brokerage agreements. Consistent with existing NASD Code of Conduct provisions, the prohibition on member loans to Exchange employees in new Amex Rule 417(b) would not apply to loans that are clearly motivated by a family or personal relationship. Thus, for example, a registered representative would not be precluded from making a personal loan to an adult child who works at the Amex.

B. Brokerage Accounts of Exchange Employees

The NASD Code of Conduct requires *disclosure* of all security and commodity accounts that an employee maintains and accounts in which an employee has a financial interest or controls trading.[8] Employees are required to instruct the institutions where such accounts are maintained to provide duplicate account statements (but not confirmations) to the NASD Office of General Counsel, which records transaction information in a database

Commentary .01 to Amex Rule 416 currently requires members to obtain the Exchange's prior written *approval* before opening an account for an Exchange employee and to provide duplicate confirmations and statements to the Exchange. To conform Amex rules to the NASD Code of Conduct, the Exchange approval requirement for the opening of accounts and the requirement to furnish duplicate confirmations are being deleted. The requirement to provide duplicate statements to the Exchange is being retained. The Amex also proposes to adopt new Amex Rule 417(a), which provides that when a member has actual notice that an Exchange employee has a financial interest in an account or controls trading in an account, duplicate account statements shall be provided by the member to the Exchange.

C. Member Gifts to Exchange Employees

Currently under Amex Rule 348, Amex members must obtain approval from the Corporate Secretary's Office before giving an Exchange employee gifts valued at over $50 per year. The Secretary's Office does not approve gifts that exceed the $50 threshold for employees in the Exchange's Member Firm Regulation area. There is no such pre-approval mechanism, however, under the NASD Code of Conduct.[9]

To conform Amex rules to the NASD Code of Conduct, Amex Rule 348 (Gratuities to Employees of Exchange) would be deleted and replaced with new Amex Rule 417(c), a provision that parallels the NASD Code of Conduct. New Amex Rules 417(c) permits members to give non-cash business gifts with an aggregate annual value of $100 to Exchange employees when no conflict of interest exists, but prohibits members from giving business gifts or courtesies of more than nominal value to any Exchange employee who has responsibility for a specific regulatory matter that involves the member. A ''regulatory matter'' would include such matters as examinations, disciplinary proceedings, membership applications, listing applications, delisting proceedings, and dispute resolution proceedings involving the member. The proposed rule would permit members to give items of nominal value to employees responsible for regulatory matters affecting the member.

III. Discussion

The Commission has reviewed carefully the Amex's proposed rule change and believes, for the reasons set forth below,[10] the proposal is consistent with the requirements of Section 6 of the Act[11] 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.[12] Section 6(b)(5) requires that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. The proposed rule change is based upon recommendations made by SEC staff following an inspection of the ethical conduct and conflicts of interest rules, policies, and procedures of the Exchange. The amendments to the rules are designed to promote a high level of professional and personal ethical conduct by Exchange members and employees and to ensure that Exchange members and employees do not place their own personal and financial interests above the regulatory interests of the Exchange. The proposal also helps to bring the Amex's conflict of interest and ethical conduct provisions in line with those of the NASD and helps eliminate any confusion regarding the application of these provisions to employees of both self-regulatory organizations.

The Commission finds good cause for approving the proposed rule change (SR-Amex-00–23) prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that Amex employees have become subject to the NASD Code of Conduct as of October 2000.[13] The Commission has not received any comments in response to the filing of the proposed rule change.

IV. Conclusion

For the foregoing reasons, the Commission finds that the proposal is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2)[14] of the Act, that the proposed rule change (SR-Amex-00–23), as amended, is hereby approved on an accelerated basis.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–30377 Filed 11–28–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43582; File No. SR–Amex–99–27]

Self-Regulatory Organizations; American Stock Exchange LLC; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 to the Proposed Rule Change Relating to Amex Rule 462, ''Minimum Margins''

November 17, 2000.

I. Introduction

On July 23, 1999, the American Stock Exchange LLC (''Amex'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''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 amend Amex Rule 462, ''Minimum Margins,'' to revise the margin requirements for stock options and stock index options. The proposed rule

[8] NASD Code of Conduct, Section VIII, Paragraph C.

[9] NASD Code of Conduct, Section IX, Paragraph B.1.

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

[11] 15 U.S.C. 78f.

[12] 15 U.S.C. 78f(b)(5).

[13] *See* SR–NASD–00–58.

[14] 15 U.S.C. 78s(b)(2).

[15] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

change was published for comment in the **Federal Register** on September 8, 1999.[3] No comments were received on the notice of the proposed rule change. The Exchange filed Amendment Nos. 1[4] and 2[5] to the proposal on June 1, 2000, and September 25, 2000, respectively. This order approves the proposed rule change and grants accelerated approval to Amendment Nos. 1 and 2.

II. Description of the Proposal

A. Background

Until several years ago, the margin requirements governing listed options were set forth in Regulation T, ''Credit by Brokers and Dealers.''[6] However, Federal Reserve Board amendments to Regulation T that became effective June 1, 1997, modified or deleted certain margin requirements regarding options transactions in favor of rules to be adopted by the options exchanges, subject to approval by the Commission.[7]

At the present time, the Exchange seeks to further revise its margin rules to implement enhancements long desired by Exchange members and member firms, public investors, and the Exchange staff. The Exchange believes that certain multiple options position strategies and other strategies that combine stock with option positions warrant more equitable margin treatment. The Exchange further believes that the offset in risk that results if the stock and options position are viewed collectively is not reflected in the current maintenance margin requirements. The Exchange believes that market participants should have the ability to use these strategies for the least amount of margin necessary. In addition, the Exchange believes it is appropriate for member firms to extend credit on certain types of long term options.

In its proposal, the Exchange reviewed all of its margin rules with a view toward updating or improving margin provisions as necessary. The Exchange also found it necessary to propose minor changes to certain rules because they are closely related to, and will be impacted by, the more substantive proposals.

In sum, the proposed revisions to the Exchange's margin rules would: (1) Permit the extension of credit on certain long term options and warrants with over nine months until expiration, and on certain long box spreads comprised entirely of European-style options; (2) recognize butterfly and box spread strategies for purposes of margin treatment and establish appropriate margin requirements for them; (3) recognize various strategies involving stocks (or other underlying instruments) paired with a long option, and provide for lower maintenance margin requirements on such hedged stock positions; (4) expand the types of short options positions that would be considered ''covered'' in a cash account, specifically, certain short positions that are components of limited risk spread strategies (*e.g.,* butterfly and box spreads); (5) allow a bank issued escrow agreement that conforms to Exchange standards to serve as cover for certain spread positions held in a cash account; and (6) update and improve, as necessary, Exchange current margin rules.

