filings have been withdrawn. Since the latter filing merely consolidates prior filings that were published for public comment, and contains amendments with respect to matters already published for comment, the Commission believes there is good cause for approval prior to the thirtieth day after publication of notice thereof. See p. 17-18, infra.

2/ The Commission also has addressed the Treasury options proposals in a related context. See Securities Exchange Act Release No. 18297 (December 2, 1981), 46 FR 60376 (December 9, 1981), where the Commission announced that it did not intend to limit trading of particular non-equity options to a single market.

3/ Securities Exchange Act Release No. 17795 (May 11, 1981), 46 FR 27430 (May 19, 1981). The release also extended the period of time for submission of public comments.

addition, letters were sent to the Commodity Futures Trading Commission ("CFTC"), the Federal Reserve Bank of New York ("FRB-NY"), the Federal Reserve Board ("FRB"), and the U.S. Department of the Treasury ("Treasury") specifically inviting the views of those agencies. 4/ In response, the Commission received 14 comment letters on the proposals, including letters from the foregoing governmental agencies, 5/ as well as from Amex, CBOE and the New York Stock Exchange, Inc. ("NYSE"). 6/ Specific comments are discussed as appropriate in this order. 7/

4/ Letters from Douglas Scarff, Director, Division of Market Regulation, SEC, to Stephen H. Axilrod, Director, Office of Staff Director for Monetary and Financial Policy, FRB; Peter D. Sternlight, Manager for Domestic Operations, System Open Market Account, FRB-NY; and Roger W. Mehle, Assistant Secretary-Domestic Finance, Treasury, dated May 11, 1981.

5/ Letters to Douglas Scarff, Director, Division of Market Regulation, SEC, from James A. Culver, Director, Division of Economics and Education, CFTC (August 24, 1981); Peter D. Sternlight, Senior Vice President, FRB-NY (August 6, 1981); Stephen H. Axilrod, Staff Director for Monetary and Financial Policy, FRB (September 18, 1981); and Roger W. Mehle, Assistant Secretary (Domestic Finance), Treasury (June 22, 1981).

6/ Letters to George A. Fitzsimmons, Secretary, SEC, from James E. Buck, Secretary, NYSE (July 1, 1981); Nathan Most, Vice President, New Products Development, Amex (July 9, 1981); and Walter E. Auch, Chairman, CBOE (August 18, 1981).

7/ The Commission has received five comment letters that raised questions relating to the applicability of the Commodity Exchange Act ("CEA") to the trading of the instruments contemplated by these proposals and to the Commission's jurisdiction over and authority to regulate that trading. See letter to Douglas Scarff, Director, Division of Market Regulation, from James A. Culver, Director, Division of Economics and Education, CFTC (August 24, 1981); and letters to George A. Fitzsimmons, Secretary, SEC, from Robert K. Wilmoth, President, Chicago Board of Trade ("CBOT") (June 30, 1981), Mahlon M. Frankhauser, Kirkland and Ellis, counsel for CBOT (September 1, 1981 and October 16, 1981), and Clayton Yeutter, President, Chicago Mercantile Exchange (October 16, 1981). As set forth in its brief in Board of Trade of the City of Chicago v. Securities and Exchange Commission, No. 81-1660 (7th Cir. 1981), the Commission believes that it has authority to approve proposed rule changes by national securities

(Footnote continued)

II. Economic Basis

In their submissions, the exchanges have asserted that standardized, exchange-traded put and call options on Treasury securities would serve an important economic function. In particular, the exchanges believe that such options could be used by a wide range of individuals and businesses engaged in enterprises that are sensitive to changes in interest rates. Through the use of various options purchasing and writing strategies, such persons can hedge against the risks associated with adverse interest rate movements, and at the same time retain the opportunity to profit from favorable movements.

