

6521.
ADVICE MEMORANDUM

June 13, 1983

TO: The Commission

FROM: The Division of Market Regulation

SUBJECT: Status of Pending "New Product" Stock Index Options in Light of Request by Securities Industry Association Options and Derivative Products Committee ("SIA Options Committee") for a Voluntary Moratorium on the Introduction of Trading in New Options Products.

[Handwritten signature: J. F. Foulk]

PROPOSED ACTION: Unless otherwise instructed, the staff intends to approve, by delegated authority, the Chicago Board Options Exchange, Incorporated ("CBOE") proposal to trade options on the Standard and Poor's ("S&P") 500 index.

TRIGGER DATE: June 21, 1983. (The CBOE has indicated it wishes to begin trading the S&P 500 options on June 24, 1983.)

PERSONS TO CONTACT: Thomas G. Lovett - 272-2913
Sharon K. Zackula - 272-2843

I. Introduction

Since the enactment of the Securities Acts Amendments of 1982 (enacting the amendments to the securities acts called for by the SEC/CFTC Accord) on October 13, 1982, the Commission, and the Division of Market Regulation by delegated authority, have approved several types of new options products for trading on national securities exchanges. 1/ Of the new options products that have commenced trading, 2/ stock index options have proved

1/ See Appendix A for a list of new options products approved following the enactment of the legislation.

2/ The Division intends to submit to the Commission within the next week a memorandum concerning the markets in new options products. The primary focus of that memo will be stock index options because of the greater volume and the greater interest in those markets than in other new options products markets.

most successful. 3/ As a result, the American Stock Exchange, Inc. ("Amex") and the CBOE are seeking approval of additional index options to be traded in the near future and the New York Stock Exchange, Inc. ("NYSE") has indicated it plans to commence trading in September, 1983 in options on the NYSE Composite Index. 4/

The Amex proposes to trade options on eleven narrow-based (or "industry") indices, and wishes to commence trading on one or two of these options in late June. 5/ The CBOE seeks approval to trade, in the near future, options on the S&P 500 index 6/ as part of an agreement with the Chicago Mercantile Exchange, Inc. ("CME"). 7/

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- 3/ The CBOE-100 stock index option is averaging approximately 40,000 contracts a day while the Amex Major Market Index ("MMI") is averaging 4000 to 5000 contracts a day.
- 4/ On November 22, 1982, the Commission authorized the NYSE to trade index options, including the NYSE Composite Index option. See Securities Exchange Act Release No. 19264, 47 FR 53891 (November 30, 1982).
- 5/ The eleven indices on which Amex wishes to trade options are composed of securities from the following industries: (i) Aerospace/Air Transport; (ii) Drugs; (iii) Electronics Instrumentation and Components; (iv) Financial Services; (v) Hospital Management/ Specialities/Supplies; (vi) Computer Technology; (vii) Media/Entertainment; (viii) Merchandising; (ix) Metals; (x) Oil and Gas; and (xi) Oil Services. See File No. SR-Amex-82-22.
- 6/ The rules proposed by the CBOE to provide for the listing and trading of S&P 500 options were filed on April 25, 1983. Notice of the proposed rule change was given in Securities Exchange Act Release No. 19718 (April 29, 1983), 48 FR 20835 (May 9, 1983). See File No. SR-CBOE-83-8.
- 7/ The CBOE and the CME are attempting to establish related options and futures markets under which market participants could trade the S&P 500 options on the CBOE in conjunction with the CME's S&P 500 futures contract (and with the CME's option on the S&P 500 futures contract). Under the agreement, the CME will also have the right to trade futures on the CBOE-100 index (to be renamed the S&P 100).