B. Definitions

Currently, Amex Rule 462 defines the ''current market value'' or ''current market price'' of an option, currency warrant, currency index warrant, or stock index warrant as the total cost or net proceeds of the option contract or warrant on the day it was purchased or sold. The Amex proposes to revise the definition to indicate that the current market value or current market price of an option, currency warrant, currency index warrant, or stock index warrant are as defined in Section 220.2 of Regulation T of the Federal Reserve Board.

The Exchange also proposes to establish definitions for ''butterfly spread''[8] and ''box spread''[9] options

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[3] *See* Securities Exchange Act Release No. 41808 (August 30, 1999), 64 FR 48882.

[4] *See* letter from Scott G. Van Hatten, Attorney, Amex, to Jack Drogin, Assistant Director, Division of Market Regulation (''Division''), Commission, dated May 31, 2000 (''Amendment No. 1''). Among other things, Amendment No. 1 revises the proposal to: (1) Add a definition of ''OTC Margin Bond'' to Amex Rule 462(d) to account for the Federal Reserve Board's removal of the definition from Section 220 of Regulation T of the Federal Reserve Board; (2) add a definition to Amex Rule 462(d) of ''escrow agreement'' with respect to cash settled options or warrants; (3) remove a reference to packaged vertical spreads and packaged butterfly spreads as the Exchange currently does not have Commission approval to trade these products; (4) remove certain margin provisions relating to unit investment trusts from proposed Amex Rule 462(d)(2)(I)(ii)(a)(2) and proposed Amex Rule 462(d)(10)(B)(iii) and (iv) as eligible securities to serve as a cover for index call options as a result of the approval of SR–Amex–98–33 which addressed such positions; (5) make certain other non-substantive revisions to correct typographical errors and to make the filing consistent; (6) move the definition of ''cash equivalent'' from Commentary .03(c) of Amex Rule 462 to proposed Amex Rule 462(d); (7) add citations to more clearly indicate the removal and insertion of various provisions of the Rule (for example, Amex is removing paragraphs (E) through (I) of Amex Rule 462(d)(2) as these paragraphs will be covered by proposed Amex Rule 462(d)(10)(B)); (8) remove Commentaries .06–.08 of Amex Rule 462 because the Amex has rephrased and updated these margin provisions and has relocated them to other sections of the same rule. Specifically, the Amex proposes to delete the margin provisions relating to capped style options in Commentaries .06 and .07 because the Amex has proposed new provisions relating to these options in Amex Rule 462(d)(10)(B). The Amex also proposes to delete Commentary .08 of Amex Rule 462 and current Amex Rule 462(d)(2)(O) concerning margin provisions relating to debit put spread positions in broad based European style index options because the Amex has now proposed new margin for spread provisions in Amex Rule 462(d)(2)(J); (9) delete the current provision in Commentary .09 of Amex Rule 462 relating to a margin rule regarding offset margin treatment for currency warrants, currency index warrants and listed options under a pilot program that has expired and therefore is no longer necessary; (10) revise and move provisions regarding straddle/combination from Amex Rule 462(d)10(B)(v) to proposed Amex Rule 462(d)(10)(B)(vi); and (11) move the rule text of Amex Rule 462(d)(2)(H)(iv) and current Commentary .10 of the same rule concerning margin for certain short index options positions covered by positions in Portfolio Depositary Receipts or Index Fund Shares to proposed Amex Rule 462(d)(10)(B)(ii)(c) and proposed Commentary .06 of the same rule to reflect the rule language as approved in the filing SR–Amex–98–33.

[5] *See* letter from Scott G. Van Hatten, Attorney, Amex, to Jack Drogin, Assistant Director, Division, Commission, dated September 22, 2000 (''Amendment No. 2''). Amendment No. 2 revises the proposal to: (1) Provide a technical correction to the proposed rule text for OTC options and warrants with expirations exceeding nine months (''long term''); (2) add the word ''aggregate'' in appropriate places in the definitions of ''butterfly spread'' and ''box spread;'' and delete the word ''aggregate'' in proposed Amex Rule 462(d)(10)(B)(iv) relating to ''Exceptions'' referring to the general maintenance margin requirement provision for certain hedged option or warrant strategies; and (3) change the term ''deliver'' to ''pay'' in the definition of ''escrow agreement'' in connection with cash settled options or warrants to more accurately reflect that a bank is obligated to pay to the creditor in the case of an option the exercise settlement amount (in the event an option) is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy-in.

[6] 12 CFR 220 *et seq.* The Board of Governors of the Federal Reserve System (''Federal Reserve Board'') issued Regulation T pursuant to the Act.

[7] *See* Board of Governors of the Federal Reserve System Docket No. R–0772 (Apr. 24, 1996), 61 FR 20386 (May 6, 1996) (permitting the adoption of margin requirements ''deemed appropriate by the exchange that trades the option, subject to the approval of the Securities and Exchange Commission'').

[8] The proposal defines ''butterfly spread'' as:

[A]n aggregation of positions in three series of either put or call options all having the same underlying component or index and time of expiration, and based on the same aggregate current underlying value, where the interval between the exercise price of each series is equal, which positions are structured as either (A) a ''long butterfly spread'' in which two short options in the same series are offset by one long option with a higher exercise price and one long option with a lower exercise price, or (B) a ''short butterfly spread'' in which two long options in the same series offset one short option with a higher exercise price and one short option with a lower exercise price. *See* Amendment No. 2, *supra* note 5.

[9] The proposal defines ''box spread'' as:

[A]n aggregation of positions in a long call option and short put option with the same exercise price (''buy side'') coupled with a long put option and short call option with the same exercise price (''sell side'') all of which have the same underlying component or index and time of expiration, and are strategies. The definitions are important elements of the Exchange's proposal to recognize and specify cash and margin account requirements for butterfly and box spreads. The definitions will specify what multiple option positions, if held together, qualify for classification as butterfly or box spreads, and consequently are eligible for the proposed cash and margin treatment.