Treasury options also can be attractive for speculators. For example, options purchasers can profit from favorable movements in interest rates on a leveraged basis, while at the same time limiting their risk exposure to the amount of the premium paid. Of course, since options are wasting assets of limited duration the investor stands potentially to lose his entire investment in a short period of time. Accordingly, notwithstanding the limited risk features of options, the exchanges acknowledge that it is important that the risks of options trading are adequately disclosed to investors and that the sale of options to public customers be rigorously supervised. In this regard, as discussed in part IV, infra, the exchanges have proposed rules to govern the marketing of Treasury options by member organizations, including rules relating to the supervision of sales personnel, risk disclosure and suitability, which are designed to ensure that such trading occurs in a well-ordered regulatory environment.

The exchanges also contend that trading standardized options in an exchange context offers other benefits. They assert that the intermediation of the Options Clearing Corporation ("OCC") virtually eliminates any credit risk which might otherwise be associated with over-the-counter trading in Treasury options. In addition, they indicate that standardization and centralization

(Footnote continued)

exchanges providing for the trading of options on government securities and to regulate that trading, and that nothing in the CEA restricts that authority. Moreover, Commission approval of rule changes providing for the trading on national securities exchanges of options on Treasury securities is contemplated by the resolution of jurisdictional issues reached by the Commission and the CFTC, and announced in their joint press release on December 7, 1981.

of trading would contribute to market liquidity and pricing efficiency. 8/

The FRB-NY and the FRB stated that properly regulated Treasury options markets could be expected to improve the efficiency and liquidity of the cash market for Treasury instruments, as well as serve as a useful adjunct to the trading activities of dealers in government securities. 9/ The Treasury indicated that it did not believe that options trading on Treasury securities would have an adverse effect on its auction activities. 10/

III. Contract Design

To accommodate the trading of options on Treasury securities each exchange has submitted general enabling rules which authorize the listing of options on specific Treasury bonds, notes and bills. In addition, the CBOE has proposed rules which would authorize it to list options on a "market basket" of Treasury bonds. Both Amex and CBOE have indicated, however, that they do not intend, at least initially, to commence options trading on the full range of Treasury instruments. 11/ Accordingly, both exchanges have

8/ See Amex, The Amex Plan for Trading Options on U.S. Treasury Department Securities (File No. SR-Amex-81-1); and CBOE, A Market for Options on Government Securities (File No. SR-CBOE-80-8). See also comment letter of Ross M. Starr, Hedging Interest Rate Risks with Bond Options Markets (June 19, 1981).

9/ With respect to proper regulation of the Treasury options markets, the FRB-NY indicated that one objective of such regulation should be to discourage excessive speculation and other disruptive activities. Toward this end, the FRB-NY emphasized the need for adequate margin requirements, reasonable market-wide position and exercise limits, market-wide surveillance and monitoring of developments by knowledgeable parties. Comment letter of the FRB-NY, at 4. These matters are addressed in parts III and VI, infra.

10/ Comment letter of the Treasury, at 3.

11/ Amex initially has proposed to trade standard-sized and mini-contracts on 13-week Treasury bills and on 26-week Treasury bills. See Letter to Gene E. Carasick, Assistant Director, from Nathan Most, Vice President, New Products Development, Amex (December 11, 1981). CBOE initially proposes a standard-sized contract and a mini-contract on Treasury bonds. At the present time, CBOE does not contemplate trading a market basket Treasury bond contract. See Letter to Gene E. Carasick, Assistant Director, from Arne R. Rode, General Counsel, CBOE (November 4, 1981).

set forth in their filings the terms of the specific options contracts in which they will begin trading. 12/

In designing the proposed options contracts the exchanges have sought to be responsive to the economic needs of the marketplace. For example, to accommodate the interests of both large-scale and smaller investors, the exchanges have proposed two sizes for Treasury options contracts: "standard-sized" contracts representing a principal amount of \$100,000 for Treasury bonds and notes and \$1 million for Treasury bills, and "mini-contracts" on each instrument with principal amounts that are one-fifth the standard size. The exchanges have proposed to introduce options series at three-month intervals with maturities ranging from one to fifteen months. Options series would expire on various quarterly cycles selected by the exchanges based on a correspondence to the Treasury auction cycle for the particular underlying instrument or the perceived interests of market participants. Initial options series in each expiration month would be introduced at or near the price of the underlying security; contracts with new exercise prices would be added generally in response to substantial price changes. 13/

With respect to matters of contract design and delivery specifications, so long as the Commission has no regulatory concerns it is not inclined to substitute its judgment for the business judgment of the self-regulatory organizations. Rather, in matters such as these, the marketplace generally should be

12/ The listing of any additional Treasury options classes, or any material change in the contract terms of an existing class, will constitute a proposed rule change under Section 19(b)(1) of the Act and must be filed with the Commission for approval. Such rule changes must set forth the material terms of the proposed contract, including identification of the specific Treasury security or securities underlying the contract, the contract size and the expiration cycle.