In addition, the CBOE has submitted recently proposals to trade a number of narrow-based indices. 8/

The development and commencement of trading in these new options products has come at a time when the securities industry is enjoying the greatest stock market rally in history. Accordingly, there has been some reluctance within the member firm community to expend the time and money necessary to educate registered representatives about each new product as it becomes available. The SIA Options Committee has been quite vocal in urging the options exchanges to slow the introduction of new options products and in a recent letter requested that all exchanges voluntarily refrain from commencing trading in any additional "new" options products, until at least January 1, 1984. 9/ The SIA Options Committee argues that in order to develop liquid, active, and fair markets in these new products broker-dealers must educate their firms' sales forces and modify margin, compliance and other procedures, which require a much longer lead time than the exchanges have been giving them. As a result, many broker-dealers have not been able to keep up with the introduction of these products and are not marketing them or are marketing them ineffectively. |||

Only the two options exchanges seeking Commission approval to trade proposed stock index options in the near future have responded to the SIA Options Committee suggestion. The CBOE indicated that it agreed in principle with the need for a moratorium, but added that it felt the S&P 500 should be excepted because it was a broad-based index, similar to the CBOE-100, and its introduction would not raise additional burdens with respect to member firm education or compliance. 10/ Amex has indicated that it would favor a voluntary moratorium only if it applied to all new products, including the S&P 500

8/ See File Nos. SR-CBOE-83-14, SR-CBOE-83-15, SR-CBOE-83-16, SR-CBOE-83-17, and SR-CBOE-83-18, filed on June 9, 1983.

9/ See letter to Charles Henry, President, CBOE, from Howard Brenner, Chairman, SIA Options Committee, dated May 24, 1983, a copy of which is attached as Appendix B. Similar letters were sent to the Amex, Philadelphia Stock Exchange, Inc. ("Phlx"), National Association of Securities Dealers ("NASD"), NYSE and New York Futures Exchange ("NYFE").

10/ See letter to Howard Brenner, Chairman, SIA Options Committee, from Walter Auch, Chairman, CBOE, dated June 6, 1983.

and not just to proposals to trade narrow-based indices such as the Amex's. 11/

II. Discussion

As a general matter, the Division's staff does not favor governmentally-imposed moratoria without evidence of serious regulatory abuses, evidence of which is entirely absent here. 12/ However, the Division does recognize that the small index option proposals raise a number of important questions regarding appropriate margin and position limit levels as well as possible concerns regarding multiple trading. These multiple trading concerns arise when narrow-based index options dominated by one or a few stocks are traded on exchanges other than the exchanges trading options on the individual stocks. Accordingly, the Division expects to send a memorandum discussing these issues to the Commission in the next few weeks. However, for the reasons discussed below, the Division does not believe that the CBOE's proposal to trade options on the S&P 500 raises any significant proliferation concerns or other new issues and therefore recommends that the proposal be approved at this time.

First, the experience of the CBOE and Amex to date in the two stock index options currently trading has been a successful one. Volume and open interest in each index option have been expanding while firm and customer participation in the index option market has also grown. As noted above, volume in the CBOE 100 option has been averaging 40,000 contracts a day, while the Amex MMI option consistently has been averaging 4000 to 5000 contracts a day and over 10,000 contracts per day the last week. In addition, despite the cash settlement feature of the options, there have been no significant problems in the first three months of trading. 13/

11/ See letter to Howard Brenner from Robert Birnbaum, President, Amex, dated June 1, 1983.

12/ The staff believes that a moratorium on all new products would tend to favor those exchanges already trading new options products and might tend to stifle creativity in new product development. The staff also believes that the market place, through the individual member firms, should decide which products to trade. ||

13/ The CBOE, however, has made minor adjustments to its rules to correct trading problems encountered in the first few months of trading the index options.

Second, the Division staff does not believe that consideration of the CBOE S&P 500 contract raises any significant regulatory questions. The margin and position limit levels would be similar to existing levels for broad-based index options and firms would not be required to reprogram their systems or compliance departments.

In addition, although a larger contract, the S&P 500 option would trade in a manner similar to the CBOE-100 and Amex MMI options. The current value of the index is widely available and the industry is familiar with movements in the index. Indeed, the staff views the introduction of trading in this option as analogous to the listing of an additional equity security because its introduction will not require any additional broker-dealer or exchange procedural modifications.