The proposal would define the term ''OTC margin bond.'' [10] The definition is necessary because the Exchange's margin rules currently cross-reference the Regulation T definition of ''OTC margin bond,'' which was eliminated by the Federal Reserve Board as of April 1, 1998.[11]

The Amex proposes to define an ''escrow agreement,'' when used in connection with cash settled calls, puts, currency warrants, currency index warrants or stock index warrants, carried short, any agreement issued in a form acceptable to the Exchange under which a bank holding cash, cash equivalents, one or more qualified equity securities or a combination thereof is obligated in the case of a call option or warrant; or cash, cash equivalents or a combination thereof in the case of a put option or warrant is obligated to pay to the creditor (in the case of an option) the exercise settlement amount in the event an option is assigned an exercise notice or (in the case of a warrant) the funds sufficient to purchase a warrant sold short in the event of a buy-in.[12] The Exchange also proposes to revise the definition of ''escrow agreement,'' when used in connection with non-cash settled call or put options carried short, as any agreement issued in a form acceptable to the Exchange under which a bank holding the underlying security (in the case of a call option) or required cash, cash equivalents, or a combination thereof (in the case of a put option), is obligated to deliver to the creditor (in the case of a call option) or accept from the creditor (in the case of a put option) the underlying security against payment of the exercise price in the event the call or put is assigned an exercise notice.

The Exchange also seeks to define the term ''listed.'' [13] Because the term ''listed'' is frequently used in the Exchange's margin rules, the Exchange believes that it would be more efficient to define the term once rather than specifying the meaning of the term each time it is used.

The Exchange would also define the term ''underlying stock basket.'' [14]

C. Extension of Credit on Long Term Options and Warrants

The proposal would allow extensions of credit on certain long listed and OTC [15] options (*i.e.,* put or call options on a stock or stock index) and warrant products (*i.e.,* stock index warrants, but not traditional stock warrants issued by a corporation on its own stock).[16] The proposal provides no loan value for long term foreign currency options. Only long term options or warrants with expirations exceeding nine months will be eligible for credit extension.[17] For long term listed options and warrants, the proposal requires initial and maintenance margin of not less than 75 percent of the current market value of the option or warrant. Therefore, Amex member firms would be able to loan up to 25 percent of the current market value of a long term listed option or warrant.[18]

The proposal would permit the extension of credit on certain long term OTC options and warrants. Specifically, an Amex member firm could extend credit on a OTC put or call option on a stock or stock index, and on an OTC stock index warrant. In addition to being more than nine months from expiration, a marginable OTC option or warrant must: (1) Be in-the-money and valued at all time for margin purposes at an amount not to exceed the in-the-money amount; (2) be guaranteed by the carrying broker-dealer, and (3) have an American-style [19] exercise provision.[20] The proposal requires an initial and maintenance margin of 75 percent of the long term OTC option's or warrant's in-the-money amount (*i.e.,* its intrinsic value).

When the time remaining until expiration for an option or warrant (listed or OTC) on which credit has been extended reaches nine months, the maintenance margin requirement would become 100 percent of the current market value. Options or warrants expiring in less than nine months would have no loan value under the proposal because of the leverage and volatility of those instruments.

D. Extension of Credit on Long Box Spread in European-Style Options

The proposal also would permit the extension of credit on a long box spread composed entirely of European-style options [21] that are listed or guaranteed by the carrying broker-dealer. A long box spread is a strategy that is composed of four option positions and

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based on the same aggregate current underlying value, and are structured as either: (A) a ''long box spread'' in which the sell side exercise price exceeds the buy side exercise price, or (B) a ''short box spread'' in which the buy side exercise price exceeds the sell side exercise price. *See* Amendment No. 2, *supra* note 5.

[10] The proposal defines ''OTC margin bond'' as:

(1) Any debt securities not traded on a national securities exchange that meet all of the following requirements (a) at the time of the original issue, a principal amount of not less than $25,000,000 of the issue was outstanding; (b) the issue was registered under Section 5 of the Securities Act of 1933 and the issuer either files periodic reports pursuant to the Act or is an insurance company under Section 12(g)(2)(G) of the Act; or (c) at the time of the extension of credit the creditor has a reasonable basis for believing that the issuer is not in default on interest or principal payments; or (2) any private pass-through securities (not guaranteed by a U.S. government agency) that meet all of the following requirements: (a) an aggregate principal amount of not less than $25,000,000 was issued pursuant to a registration statement filed with the Commission; (b) current reports relating to the issue have been filed with the Commission; and (c) at the time of the credit extension, the creditor has a reasonable basis for believing that mortgage interest, principal payments and other distributions are being passed through as required and that the servicing agent is meeting its material obligations under the terms of the offering. *See* Amendment No. 1, *supra* note 4.

[11] *See* Board of Governors of the Federal Reserve System Docket Nos. R–0905, R–0923, and R–0944 (Jan. 8, 1998), 63 FR 2806 (Jan. 16, 1998).

[12] *See* Amendment No. 2, *supra* note 5.

[13] The proposal defines the term ''listed'' as a security traded on a registered national securities exchange or automated facility of a registered national securities association.

[14] The proposal defines ''underlying stock basket'' as:

[A] group of securities which includes each of the component securities of the applicable index and which meets the following conditions: (i) The quantity of each stock in the basket is proportional to its representation in the index; (ii) the total market value of the basket is equal to the underlying index value of the index options or warrants to be covered; (iii) the securities in the basket cannot be used to cover more than the number of index options or warrants represented by that value; and (iv) the securities in the basket shall be unavailable to support any other option or warrant transaction in the account.

[15] Unlike listed options, OTC options are not issued by The Options Clearing Corporation (''OCC''). OTC options and warrants are not listed or traded on a registered national securities exchange or through the automated quotation system of a registered securities association.

[16] Throughout the remainder of this approval order, the term ''warrant'' means this type of warrant.

[17] For any stock option, stock index option, or stock index warrant, carried long in a customer's account, that expires in nine months or less, initial margin must be deposited and maintained equal to at least 100% of the purchase price of the option or warrant.

[18] For example, if an investor purchased a listed call option on stock XYZ that expired in January 2001 for approximately $100 (excluding commissions), the investor would be required to deposit and maintain at least $75. The investor could borrow the remaining $25 from its broker. Under the Amex's current margin rules, the investor would be required to pay the entire $100. *See* Securities Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (''COBE Approval Order''), at footnote 18.