13/ For options on Treasury bonds and notes, options series would be introduced on a selected underlying instrument immediately after it is auctioned by the Treasury. Approval of the instrument for options listing generally would not extend beyond 18 months; options series expiring thereafter would relate to a more recently issued Treasury security. For options on Treasury bonds and notes, both Amex and CBOE propose a March/June/September/December cycle. In contrast, the proposed Treasury bill options contract would not be based upon a particular underlying security. Rather, upon exercise of a Treasury bill options contract, delivery could be made with bills having a term to maturity specified by the contract, generally either 13 or 26 weeks. Each exchange has selected a March/June/September/December expiration cycle. See Amex Rules 901, 903, 916, and 917; CBOE Rules 21.6, 21.7, 21.8, 21.9.

permitted to determine whether a particular contract meets the needs of market participants. 14/

The Commission, however, does maintain a regulatory interest in certain other terms of the proposed Treasury options contracts. These include the qualification of underlying Treasury securities for options trading and the establishment of position and exercise limits. Each exchange proposes that in order to qualify for options listing an underlying issue of Treasury bonds or notes must have an initial public issuance of

14/ Accord, Securities Exchange Act Release No. 17577 (February 26, 1981), at 6-7, 46 FR 15242, (March 4, 1981) (approving the CBOE GNMA options proposal). Several commentators expressed concern that excessively narrow exercise price intervals could lead to an undesirable proliferation of illiquid options series particularly during a period of significant interest rate volatility. See letter to George A. Fitzsimmons, Secretary, SEC, from William A. Schreyer, Chairman, Merrill Lynch, at 5 (July 1, 1981), ("comment letter of Merrill Lynch") and letter to George A. Fitzsimmons, Secretary, SEC, from George M. Bollenbacher, Vice President, Paine Webber, at 4 (June 9, 1981), ("comment letter of Paine Webber"). The Commission believes, however, that the competitive interests of the exchanges in channeling participation into a limited number of liquid options series are sufficient to substantially ameliorate any potential regulatory concerns.

With regard to contract design, several commentators also indicated their belief that a market basket contract would be preferable to specific issues contracts from a regulatory standpoint. These same commentators acknowledged, however, that specific issue contracts in the long run would be more economically viable. See comment letter of the FRB, at 1-2, and comment letter of Merrill Lynch, at 1-2. The Commission believes that so long as specific issue contracts are designed in a manner which mitigates the potential for regulatory problems, the choice between listing a market basket contract and specific issue contracts largely is a matter of business judgment.

at least \$1 billion. 15/ Because of the nature of the proposed 13-week and 26-week Treasury bill contracts, the deliverable supply of the underlying instrument depends on the size of the Treasury auctions that correspond to the date of exercise and, therefore, may vary from week to week. 16/ In the Commission's view, the

15/ Amex Rule 917; CBOE Rule 21.7, Interpretation .01. The amount of the initial public issuance is to be determined not by the principal amount of the issue actually sold, but by the portion of the issue sold other than to U.S. Government accounts and Federal Reserve Banks. The amount of the initial public issuance will be determined from information made publicly available by the U.S. Treasury. Continued approval for options trading would be revoked if an exchange determined that the principal amount of the underlying securities publicly outstanding had declined to less than \$750 million. Upon such a determination, additional expiration months could not be opened with respect to the underlying security. Amex Rule 716, Commentary .03; CBOE Rule 21.7, Interpretation .02.

