

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44507; File No. SR-AMEX-2001-31]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the American Stock Exchange LLC Relating to the Pilot Program Eliminating Position and Exercise Limits for Certain Broad Based Index Options

July 3, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 23, 2001, the American Stock Exchange LLC ("Amex" or the "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

#### I. Self Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to re-establish a pilot program eliminating position and exercise limits for the Major Market ("XMI") and Institutional ("XII") broad-based index options, as well as FLEX Options on these indexes for a period of six months. The Commission previously approved the pilot program on a two-year basis that ended on February 1, 2001.<sup>3</sup> Unfortunately, the pilot program lapsed without the Exchange submitting a required rule filing for an extension of the program. As part of any extension, the Commission in the Pilot Program Release required the Exchange to submit a report detailing the size and different types of strategies employed with respect to positions in those classes not subject to position and exercise limits.<sup>4</sup> The experience at the Amex shows that the reporting threshold of over 100,000 contracts on the same side of the market for members and member organizations was never reached during the pilot program period.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Amex included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Amex has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

The Exchange is proposing to re-establish the two-year pilot program eliminating position and exercise limits for XMI and XII index options, as well as FLEX Options on these indexes for six months. The Exchange will continue to apply the requirements required by the Commission in the Pilot Program Release. Specifically, the Exchange will require that each member or member organization that maintains a position on the same side of the market in excess of 100,000 contracts in XMI, XII or FLEX Options on these indexes, for its own account or for the account of a customer, to report certain information.<sup>5</sup> In addition, the Amex will continue to require that member organizations report all index option positions exceeding 200 contracts, pursuant to Exchange Rule 906C.

Although the reporting thresholds in the lapsed pilot program were never met, the Exchange continues to believe that investors and member firms may require such flexibility in the future. In particular, the base limits for XMI and XII options may not be adequate for certain hedging needs for institutions that engage in trading strategies differing from those covered under the existing index hedge exemption policy (e.g., delta hedges; OTC vs. listed hedges). Accordingly, the Amex believes that, with the elimination of position and exercise limits for these products, staff resources could be better utilized elsewhere.

###### Manipulation

Position and exercise limits were first imposed at the inception of options

trading in 1973 in response to regulatory concerns over the potential for manipulation and market instability. The Amex believes that position and exercise limits in broad-based index options no longer serve their stated purpose largely due to increased trading in the underlying market and better surveillance procedures. The Commission has stated that:

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. In particular, position and exercise limits are designed to minimize the potential for manipulations and for corners or squeezes of the underlying market. In addition such limits serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.<sup>6</sup>

The Exchange believes that the size and breadth of the market underlying broad-based index options is so large and liquid as to dispel any concerns regarding market manipulation.<sup>7</sup> To date, there has not been a single disciplinary action involving manipulation in any broad-based index product listed on the Exchange. The Exchange believes that its eighteen years of experience conducting surveillance of index options and program trading activity is sufficient to identify improper activity. Routine oversight inspections of Amex's regulatory programs by the Commission have not uncovered any inconsistencies or shortcomings in the manner in which index option surveillance is conducted. These procedures entail a daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both the options and underlying stock basket components. In addition, to date, there have been no adverse effects on markets as a result of the elimination of position and exercise limits for FLEX equity options.<sup>8</sup>

The Exchange continues to believe that financial requirements imposed by

<sup>6</sup> See Securities Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998).

<sup>7</sup> The market capitalization as of May 21, 2001 for the underlying stocks of the XMI and XII are approximately \$2.2 trillion and \$7.7 trillion, respectively. In the Exchange's view, the large capitalizations and trading volumes of these underlying stocks renders unnecessary the need for position and exercise limits to protect against possible manipulative behavior.

<sup>8</sup> See Securities Exchange Act Release No. 39032 (September 9, 1997), 62 FR 48683 (September 16, 1997).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 41011 (February 1, 1999), 64 FR 6405 (February 9, 1999) ("Pilot Program Release").