[19] American-style options are exercisable on any business day prior to its expiration date and on its expiration date.

[20] *See* Amendment No. 2, *supra* note 5.

[21] A European-style option may be exercised only at its expiration pursuant to the rules of The OCC. *See* Amex Rule 900C(20).

is designed to lock in the ability to buy and sell the underlying component or index for a profit, even after netting the cost of establishing the long box spread. The two exercise prices embedded in the strategy determine the buy and the sell price.[22]

For long box spreads made up of European-style options, the proposal would require initial and maintenance margin of 50 percent of the aggregate difference in the two exercise prices (buy and sell), which results in a margin requirement slightly higher than 50 percent of the net debit typically incurred.[23] Under the proposal, a long box spread would be allowed market value for margin equity purposes of not more than 100 percent of the aggregate difference in exercise prices of the options.

E. Cash Account Treatment of Butterfly Spreads and Box Spreads, Other Spreads, and Short Options

The proposal would permit butterfly spreads and box spreads in cash-settled, European-style options eligible for the cash amount. A butterfly spread is a pairing of two standard spreads, one bullish and one bearish. To qualify for carrying in the cash account, the butterfly spreads and box spreads must meet the specifications contained in the proposed definition section,[24] and must be comprised of options that are listed or guaranteed by the carrying broker-dealer. In addition, the long options must be held in, or purchased for, the account on the same day.

For long butterfly spreads and long box spreads, the proposal would require full payment of the net debit that is incurred when the spread strategy is established. According to the Amex, full payment of the net debit incurred to establish a long butterfly or box spread will cover any potential risk to the carrying broker-dealer.[25]

Shortly butterfly spreads generate a credit balance when established (*i.e.,* the proceeds from the sale of short option components exceed the cost of purchasing long option components). However, in the worst case scenario where all options are exercised, a debit (loss) greater than the initial credit balance received would accrue to the account. To eliminate the risk to the broker-dealer carrying the short butterfly spread, the proposal will require that an amount equal to the maximum risk be held or deposited in the account in the form of cash or cash equivalents.[26] The maximum risk potential in a short butterfly spread comprised of call options is the aggregate difference between the two lowest exercise prices.[27] With respect to short butterfly spreads comprised of put options, the maximum risk potential is the aggregate difference between the two highest exercise prices. The net credit received from the sale of the short option components could be applied towards the requirement. Short box spreads also generate a credit balance when established. This credit is nearly equal to the total debit (loss) that, in the case of a short box spread, will accrue to the account if held to expiration. The proposal will require that cash or cash equivalents covering the maximum risk, which is equal to the aggregate difference in the two exercise prices involved, be held or deposited.[28] The net credit received from the sale of the short option components may be applied towards the requirement; if applied, only a small fraction of the total requirement need to be held or deposited.[29]

In addition to butterfly spreads and box spreads, the proposal will permit investors to hold in their cash accounts other spreads made up of European-style, cash-settled stock index options, stock index warrants, or currency index warrants. A short position would be considered covered, and thus eligible for the cash account, if a long position in the same European-style, cash-settled index option, stock index warrant, or currency index warrant was held in, or purchased for, the account on the same day.[30] The long and short positions making up the spread must expire concurrently, and the long position must be paid in full. Lastly, the cash account must contain cash, cash equivalents, or an escrow agreement equal to at least the aggregate exercise price differential.

The proposal also would establish requirements for the following types of options and warrants carried short in the cash account: equity options, index options, capped-style index options, stock index warrants, and currency index warrants. For each of these securities, the proposal specifies certain criteria that must be satisfied for the short position to be deemed a covered position, and thus considered eligible

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[22] For example, an investor might be long 1 XYZ Jan 50 Call @ 7 and short 1 XYZ Jan 50 Put @ 1 (''buy side''), and short 1 XYZ Jan 60 Call @ 2 and long 1 XYZ Jan 60 Put @ 5½ (''sell side''). As required by the Exchange's proposed definition of ''long box spread,'' the sell exercise price exceeds the buy side exercise price. In this example, the long box spread is a riskless position because the net debit ((2 + 1) − (7 + 5½) = net debit of 9½) is less than the exercise price differential (60 − 50 = 10). Thus, the investor has locked in a profit of $50 (½ × 100). *See* CBOE Approval Order, *supra* note 18, at footnote 22.

[23] In the example appearing in the preceding footnote, the margin required (50% × (60 − 50) = 5) would be slightly higher than 50% of the net debit (50% × 9½ = 4¾). *See* CBOE Approval Order, *supra* note 18, at footnote 23.

[24] *See supra* notes 8 and 9 (definitions of butterfly and box spreads).

[25] For example, to create a long butterfly spread, which is comprised of call options, an investor may be long 1 XYZ Jan 45 Call @ 6, short 2 XYZ Jan 50 Calls @ 3 each, and long 1 XYZ Jan 55 Call @ 1. The maximum risk for this long butterfly spread is the net debit incurred to establish the strategy ((3 + 3) − (6 + 1) = net debit of 1). Under the proposal, therefore, the investor would be required to pay the net debit, or $100 (1 × 100) *See* CBOE Approval Order, *supra* note 18, at footnote 25.

[26] An escrow agreement could be used as a substitute for cash or equivalents if the agreement satisfies certain criteria. For short butterfly spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the two lowest exercise prices with respect to short butterfly spreads comprised of call options or the aggregate difference between the two highest exercise prices with respect to short butterfly spreads comprised of put options and that the bank will promptly pay the member organization such amount in the event the account is assigned an exercise notice on the call (put) with the lowest (highest) exercise price.

[27] For example, an investor may be short 1 XYZ Jan 45 Call @ 6, long 2 XYZ Jan 50 Calls @ 3 each, and short 1 XYZ Jan 55 Call @ 1. Under the proposal, the maximum risk for this short butterfly spread, which is comprised of call options, is equal to the difference between the two lowest exercise prices (50 − 45 = 5). If the net credit received from the sale of short option components ((6 + 1) − (3 + 3) = net credit of 1) is applied, the investor is required to deposit an additional $400 (4 × 100). Otherwise, the investor would be required to deposit $500 (5 × 100). *See* CBOE Approval Order, *supra* note 18, at footnote 27.