16/ According to the terms of the 13-week Treasury bill contract proposed by Amex, delivery could be made with 13-week bills issued pursuant to the Treasury auction corresponding to the week of exercise, or with 26-week or 52-week Treasury bills with 13 weeks remaining to maturity. Similarly, the 26-week Treasury bill contract would permit delivery of newly-issued 26-week bills or previously issued 52-week bills with 26 weeks remaining to maturity. The 13- and 26-week Treasury bill contracts proposed by CBOE would supplement the deliverable supply by also permitting delivery of bills with a maturity of less than the nominal maturity, but would not recognize the higher market value of the shorter maturity instruments. Over the past year, the competitive bids accepted for the combined weekly 13- and 26-week bills auctions has ranged generally between \$6 and \$8 billion. The deliverable supply made available by the weekly 13- and 26-week bill auctions would be supplemented every fourth week with bills issued pursuant to the 52-week bill auction which over the past year has averaged approximately \$4 billion. See Treasury Bulletin, Tables PDO-2 and PDO-3 (October 1981).

proposed listing standards appear reasonably designed to ensure the existence of a deliverable supply which is sufficient to avert the possibility of market congestion. 17/

With respect to position and exercise limits, each of the exchanges has proposed rules that will prohibit any market

17/ Should congestion nevertheless occur, it should be noted that the Options Clearing Corporation ("OCC") will have authority to take remedial action. In this regard, the OCC is expected in the near future to submit a proposed rule change relating to the issuance of Treasury options contracts, the clearance and settlement of Treasury options transactions and the processing and settlement of Treasury options exercises. This proposed rule change must be approved by the Commission prior to the commencement of Treasury options trading on any exchange.

Under its existing rules, the OCC has authority to impose restrictions on exercises and, if necessary, to prescribe cash settlement in lieu of the underlying security. See Article VI, Section 7 of the OCC rules. It is anticipated that these restrictions also will be made applicable to Treasury options.

In its comment letter, at 3, the FRB-NY expressed concern regarding the possibility of congestion caused by a coincidence of the proposed expiration dates for the 13-week Treasury bill options contracts with the termination date for the 13-week Treasury bill futures contract traded on the Chicago Mercantile Exchange ("CME"), which would result in identical delivery dates. To avoid coinciding settlement dates, the Commission understands that the OCC intends to seek authorization to select dates for the expiration of options contracts that occur other than in the week that the CME's futures contract is scheduled to terminate.

participant from acquiring a position in Treasury bond or note options, or from acquiring securities through exercise of options over a period of five consecutive business days, in excess of 10 percent of the initial public issuance of the underlying security. 18/ For 13- and 26-week Treasury bill options each exchange has proposed position and exercise limits which, based on the average amount of the total competitive bids accepted by the Treasury at the weekly bill auctions over the past year, generally would range from 3 to 6 percent of the public issuance. 19/ In applying the position and exercise limit rules, all options relating to an underlying security must be taken into consideration irrespective of the exchange on which the position is acquired. Accordingly, options contracts traded on different exchanges with identical or substantially overlapping deliverable supplies must be aggregated. 20/ On the basis of the foregoing, the Commission believes that the proposed position and exercise limits generally

18/ To accommodate mini-contracts the position and exercise limits for options on Treasury securities are denominated in terms of the corresponding principal amount of the underlying security. For Treasury bond and note options contracts, the exchanges propose a two-step formula for position and exercise limits: if the initial public issuance of the underlying security does not exceed \$2 billion, position and exercise limits would be established at a principal amount of \$100 million. If the initial public issuance was \$2 billion or more the limits would be established at \$200 million. Amex Rule 904 and 905; CBOE Rules 21.3 and 21.4.

19/ Amex Rules 904 and 905; CBOE Rule 21.31(f).

20/ On this basis, although the Amex and CBOE Treasury bill contracts differ in minor respects, all positions in either the 13- or 26-week contract acquired on either exchange would have to be aggregated with positions in the same type of contract acquired on the other exchange.

would be sufficient to protect the options and related markets from disruptions caused either by congestion or manipulation. 21/

IV. Sales Practice Regulation

After conducting an extensive review of stock options sales practices during the Options Study, 22/ the Commission approved in early 1980 a package of rule changes submitted by several securities exchanges and the National Association of Securities Dealers in response to Options Study recommendations designed to enhance the quality of regulation governing securities firms doing a public options business. 23/ To govern the sales practices of member firms doing a public Treasury options business, Amex and CBOE each have proposed a regulatory structure that generally parallels that adopted for equity options.

