

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52649; File No. SR-Amex-2005-063)

October 21, 2005

Self-Regulatory Organizations; American Stock Exchange LLC; Order Approving Proposed Rule Change Relating to the Elimination of Position and Exercise Limits on NDX Options

I. Introduction

On June 9, 2005, the American Stock Exchange LLC (“Amex” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to eliminate position and exercise limits for options on the Nasdaq 100 Index (“NDX”). The Commission published the proposed rule change for comment in the Federal Register on August 26, 2005.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Amex proposes to amend its rules to eliminate position and exercise limits for options on the NDX. In connection with this change, options on the NDX would be subject to specific reporting requirements and additional margin provisions imposed by the Amex with respect to options on the Major Market Index (“XMI”) and the Institutional Index (“XII”), the two broad-based index options that, under the Exchange’s current rules, are not subject to position and exercise limits.⁴

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 52312 (August 22, 2005), 70 FR 50431 (“Notice”).

⁴ According to the Amex, options on the XII are no longer listed and traded on the Exchange.

The Exchange noted that in approving the elimination of position limits for XMI and XII options, the Commission considered the enormous capitalization of each of these indexes and the deep and liquid markets for the securities underlying each index significantly reduced concerns of market manipulation or disruption in the underlying markets.⁵ The Amex noted that the market capitalization of NDX, as of June 1, 2005, was \$1.86 trillion and the average daily trading volume (“ADTV”), in the aggregate, for the component securities of the NDX, for the period from January 1, 2005 through May 31, 2005 was 425.8 million shares. For the same period, the ADTV for options on the NDX was 45,820 contracts.

The Exchange also stated that in the XMI/XII Permanent Approval Order, the Commission noted that the financial requirements imposed by both the Exchange and the Commission serve to address any concerns that an Exchange member or its customer(s) may try to maintain an inordinately large unhedged position in XMI/XII options. The Amex noted that these same financial requirements would apply equally to NDX options. The Exchange further noted that it has the authority to impose additional margin upon accounts maintaining underhedged positions, and is further able to monitor accounts to determine when such action is warranted. As noted in the Exchange’s rules, the clearing firm carrying such an account would be subject to capital charges under Rule 15c3-1 under the Act⁶ to the extent of any resulting margin deficiency.⁷

⁵ See Securities Exchange Act Release No. 46393 (August 21, 2002), 67 FR 55289 (August 28, 2002) (order granting permanent approval to the elimination of position and exercise limits on the Major Market index and the Institutional Index) (“XMI/XII Permanent Approval Order”).

⁶ 17 CFR 240.15c3-1.

⁷ See Commentary .03 to Amex Rule 904C. Clarified as per telephone conversation between Ira Brandriss, Special Counsel, and Theodore Venuti, Attorney, Division of

The Amex indicated that the Commission, in the XMI/XII Permanent Approval Order, relied substantially on the Exchange's ability to provide surveillance and reporting safeguards to detect and deter trading abuses arising from the elimination of position and exercise limits on XMI and XII options. The Exchange represents that it monitors the trading in NDX options in the same manner as trading in XMI options and that the current Amex surveillance procedures are adequate to continue monitoring NDX options. In addition, the Exchange intends to impose a reporting requirement on Amex members (other than Amex specialists and registered options traders) or member organizations who trade NDX options. This reporting requirement, which is currently imposed on members who trade XMI options, would require members or member organizations who maintain in excess of 100,000 NDX option contracts on the same side of the market, for their own accounts or for the account of customers, to report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in a manner and form required by the Exchange's Regulation Department. The Exchange also would be permitted to specify other reporting requirements, as well as the limit at which the reporting requirement may be triggered.⁸

Finally, the Amex proposes to amend Exchange rules relating to the trading of FLEX broad-based index options to eliminate position and exercise limits on FLEX NDX options, and to adopt for NDX FLEX options the same 100,000 contract reporting requirement and additional margin provisions that apply for XMI FLEX options.