As a final matter, it should be noted that upon Commission approval of the S&P 500 options, options and futures (and options on futures) would be traded on the same index. In order to ensure that the surveillance of these related markets is adequate and effective, the staff has suggested that the CBOE and the CME coordinate surveillance of their respective markets, at a minimum sharing surveillance information. The CBOE has agreed to supply such an undertaking to the Commission and the CME is making a similar representation to the Commodity Futures Trading Commission ("CFTC"). Other than this surveillance question, however, the Division staff does not believe any unique issues are present in the CBOE S&P 500 options filing.

III. Conclusion

Unless otherwise instructed by the Commission, the staff intends to approve the CBOE proposed rule change to trade options on the S&P 500 on June 21, 1983.

Appendix A - List of New Options Products
Appendix B - SIA Letter

APPENDIX A

Approved New Options Products

Product and Exchange Approved

<u>Stock Index Options</u>	<u>File No(s).*</u>	<u>Date Approved</u>	<u>Date Trading Began</u>
NYSE - Options on			
(1) NYSE Composite Index	SR-NYSE-82-2	November 22, 1982	NT**
(2) NYSE Industrial Index	SR-NYSE-82-2	November 22, 1982	NT
(3) NYSE Financial Index	SR-NYSE-82-2	November 22, 1982	NT
(4) NYSE Utility Index	SR-NYSE-82-2	November 22, 1982	NT
(5) NYSE Transportation Index	SR-NYSE-82-2	November 22, 1982	NT
Amex - Options on			
(1) Amex Market Index	SR-Amex-82-8	November 22, 1982	NT
(2) Amex Major Market Index	SR-Amex-82-22	April 27, 1982	April 29, 1983
	SR-Amex-83-9	April 27, 1983	April 29, 1983
CBOE - Options on			
CBOE-100 Index	SR-CBOE-82-11	November 22, 1982	March 11, 1983
	SR-CBOE-83-2	March 10, 1983	
	SR-CBOE-83-3	March 10, 1983	
	SR-CBOE-83-6	March 10, 1983	

* File No. references may be incomplete to the extent that approval of the rules with respect to that option product are supplemental to general rules approved previously or concurrently.

** "NT" - Not trading.

Product and Exchange Approved

Foreign Currency Options

File No(s).*

Date Approved

Date Trading Began

Phlx - Options on

(1) British Pound	SR-Phlx-81-4	October 14, 1982	December 10, 1982
(2) Japanese Yen	SR-Phlx-81-4	October 14, 1982	January 14, 1983
(3) Swiss Franc	SR-Phlx-81-4	October 14, 1982	January 26, 1983
(4) German Mark	SR-Phlx-81-4	October 14, 1982	February 4, 1983
(5) Canadian Dollar	SR-Phlx-81-4	October 14, 1982	February 11, 1983

GNMA Options

CBOE	SR-CBOE-80-7	February 26, 1981 and October 14, 1982	NT
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Options on Bank-Issued Certificates
of Deposit

Amex	SR-Amex-81-20	November 22, 1982	NT
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Options on U.S. Treasury Securities+

CBOE - Options on

30-Year Treasury Bond	SR-CBOE-82-16***	October 14, 1982	October 22, 1982
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Amex - Options on

10-Year Treasury Notes	SR-Amex-82-15****	October 14, 1982	October 22, 1982
Treasury Bills	SR-Amex-82-15****	October 14, 1982	November 5, 1982

*** Incorporates by reference all or parts of SR-CBOE-81-13, SR-CBOE-81-17, SR-CBOE-81-19, SR-CBOE-81-27 and SR-CBOE-82-1.

**** Incorporates by reference SR-Amex-81-1, SR-Amex-81-25 and SR-Amex-82-1.

+ Both Amex and CBOE have received Commission approval to trade options on most U.S. Treasury bonds, bills and notes. The above listing reflects the products in which each exchange has chosen to commence trading.