[28] As a substitute for cash or cash equivalents, an escrow agreement could be used if it satisfies certain criteria. For short box spreads, the escrow agreement must certify that the bank holds for the account of the customer as security for the agreement (1) cash, (2) cash equivalents, or (3) a combination thereof having an aggregate market value at the time the positions are established of not less than the amount of the aggregate difference between the exercise prices, and that the bank will promptly pay the member organization such amount in the event the account is assigned an exercise notice on either short option.

[29] To create a short box spread, an investor may be short 1 XYZ Jan 60 Put @ 5½ and long 1 XYZ Jan 60 Call @ 2 (''buy side''), and short 1 XYZ Jan 50 Call @ 7 and long 1 XYZ Jan 50 Put @ 1 (''sell side''). As required by the Exchange's proposed definition of ''short box spread'' (*supra* note 9), the buy side exercise price exceeds the sell side exercise price. In this example, the maximum risk for the short box spread is equal to the difference between the two exercise prices (60 − 50 = 10). If the net credit received from the sale of short option components ((5½ + 7) − (2 + 1) = net credit of 9½) is applied, the investor is required to deposit an additional $50 (½ − 100). Otherwise, the investor would be required to deposit $1,000 (10 × 100). *See* CBOE Approval Order, *supra* note 18, at footnote 29.

[30] Under the proposal, a long warrant may offset a short option contract and a long option contract may offset a short warrant provided they have the same underlying component or index and equivalent aggregate current underlying value.

for the cash account. For example, a short put warrant on a market index would be deemed covered if, at the time the put warrant is sold or promptly thereafter, the cash account holds cash, cash equivalents, or an escrow agreement equal to the aggregate exercise price.

F. Margin Account Treatment of Butterfly and Box Spreads

The Exchange's margin rules presently do not recognize butterfly spreads for margin purposes. Under the Exchange's current margin rules, the two spreads (bullish and bearish) that make up a butterfly spread each must be margined separately. The Exchange believes that the two spreads should be viewed in combination, and that commensurate with the lower combined risk, investors should receive the benefit of lower margin requirements.

The Exchange's proposal would recognize as a distinct strategy butterfly spreads held in margin accounts,and specify requirements that are the same as the cash account requirements for butterfly spreads.[31] Specifically, in the case of a long butterfly spread, the net debit must be paid in full. For short butterfly spreads comprised of call options, the initial and maintenance margin must equal at least the aggregate difference between the two lowest exercise prices. For short butterfly spreads comprised of put options, the initial and maintenance margin must equal at least the aggregate difference between the two highest exercise prices. The net credit received from the sale of the short option components may be applied towards the margin requirement for short butterfly spreads.

The proposed requirements for box spreads held in a margin account, where all option positions making up the box spread are listed or guaranteed by the carrying broker-dealer, also are the same as those applied to the cash account. With respect to long box spreads, where the component options are not European-style, the proposal would require full payment of the net debit that is incurred when the spread strategy is established.[32] For short box spreads held in the margin account, the proposal would require that cash or cash equivalents be deposited and maintained, covering the maximum risk, which is equal to the aggregate difference in the two exercise prices involved. The net credit received from the sale of the short option components may be applied towards the margin requirement. Generally, long and short box spreads would not be recognized for margin equity purposes; however, the proposal would allow loan value for one type of long box spread where all component options have a European-style exercise provision and are listed or guaranteed by the carrying broker-dealer.

G. Maintenance Margin Requirements for Stock Positions Held With Options Positions

The Exchange proposes to recognize, and establish reduced maintenance margin requirements for five options strategies that are designed to limit the risk of a position in the underlying component. The strategies are: (1) Long Put/Long Stock; (2) Long Call/Short Stock; (3) Conversion; (4) Reverse Conversion; and (5) Collar. Although the five strategies are summarized below in terms of a stock position held in conjunction with an overlying option (or options), the proposal is structured to also apply to components that underlie index options and warrants. For example, these same maintenance margin requirements will apply when these strategies are utilized with a stock basket underlying index options or warrants. Proposed Exchange Rule 462(d)(10)(B)(iv), ''Exceptions,'' will define the five strategies and set forth the respective maintenance requirements for the stock component of each strategy.[33]

1. Long Put/Long Stock

The Long Put/Long Stock hedging strategy requires an investor to carry in an account a long position in the component underlying the put option, and a long put option specifying equivalent units of the underlying component. The maintenance margin requirement for the Long Put/Long Stock combination would be the lesser of: (i) 10 percent of the put option aggregate exercise price, plus 100 percent of any amount by which the put option is out-of-the-money; or (ii) 25 percent of the current market value of the long stock position.[34]

2. Long Call/Short Stock

The Long Call/Short Stock hedging strategy requires an investor to carry in an account a short position in the component underlying the call option, and a long call option specifying equivalent units of the underlying component. For a Long Call/Short Stock combination, the maintenance margin requirement would be the lesser of: (i) 10 percent of the call option aggregate exercise price, plus 100 percent of any amount by which the call option is out-of-the-money; or (ii) the maintenance margin requirement of the short stock position as specified in Amex Rule 462(b).[35]

3. Conversion (Long Stock/Long Put/Short Call)

A ''Conversion'' is a long stock position held in conjunction with a long put and a short call. For a Conversion to qualify as hedged, the long put and short call must have the same expiration date and exercise price. The short call is covered by the long stock and the long put is a right to sell the stock at a predetermined price—the exercise price of the long put. Thus, regardless of any decline in market value, the stock position, in effect, is worth no less than the exercise price of the put.

Current Amex margin rules specify that no maintenance margin would be required on the short call option because it is covered, but the underlying long stock position would be margined according to the present maintenance margin requirement (*i.e.,* 25 percent of the current market value).[36] Under the

[31] *See supra,* Section II.E., ''Cash Account Treatment of Butterfly Spreads and Box Spreads, Other Spreads, and Short Options.'' The margin requirements would apply to butterfly spreads where all option positions are listed or guaranteed by the carrying broker-dealer.

[32] As discussed above in Section II.D., ''Extension of Credit on Long Box Spread in European-Style Options,'' the margin requirement for a long box spread made up of European-style options is 50% of the aggregate differrence with the two exercise prices.