In accordance with these rules, each member organization as a pre-condition to engaging in a Treasury options business would be required to develop and implement a written program for the review of customer accounts and orders under the supervision of a Senior Registered Options Principal ("SROP")

21/ The position and exercise limit levels finally proposed by the exchanges are lower than those originally under consideration and respond to the concerns of several commentators that the initial proposals, particularly as they related to exercise limits, were excessive. See comment letter of the FRB-NY, at 2; and comment letter of Merrill Lynch, at 3-4. In this regard, these commentators indicated that the regulatory concerns associated with large options positions might be solved, and the hedging needs of large institutions accommodated, by permitting the establishment of position limit levels that are higher than the limits imposed on exercises or by exempting covered positions from the position limit ceiling. The exchanges have not elected to pursue either of these courses at this time.

22/ See Report of the Special Study of the Options Markets to the Securities and Exchange Commission, H.R. Rep. No. IFC3, 96th Cong., 1st Sess. (Comm. Print 1978).

23/ See Securities Exchange Act Release Nos. 16696 and 16701 (March 26, 1980), and 16807 (May 15, 1980).

who is a partner or officer of the member organization. 24/ Each organization also would be required to have a Compliance Registered Options Principal ("CROP") who would be responsible for ensuring compliance with the securities laws and applicable exchange rules. 25/ Direct supervision of registered representatives would be the responsibility of Registered Options Principals ("ROPs") whose functions would include approval of customer accounts for Treasury options trading and the approval and initialing of all orders for discretionary accounts. 26/ The principal supervisor of any member organization branch office with more than three registered representatives engaged in Treasury options trading would have to be qualified as a ROP. 27/

The proposed rules governing supervision of Treasury options trading will enable member organizations presently engaged in an equity options business to utilize the same supervisory structure for Treasury options, provided that such personnel are Treasury-options qualified. Member organizations that choose to conduct their Treasury options business other than in conjunction with their equity options business would be required to implement a parallel supervisory structure. In order to allow such firms sufficient time to comply with this requirement, the effective date of the supervisory rules is being delayed until six months after the commencement on any exchange of trading in a debt options product other than GNMA options. In the interim, exchange rules will require adherence to the supervisory structure adopted by the CBOE and approved

24/ Amex Rule 922(a) and CBOE Rule 9.8(a). The SROP also would have responsibility to review the acceptance of discretionary accounts.

25/ Amex Rule 922(b) and CBOE Rule 9.8(b).

26/ Amex Rule 924 and CBOE Rule 9.10.

27/ Amex Rule 922(d) and CBOE Rule 9.6. A branch office with three or fewer registered representatives engaged in Treasury options trading could engage in a public Treasury options business only so long as the activities of the branch office are appropriately supervised by a ROP.

by the Commission with respect to GNMA options trading. 28/
In all other respects, the rules governing the marketing of
Treasury options to public customers will be effective immediately.

To ensure that member firm personnel are properly qualified,
each registered representative engaged in the sale of Treasury
options and all supervisory personnel responsible for overseeing
the firm's Treasury options activities would be required to
complete successfully the Interest Rate Options Qualification
Examination which tests a candidate's knowledge of both the
debt options markets and the market for the underlying securi-
ties. 29/

To provide customers with a description of Treasury options
and an explanation of the special risks associated with Treasury
options trading, exchange rules would require that prospective
Treasury options customers be supplied with a copy of the Treasury
options supplement to the OCC prospectus at or before the time
their accounts are approved for Treasury options trading. 30/
This prospectus also would provide information concerning the
rules applicable to Treasury options trading, including the
margining of Treasury options positions, and the federal tax
implications of Treasury options trading. The rules of the
exchanges also would require that, before a member organization can
accept a customer order to purchase or write a Treasury options
contract, the customer's account must be specifically approved
in writing for Treasury options trading by a ROP qualified to

28/ Pursuant to the interim rules, supervision of non-member
customer accounts and communications relating to GNMA or
Treasury options would be the responsibility of one or more
designated options principals who are either partners or
officers of the member organization. The specific duties
of designated options principals would include approval
of customer accounts for GNMA and Treasury options trading,
review of discretionary options accounts, and general
supervision of member organization personnel engaged in
GNMA options trading. Branch offices would not have to
be staffed with a Treasury-options qualified principal.
See footnote to Amex Rule 920; CBOE Rule 21.19A.