Market Regulation, Commission, and Jeffery P. Burns, Associate General Counsel, Amex, on August 16, 2005.

⁸ Pursuant to Amex Rule 906, as referenced in Amex Rule 906C(a). Telephone conversation between Ira Brandriss, Special Counsel, and Theodore Venuti, Attorney, Division of Market Regulation, Commission, and Jeffery P. Burns, Associate General Counsel, Amex, on August 18, 2005.

The Exchange believes that eliminating position and exercise limits for NDX options and FLEX options is consistent with Amex rules relating to similar broad-based indexes and would also allow Amex members and their customers greater hedging and investment opportunities.

III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.⁹ the Commission believes the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general to protect investors and the public interest.¹⁰

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 options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position.

The Commission notes that it continues to believe that the fundamental purposes of position and exercise limits remain valid. Nevertheless, the Commission believes that

⁹ In approving this rule proposal, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

experience with the trading of index options as well as enhanced reporting requirements and the Exchange's surveillance capabilities have made it possible to approve the elimination of position and exercise limits on certain broad-based index options. Thus, in 2002, the Commission approved an Amex proposal to eliminate permanently position and exercise limits for options on the XMI and XII.¹¹

The Commission believes that the considerations upon which it relied in approving the elimination of position and exercise limits for XMI and XII options equally apply with respect to options on the NDX.

As noted by the Amex, the market capitalization of the NDX as of the date of filing of the proposal was \$1.86 trillion. The ADTV for the period from January 1, 2005 through May 31, 2005 for all underlying components of the index was 425.8 million shares. The Commission believes that the enormous market capitalization of the NDX and the deep, liquid market for the underlying component securities significantly reduce concerns regarding market manipulation or disruption in the underlying market. Removing position and exercise limits for NDX options may also bring additional depth and liquidity, in terms of both volume and open interest, to NDX options without significantly increasing concerns regarding intermarket manipulation or disruption of the options or the underlying securities.

In addition, the Commission believes that financial requirements imposed by both the Exchange and the Commission adequately address concerns that an Amex member or its customer may try to maintain an inordinately large unhedged position in NDX options. Current risk-based haircut and margin methodologies serve to limit the size of positions maintained by

¹¹ See XMI/XII Permanent Approval Order, supra note 5.

any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer.¹² Under the proposal, the Amex also would have the authority under its rules to impose a higher margin requirement upon an account maintaining an under-hedged position when it determines a higher requirement is warranted. As noted in the Amex rules, the clearing firm carrying the account would be subject to capital charges under Rule 15c3-1 under the Act to the extent of any margin deficiency resulting from the higher margin requirement.

Finally, in approving the elimination of position and exercise limits for options on the XMI and XII, the Commission took note of the enhanced surveillance and reporting safeguards that the Amex had adopted to allow it to detect and deter trading abuses that might arise as a result.¹³ The Amex represents that it monitors trading in NDX options in the same manner as trading in XMI options. These safeguards, including the 100,000-contract reporting requirement described above, would allow the Amex to monitor large positions in order to identify instances of potential risk and to assess and respond to any market concerns at an early stage. In this regard, the Commission expects the Amex to take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop. Moreover, as previously noted, the Exchange has the flexibility to

¹² See Securities Exchange Act Release No. 41011 (February 1, 1999), 64 FR 6405 (February 9, 1999) (notice of filing and order granting accelerated approval to proposed rule change implementing pilot program to eliminated position and exercise limits for XMI and XII options) (“XMI/XII Pilot Approval Order”).

¹³ See, in particular, XMI/XII Pilot Approval Order, supra note 12.

specify other reporting requirements, as well as to vary the limit at which the reporting requirements may be triggered.

The Commission further notes that in eliminating position and exercise limits for FLEX NDX options, the Amex is adopting the same additional rules for these options as for FLEX XMI options.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-Amex-2005-063) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Jonathan G. Katz
Secretary

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).