[33] The Exchange's proposal provides maintenance margin relief for the stock component (or other underlying instrument) of the five identified strategies. A reduction in the initial margin for the stock component of these strategies is not currently possible because the 50% initial margin requirement under Regulation T of the Federal Reserve Board continues to apply, and the Exchange does not possess the independent authority to lower the initial margin requirement for stock. *See* CBOE Approval Order, *supra* note 18, at footnote 33.

[34] For example, if an investor is long 100 shares of XYZ @ 52 and long one XYZ Jan 50 Put @ 2, the required margin would be the lesser of ((10%×50)+(100%×2)=7) or (25%×52=13). Therefore, the investor would be required to maintain margin equal to at least $700 (7×100). *See* CBOE Approval Order, *supra* note 18, at footnote 34.

[35] For each stock carried short that has a current market value of less than $5 per share, the maintenance margin is $2.50 per share or 100% of the current market value, whichever is greater. For each stock carried short that has a current market value of $5 per share or more, the maintenance margin is $5 per share or 30% of the current market value, whichever is greater. *See* Amex Rule 462(b). For example, for an investor who is short 100 shares of XYZ @ 48 and long 1 XYZ Jan 50 Call @ 1, the required margin would be the lesser of ((10%×50)+(100%×2)=7) or (30%×48=14.4). Therefore, the investor would be required to maintain margin equal to at least $700 (7×100). *See* CBOE Approval Order, *supra* note 18, at footnote 35.

[36] Suppose an investor who is long 100 shares of XYZ @ 48, long one XYZ Jan 50 Put @ 2, and short

Continued

proposal, the maintenance margin for a Conversion would be 10 percent of the aggregate exercise price.[37]

4. Reverse Conversion (Short Stock/Short Put/Long Call)

A ''Reverse Conversion'' is a short stock position held in conjunction with a short put and a long call. As with the Conversion, the short put and long call must have the same expiration date and exercise price. Regardless of any rise in market value, the stock can be acquired for the call exercise price, in effect, the short position is valued at no more than the call exercise price. The maintenance margin requirement for a Reverse Conversion would be 10 percent of the aggregate exercise price, plus any in-the-money amount (*i.e.,* the amount by which the aggregate exercise price of the short put exceeds the current market value of the underlying stock position).[38]

5. Collar (Long Stock/Long Put/Short Call)

A ''Collar'' is a stock position held in conjunction with a long put and a short call. A Collar differs from a Conversion in that the exercise price of the long put is lower than the exercise price of the short call. Therefore, the options positions in a Collar do not constitute a pure synthetic short stock position. The maintenance margin for a Collar would be the lesser of: (i) 10 percent of the long put aggregate exercise price, plus 100 percent of any amount by which the long put is out-of-the-money; or (ii) 25 percent of the short call aggregate exercise price.[39] Current Amex margin requirements specify that the stock may not be valued at more than the call exercise price.

H. Restructuring

The Exchange proposes to update other margin provisions with Amex Rule 462 to make its margin rule consistent with the 431 Committee's (which is comprised of industry representatives with diverse areas of expertise) recommendations. Specifically, the proposal would make some minor corrections to the table in Exchange Rule 462 that displays the margin requirements for short OTC options. The proposal also would revise and update provisions regarding straddle/combination in Amex Rule 462(d)10(B)(v) and would move those provisions to proposed Amex Rule 462(d)(10)(B)(vi)(c).[40] The proposal also would delete Commentaries .06–.08 of Amex Rule 462 because these provisions have been updated and relocated to other sections of the same rule.[41] Specifically, the Amex proposes to delete the margin provisions relating to capped style options in Commentaries .06 and .07 of Amex Rule 462 because the Amex has proposed new provisions relating to these options in Amex Rule 462(d)(10)(B).[42] The Amex also proposes to delete the Commentary .08 of Amex Rule 462 and current Amex Rule 462(d)(2)(O) concerning margin provisions relating to debit put spread positions in broad based European style index options because the Amex has now proposed new margin for spread provisions in Amex Rule 462(d)(2)(J).[43] Moreover, the Exchange proposes to delete the current provision in Commentary .09 of Amex Rule 462 relating to a margin rule regarding offset margin treatment for currency warrants, currency index warrants and listed options under a pilot program that has expired and therefore is not longer necessary.[44] The Amex also would move the rule text concerning margin fro certain short index options positions covered by positions in Portfolio Depositary Receipts or Index Fund Shares from current Amex Rule 462(d)(2)(H)(iv) and current Commentary .10 of the same rule to proposed Amex Rule 462(d)(10)(B)(ii)(c) and proposed Commentary .06 of the same rule to reflect the text language that was approved by the Commission in SR–Amex–98–33.[45] The Exchange also proposes to move the definition of ''cash equivalent'' from Commentary .03(c) of Amex Rule 462 to proposed Amex rule 462(d).[46]

I. Effect of Mergers and Acquisitions on the Margin Required for Short Options

The Exchange proposes to adopt proposed Commentary .10 to Exchange Rule 462 to provide an exception to the margin requirement for short equity options in the event trading in the underlying security ceases due to a merger or acquisition. Under this exception, if an underlying security ceases to trade due to a merger or acquisition, and a cash settlement price has been announced by the issuer of the option, margin would be required only for in-the-money options and would be set at 100 percent of the in-the-money amount.

J. Determination of Value for Margin Purposes

The proposal would revise Exchange Rule 462(d)1 to make it consistent with that portion of the Exchange's proposal that allows the extension of credit on certain long term options and warrants (*i.e.,* stock options, stock index options, and stock index warrants). Currently, Exchange Rule 462(d)1 does not allow certain long term options or warrants to have market value for margin purposes. The revision would allow options and warrants eligible for loan value under proposed Exchange Rules 462 to have market value for margin purposes. The Exchange believes that this change is necessary to ensure that the value of the marginable option or warrant (the collateral) is sufficient to cover the debit carried in conjunction with the purchase.

III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change is

one XYZ Jan 50 Call @ 1, the present maintenance margin on the long stock position would be $1,200 ((25% × 48) × 100). However, if the price of the stock increased to 60, the Amex currently specifies that the stock may not be valued at more than the short exercise price. Thus, the maintenance margin on the long stock position would be $1,250 ((25% × 50) × 100). The writer of the call option cannot receive the benefit (*i.e.,* greater loan value) of a market value that is above the call exercise price because, if assigned an exercise, the underlying component would be sold at the exercise price, not the market price of the long position. *See* CBOE Approval Order, *supra* note 18, at footnote 36.