29/ Amex Rule 920, Commentary .01; CBOE Rules 9.2, 21.19A
and 21.28. This examination also qualifies a candidate
to sell GNMA options. The specifications of the Interest
Rate Options Qualification Examination have been approved
by the Commission. Securities Exchange Act Release No.
18069 (August 28, 1981). Persons previously passing this
examination for purposes of GNMA options would not be
required to be retested.

30/ Amex 926; CBOE Rules 9.15, 21.19A and 21.21. The supplemental
prospectus prepared by the OCC must be filed with the
Commission for review prior to the commencement of Treasury
options trading.

supervise the sale of Treasury options. 31/ In making recommendations to customers concerning the purchase or sale of Treasury options sales personnel would be subject to the same suitability rule applicable to equity options trading. 32/

V. Floor Procedures

CBOE intends to trade Treasury options in the context of its competing market maker system. Treasury options would be traded in the same manner and under the same rules as the exchange's equity options, except that certain modifications previously adopted to accommodate GNMA options also would be extended to govern options on Treasury securities. 33/

In contrast, Amex contemplates trading options on Treasury securities in the context of a specialist system that utilizes supplemental market makers. This involves merely extending, with minor modifications, its current rules governing equity options. 34/ Each Treasury options contract would be assigned to a particular specialist whose responsibilities would be generally the same as those applicable to equity options specialists, including responsibility for administering a limit order book. The rules governing supplemental market makers, referred to as Registered Options Traders ("ROTs"), generally mirror the current Amex rules governing the equity options trading of ROTs.

31/ Amex Rule 921; CBOE Rules 21.19A and 21.20.

32/ Amex Rule 923 and CBOE Rule 9.9.

33/ See generally, CBOE Rules 21.10 through 21.19. The principal modification is the CBOE's decision not to maintain a public limit order book for Treasury options. Pending actual trading experience, the Commission is not prepared to conclude that the absence of a public limit order book for Treasury options is inappropriate.

34/ See generally, Amex Rules 950-959.

The Commission has examined carefully the proposed rules governing trading activities in Treasury options on the floors of the respective exchanges, and has concluded that the proposed rules are consistent with the requirements of the Act and the rules thereunder, and, in particular, are in accordance with the maintenance of a fair and orderly market.

VI. Surveillance

Section 6(b)(5) of the Act requires an exchange to have rules designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade. Section 6(b)(1) of the Act requires that an exchange be organized and have the capacity to comply, and to enforce compliance by its members and associated persons, with the provisions of the Act, the rules thereunder, and the rules of the exchange. Accordingly, an exchange has an obligation to develop and administer a comprehensive surveillance program designed to detect manipulation and other improper trading activities.

With respect to intra-market surveillance, the exchanges' techniques for monitoring trading in Treasury options generally will be similar to the procedures currently utilized for options on equity securities. Due to the limited availability of timely and independently verifiable transaction, quotation and position information with regard to activities in related markets, however, the exchanges have indicated that inter-market surveillance techniques for options on Treasury securities will differ somewhat from those currently employed for equity options.

A principal purpose of inter-market surveillance is to protect the integrity of the options markets by maintaining a capacity to detect and deter the manipulation of options prices resulting from trading in a related market. In addition,

as the FRB and FRB-NY emphasized in their comments, there is also a need for rigorous surveillance as a deterrent to the possible disruptive effect of Treasury options on the underlying cash market. 35/ To address these concerns, the options exchanges have imposed reporting and recordkeeping requirements which will enable the exchanges to identify situations potentially susceptible to manipulation, 36/ as well as rules enabling the exchanges in the course of an investigation to obtain access to the books and records maintained by corporate affiliates of Treasury options market makers relating to transactions in Government securities, Government securities options, futures on Government securities and options on such futures. 37/ The Commission believes that the data made available by these rules, if effectively utilized by the exchanges, will minimize the potential for manipulation.