<sup>4</sup> *Id.*

<sup>5</sup> This information includes the options positions, whether such position is hedged and if so a description of the hedge and if applicable the collateral used to carry the position. See Amex Rule 906C(b).

the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an inordinately large unhedged position in XMI and XII. As previously indicated in the Pilot Program Release, current margin, and risk-based haircut methodologies serve to limit the size of positions maintained by 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.<sup>9</sup>

#### Reporting Requirements

As previously required under the Pilot Program Release, the Exchange will require that each member or member organization that maintains a position on the same side of the market in excess of 100,000 contracts in XMI or XII index options, for its own account or for the account of a customer, report certain information. This data would include, but would not be limited to, the option position, whether such position is hedged and if so, a description of the hedge and if applicable, the collateral used to carry the position. Exchange market makers would continue to be exempt from this reporting requirement as market-maker information can be accessed through the Exchange's market surveillance systems. In addition, the general reporting requirement for customer accounts that maintain a position in excess of 200 contracts will remain at this level for broad-based index options.<sup>10</sup>

#### 2. Basis

The proposed rule change is consistent with Section 6(b) of the Act<sup>11</sup> in general and furthers the objectives of Section 6(b)(5)<sup>12</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

<sup>9</sup> It should also be noted that the Exchange has the authority under paragraph (d)(2)(K) of Rule 462 to impose a higher margin requirement upon the member or member organization when the Exchange determines a higher requirement is warranted.

<sup>10</sup> See Amex Rule 906C(a).

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

#### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition.

#### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Commission has reviewed carefully the Amex's proposed rule change and believes, for the reasons set forth below, the proposal is consistent with the requirements of Section 6(b) of the Act<sup>13</sup> and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission believes the proposal is consistent with Section 6(b)(5) of the Act<sup>14</sup> because it is designed to prevent fraudulent and manipulative acts and practices, to promote just principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

The Commission believes that an elimination of position and exercise limits for certain broad-based index options on a pilot basis is appropriate for the same reasons noted in the approval of the original pilot.<sup>15</sup> Overall, the Commission believes that the pilot will allow Amex to allocate certain of its surveillance resources differently, focusing on enhanced reporting and surveillance of trading to detect potential manipulation and risky positions that may unduly affect the cash market, rather than focusing on the strict enforcement of position limits. Although this regulatory approach deviates from the structure that has been in place since the beginning of index options trading, the Commission believes that the enhanced reporting and surveillance Amex is providing, as well as the fact that the pilot is limited

to two of Amex's most highly capitalized and actively traded index options, provides a sound basis for approving a six-month pilot program eliminating position and exercise limits.

The Amex requests that the proposed rule change be given expedited review and accelerated effectiveness pursuant to Section 19(b)(2) of the Act because it is an extension of a lapsed pilot program previously approved by the Commission.<sup>16</sup> The Exchange believes that the arguments set forth by the Exchange, and the basis for the Commission's prior approval, are equally applicable to this filing.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof in the **Federal Register** as the proposal does not significantly affect the protection of investors or the public interest, and does not impose any significant burden on competition. There is good cause for the Commission to accelerate effectiveness of this rule filing because the proposal raises no new or novel issues and is an extension of the XMI/XII Position Limit Pilot Program under the same terms and conditions previously approved by the Commission.<sup>17</sup> Accordingly, the Commission believes that it is consistent with Sections 6(b)(5)<sup>18</sup> and 19(b)(2)<sup>19</sup> of the Act to approve the proposal on an accelerated basis.<sup>20</sup>

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether it is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the

<sup>16</sup> 15 U.S.C. 78s(b)(2).

<sup>17</sup> See note 3, *supra*.

<sup>18</sup> 15 U.S.C. 78f(b).

<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>20</sup> The Commission requests that the Amex update the Commission on any problems that have developed with the pilot since the last extension, including any compliance issues, and whether there have been any large unhedged positions that have raised concerns for the Amex. In addition, the Commission expects that the Amex will 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.

<sup>13</sup> 15 U.S.C. 78f(b). In approving this rule change, the Commission notes that it has considered the proposal's impact on efficiency, competition, and capital formation, consistent with Section 3 of the Act. *Id.* at 78c(f).

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> See note 3, *supra*. The Commission incorporates by reference the basis for approving the original pilot as set forth in the Pilot Program Release.

proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-AMEX-2001-31 and should be submitted by August 1, 2001.