[37] For the example in the preceding footnote, where the investor was long 100 shares of XYZ @ 48, long 1 XYZ Jan 50 Put @ 2, and short 1 XYZ Jan 50 Call @ 1, the proposed maintenance margin requirement for the Conversion strategy would be $500 ((10% × 50) × 100). *See* CBOE Approval Order, *supra* note 18, at footnote 37.

[38] The seller of a put option has an obligation to buy the underlying component at the put exercise price. If assigned an exercise, the underlying component would be purchased (the short position in the Reverse Conversion effectively closed) at the exercise price, even if the current market price is lower. To recognize the lower market value of a component, the short put in-the-money amount is added to the requirement. For example, an investor holding a Reverse Conversion may be short 100 shares of XYZ @ 52, long 1 XYZ Jan 50 Call @ 2½, and short 1 XYZ Jan 50 Put @ 1½. If the current market value of XYZ stock drops to 30, the maintenance margin would be $2,500 ((10 × 50) + (50 − 30)) × 100). *See* CBOE Approval Order, *supra* note 18, at footnote 38.

[39] To create a Collar, an investor may be long 100 shares of XYZ @ 48, long 1 XYZ Jan 45 Put @ 4, and short 1 XYZ Jan 50 Call @ 3. The maintenance margin requirement would be the lesser of ((10% × 45) + 3 = 7½) or (25% × 50 = 12½). Therefore, the investor would need to maintain at least $750 (7½ × 100) in margin. *See* CBOE Approval Order, *supra* note 18, at footnote 39.

[40] *See* Amendment No. 1, *supra,* note 4.

[41] *Id.*

[42] *Id.*

[43] *Id.*

[44] *Id.*

[45] *See* Securities Exchange Act Release No. 42605 (March 31, 2000), 65 FR 18395 (April 7, 2000) (SR-Amex–98–33).

[46] *Id.*

consistent with the Section 6(b)(5)[47] requirements that the rules of an exchange be designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and protect investors and the public interest. The Commission also finds that the proposal may serve to remove impediments to and perfect the mechanism of a free and open market by revising the Exchange's margin requirements to better reflect the risk of certain hedged options strategies.[48]

The Commission believes that it is appropriate for the Exchange to allow member firms to extend credit on certain long term options and warrants, and that such practice is consistent with Regulation T of the Federal Reserve Board. In 1996, the Federal Reserve Board amended Regulation T to enable the self-regulatory organizations (''SROs'') to adopt rules permitting the margining of options.[49] As noted above, the Amex rules approved in this order, which will permit the margining of options under the grant of authority from the Federal Reserve Board, are substantially identical to rules adopted recently by the CBOE and NYSE.[50]

The Commission believes that it is reasonable for the Exchange to restrict the extension of credit to long term options and warrants. The Commission believes that by limiting loan value to long term options and warrants, the proposal will help to ensure that the extension of credit is backed by collateral (*i.e.,* the long term option or warrant) that has sufficient value.[51] Because the expiration dates attached to options and warrants make such securities wasting assets by nature, it is important that the Exchange restrict the extension of credit to only those options and warrants that have adequate value at the time of the purchase, and during the term of the margin loan.[52]

The Commission believes that the proposed margin requirements for eligible long term options and warrants are reasonable. For long term listed options and warrants, the proposal requires that an investor deposits and maintains not less than 75 percent of the long term OTC's option's or warrant's current market value. For long term OTC options and warrants, an investor must deposit and maintain margin of not less than 75 percent of the option's or warrant's in-the-money amount (*i.e.,* its intrinsic value).[53] The Commission notes that the proposed margin requirements are more stringent than the current Regulation T margin requirements for equity securities (*i.e.,* 50 percent initial margin and 25 percent maintenance margin).

The Commission recognizes that because current Exchange rules prohibit loan value for options, increases in the value of long term options cannot contribute to margin equity (*i.e.,* appreciated long term options cannot be used to offset losses in other positions held in a margin account). Consequently, some customers may face a margin call or liquidation for a particular position even though they concurrently hold a long term option that has appreciated sufficiently in value to obviate the need for additional margin equity. The Exchange's proposal would address this situation by allowing loan value for long term options and warrants.

The Commission believes that it is reasonable for the Exchange to afford long term options and warrants loan value because mathematical models for pricing options and evaluating their worth as loan collateral are widely recognized and understood.[54] Moreover, some broker-dealers and The OCC, extend credit on options as part of their current business.[55] The Commission believes that because options market participants possess significant experience in assessing the value of options, including the use of sophisticated models, it is appropriate for them to extend credit on long term options and warrants.

Furthermore, since 1998, lenders other than broker-dealers have been permitted to extend 50 percent loan value against long listed options under Regulation U.[56] The Commission understands that the current bar preventing broker-dealers from extending credit on options may place some Amex member firms at a competitive disadvantage relative to other financial service firms. By permitting Exchange members to extend credit on long term options and warrants, the proposal should enable Exchange members to better serve customers and offer additional financing alternatives.

The Commission believes that it is appropriate for the Exchange to recognize the hedged nature of certain combined options strategies and prescribe margin and cash account requirements that better reflect the true risk of the strategy. Under current Exchange rules, the multiple positions comprising an option strategy such as a butterfly spread must be margined separately. In the case of a butterfly spread, the two component spreads (bull spread and bear spread) are margined without regard to the risk profile of the entire strategy. The net debit incurred on the bullish spread must be paid in full, and margin equal

[47] 15 U.S.C. 78f(b)(5).

[48] In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78f(c)(f).

[49] *See* Board of Governors of the Federal Reserve System Docket No. R–0772 (April 24, 1996), 61 FR 20386 (May 6, 1996), and 12 CFR 220.12(f).

[50] *See* Securities Exchange Act Release No. 42011 (October 14, 1999), 64 FR 57172 (October 22, 1999) (order approving SR–NYSE–99–03) (''NYSE Approval Order''); and *See* CBOE Approval Order, *supra* note 18.

[51] The value of an option contract is made up of two components: intrinsic value and time value. Intrinsic value, or the in-the-money-amount, is an option contract's arithmetically determinable value based on the strike price of the option contract and the market value of the underlying security. Time value is the portion of the option contract's value that is attributable to the amount of time remaining until the expiration of the option contract. The more time remaining until the expiration of the option contract, the greater the time value component.