35/ Comment letter of the FRB, at 3, and comment letter of the FRB-NY, at 5-6.

36/ Each member organization will be required to file with the exchange reports of any member firm account or any customer account with an aggregate options position on the same side of the market with respect to any underlying Treasury security which is equal to or in excess of 20 percent of the applicable position limit. Amex Rule 906; CBOE Rules 21.5 and 21.31(f). In addition, market makers on the CBOE, and specialists and supplemental market makers on Amex will be required to report to the exchange all accounts maintained for, and all transactions effected in such accounts with respect to options on Treasury securities, Treasury securities underlying such options, futures contracts which permit delivery of the underlying security, and any options on such futures contracts. These rules also would require registered Treasury options specialists and market makers to keep records, which would subject to exchanges review, of other trading activity with respect to Treasury securities Amex Rules 950(k) and 957; CBOE Rule 21.30 supplementing CBOE Rule 8.9.

37/ Amex Rule 957(c); CBOE Rule 21.30.

In anticipation of GNMA options trading, the CBOE has made the necessary revisions to its surveillance modules to monitor options trading on debt securities and has submitted its updated surveillance manual for Commission review. Prior to the commencement of its Treasury options program, the Commission expects to review the manual developed by Amex outlining its surveillance procedures for Treasury options.

VII. Findings and Conclusion

Under Section 19(b)(2) of the Act, the Commission must approve the foregoing rule changes if it determines that the proposed rule changes are consistent with the requirements of the Act and the rules thereunder applicable to national securities exchanges. The Commission has reviewed carefully the rules proposed by both Amex and CBOE to accommodate the listing and trading of options on U.S. Treasury securities and has concluded, for the reasons set forth above, that the rules provide for adequate and proper regulation of the proposed markets. Accordingly, the Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder and, in particular, the requirements of Section 6 and the rules and regulations thereunder. Prior to the commencement of trading, however, the exchanges must secure Commission approval of their proposed margin rules. ^{38/} In addition, the OCC must submit for review the Treasury options prospectus and submit for approval proposed rule changes to accommodate Treasury options. The Commission finds good cause to approve the most recent amendments submitted by the Amex prior to the thirtieth day after publication of notice since the amendments relate to matters with respect to which public comments already have been solicited extensively. In addition,

^{38/} The proposed margin rules of Amex and CBOE are contained in their current Treasury options filings. See footnote 1, supra. The Commission has not fully completed its review of the margin proposals and accordingly, is not approving that aspect of the Amex's and CBOE's Treasury options filings at this time.

the Commission finds good cause to approve the CBOE rule change prior to the thirtieth day after publication since it is primarily a consolidation of proposed rule changes previously published for comment and contains amendments relating to matters on which public comments already have been solicited extensively. 39/

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the above-mentioned proposed rule changes, as amended, with the exception of those portions of the proposed rule changes concerning margin be, and hereby are, approved.

By the Commission.



George A. Fitzsimmons
Secretary

39/ The Commission also currently has pending a proposal by the NYSE to trade options on Treasury securities which is virtually identical in substance to the Amex and CBOE proposals. The NYSE's proposal was filed on February 5, 1981 and amended on September 22, 1981. Notice of the proposal and the amendments was given by Securities Exchange Act Release Nos. 17631 (March 16, 1981), 46 FR 17939, and 18222 (October 29, 1981), 46 FR 55465. Additional comments was solicited by Securities Exchange Act Release No. 17795 (May 11, 1981), 46 FR 27430. The NYSE Board of Directors, however, has not yet approved a final set of amendments to the proposal which would be similar in nature to the final amendments filed by Amex and CBOE. The Commission understands that Board approval is anticipated in January 1982. The Commission expects to be able to approve the NYSE proposal shortly thereafter.