## V. Conclusion

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change is hereby approved on an accelerated basis on a six-month pilot basis until January 3, 2002.

For the Commission by the Division of Market Regulation, Pursuant to delegated authority.<sup>22</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44509; File No. SR-DTC-2001-09]

### Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change To Raise Maximum Net Debit Caps and Required Participants Fund Contributions

July 3, 2001.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on May 29, 2001, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared primarily by DTC. The Commission is publishing this notice and order to solicit comments from interested persons and to grant accelerated approval of the proposed rule change.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change consists of (i) an increase to \$1.80 billion from \$1.15 billion in the maximum net debit

cap for any participant in the daily money settlement system of DTC, (ii) an increase of \$200 million in the cash deposits to DTC's Participants Fund so that the aggregate amount of the required deposits to DTC's Participants Fund plus the required preferred stock investments of participants will increase to \$600 million from \$400 million and (iii) a decrease in the maximum net debit monitoring level in DTC's Mortgage-Backed Securities Division (the "MBS Division") to \$1.75 billion from \$2 billion.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, DTC included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. DTC has prepared summaries, set forth in sections (A), (B) and (C) below, of the most significant aspects of these statements.<sup>2</sup>

##### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

DTC employs several risk management controls in its daily money settlement system to protect DTC and its participants against the risk that a participant will fail to pay its net debit balance. One of those risk management controls is the net debit cap control, which imposes net debit caps on all participants. Each participant's net debit is limited throughout the processing day to a net debit cap that is the lesser of four amounts: (1) A net debit cap based on the average of the three largest net debits that the participant incurs over a rolling 70 business day period, (2) an amount, if any, determined by the participant's settling bank, (3) an amount, if any, determined by DTC or (4) the aggregate of the cash deposits in the Participants Fund plus DTC's committed lines of credit minus a cushion, which amount is currently \$1.15 billion.

Similarly, in the MBS Division each participant's net debit is limited throughout the processing day to a net debit monitoring level. The maximum net debit monitoring level in the MBS Division is the lesser of two amounts: (1) 100% of the total committed lines of

credit available to DTC for the MBS Division (such total currently being \$2 billion) or (2) an amount, if any, determined by DTC.

As trading volumes, particularly money market instruments, have increased, and as associated settlement values have increased, participants increasingly have had to make settlement progress payments, which are funds wired to DTC intraday, in order to avoid having their receipts of securities blocked by their net debit caps. Participants have requested that DTC raise the maximum net debit cap, which would increase operational efficiency for participants.

In order to provide liquidity in the event of a participant's failure to settle with DTC after the proposed increase in the maximum net debit cap, DTC is increasing the amount of the required deposits to the DTC Participants Fund. The required deposits are presently an aggregate of \$325 million in cash and an aggregate of \$75 million in required preferred stock investments. The required cash deposits to the Participants Fund will be increased to \$525 million so that the aggregate amount of the required cash deposits and preferred stock investments of participants will be \$600 million.

DTC and the National Securities Clearing Corporation are also jointly obtaining a committed credit facility to replace their existing separate credit facilities. As part of the new credit facility, the amount of the credit facility supporting DTC's money settlement system will be increased to \$1.75 billion from \$1 billion. This will give DTC aggregate available liquidity resources of \$2.35 billion (*i.e.*, \$1.75 billion credit facility plus \$600 million Participants Fund and preferred stock investments). The amount of the credit facility supporting the MBS Division will be decreased to \$1.75 billion from \$2 billion.<sup>3</sup>

As a result of increasing the aggregate liquidity resources to \$2.35 billion, DTC will be able to increase the maximum net debit cap for any participant to \$1.8 billion from \$1.15 billion.

The proposed rule change is consistent with the requirements of Section 17A of the Act<sup>4</sup> and the rules and regulations thereunder applicable to DTC because the proposed rule change will be implemented consistently with the safeguarding of securities and funds

<sup>3</sup> The decrease in the amount of the credit facility supporting the MBS Division corresponds with a decrease in the volume of transactions being processed through the division and with an effort to more efficiently allocate the amount of credit available to DTC, NSCC, and the MBS Division.

<sup>4</sup> 15 U.S.C. 78q-1.

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> The Commission has modified the text of the summaries prepared by DTC.