[52] For similar reasons, the Commission believes that it is appropriate for the Exchange to permit the extension of credit on long box spreads comprised entirely of European-style options that are listed or guaranteed by the carrying broker-dealer. Because the European-style long box spread locks in the ability to buy and sell the underlying component or index for a profit, and all of the component options must be exercised on the same expiration day, the Commission believes that the combined positions have adequate value to support an extension of credit.

[53] *See* Amendment No. 2, *supra* note 5.

[54] For example, the Black-Scholes model and the Cox Ross Rubinstein model are often used to price options. *See* F. Black and M. Scholes, *The Pricing of Options and Corporate Liabilities,* 81 Journal of Political Economy 637 (1973), and J. C. Cox, S. A. Ross, and M. Rubinstein, *Option Pricing: A Simplified Approach,* 7 Journal of Financial Economics 229 (1979).

[55] In this regard, the Commission notes that the CBOE, in its options margin proposal, stated that ''[t]he fact that market-maker clearing firms and the Options Clearing Corporation extend credit on long options demonstrates that long options are acceptable collateral to lenders. In addition, banks have for some time loaned funds to market-maker clearing firms through the Options Clearing Corporation's Market Maker Pledge Program.'' *See* CBOE Approval Order, *supra* note 18.

[56] *See* Board of Governors of the Federal Reserve System Docket Nos. R–0905, R–0923, and R–0944 (January 8, 1998), 63 FR 2806 (January 16, 1998). In adopting the final rules that permitted non-broker-dealer lenders to extend credit on listed options, the Federal Reserve Board stated that it was:

> [A]mending the Supplement to Regulation U to allow lenders other than broker-dealers to extend 50 percent loan value against listed options. Unlisted options continue to have no loan value when used as part of a mixed-collateral loan. However, banks and other lenders can extend credit against unlisted options if the loan is not subject to Regulation U [12 CFR 221 *et seq.*].

The Federal Board first proposed margining options in 1995. *See* Board of Governors of the Federal Reserve System Docket No. R–0772 (June 21, 1995), 60 FR 33763 (June 29, 1995) (''[T]he Board is proposing to treat long positions in exchange-traded options the same as other registered equity securities for margin purposes.'').

to the exercise price differential must be deposited for the bearish spread.

The Commission believes that the revised margin and cash account requirements for butterfly spread and box spread strategies are reasonable measures that will better reflect the risk of the combined positions. Rather than view the butterfly and box spread strategies in terms of their individual option components, the Exchange's proposal would take a broader approach and require margin that is commensurate with the risk of the entire hedged position. For long butterfly spreads and long box spreads, the proposal would require full payment of the net debit that is incurred when the spread strategy is established.[57] For short butterfly spreads and short box spreads, the initial and maintenance margin required would be equal to the maximum risk potential. Thus, for short butterfly spreads comprised of call options, the margin must equal the aggregate difference between the two lowest exercise prices. For short butterfly spreads comprised of put options, the margin must equal the aggregate difference between the two highest exercise prices. For shore box spreads, the margin must equal the aggregate difference in the two exercise prices involved. In each of these instances, the net credit received from the sale of the short option components may be applied towards the requirement.

The Commission believes that the proposed margin and cash account requirements for butterfly spreads and box spreads are appropriate because the component options positions serve to offset each other with respect to risk. The proposal takes into account the defined risk of these strategies and sets margin requirements that better reflect the economic reality of each strategy. As a result, the margin requirements are tailored to the overall risk of the combined positions.

For similar reasons, the Commission approves of the proposed cash account requirements for spreads made up of European-style cash-settled stock index options, stock index warrants, or currency index warrants. Under the proposal, a short position would be considered covered, and thus eligible for the cash account, if a long position in the same European-style cash-settled stock index option, stock index warrant, or currency index warrant was held in, or purchased for, the account on the same day. In addition, the long and short positions must expire concurrently, and the cash account must contain cash, cash equivalents, or an escrow agreement equal to at least the aggregate exercise price differential.

The Commission believes that it is appropriate for the Exchange to revise the maintenance margin requirements for several hedging strategies that combine stock positions with option positions. The Commission recognizes that the hedging strategies such as the Long Put/Long Stock, Long Call/Short Stock, Conversion, Reverse Conversion, and Collar are designed to limit the exposure of the investor holding the combined stock and option positions. The proposal would modify the maintenance margin required for the stock component of a hedging strategy. For example, the stock component of a Long Put/Long Stock combination currently is margined without regard to the hedge provided by the long put position (*i.e.,* the 25 percent maintenance margin requirement for the stock component is applied in full). Under the proposal, the maintenance margin requirement for the Long Put/Long Stock combination strategy would be the lesser of: (1) 10 percent of the put option aggregate exercise price, plus 100 percent of any amount by which the put option is out-of-the money; or (2) 25 percent of the current market value of the long stock position. Although for some market values the proposed margin requirement would be the same as the current requirement, in many other cases it would be lower.[58] The Commission believes that reduced maintenance margin requirements for the stock components of hedging strategies are reasonable given the limited risk profile of the strategies.

The Commission notes that the proposed changes were reviewed carefully by the 431 Committee and the Options Subcommittee, which are comprised of industry participants who have extensive experience in margin and credit matters. In addition, as noted above, the Amex's proposal is substantially identical to rules adopted by the CBOE and the NYSE, which the Commission approved. In approving the CBOE's proposal, the Commission noted the CBOE's experience in monitoring the credit exposures of options strategies and the fact that the CBOE regularly examines the coverage of options margin as it relates to price movements in the underlying securities and index components.[59] Therefore, the Commission is confident that the proposed margin requirements are consistent with investor protection and properly reflect the risks of the underlying options positions.

The Commission notes that the margin requirements approved in this order are mandatory minimums. Therefore, an Exchange member may freely implement margin requirements that exceed the margin requirements adopted by the Exchange.[60] The Commission recognizes that the Exchange's margin requirements serve as non-binding benchmarks, and that Exchange members often establish different margin requirements for their customers based on a number of factors, including market volatility. The Commission encourages Exchange members to continue to perform independent and rigorous analyses when determining prudent levels of margin for customers.

The Commission also believes that it is reasonable for the Exchange to define ''butterfly spread'' [61] and ''box spread.'' [62] These definitions will specify which multiple options positions, if held together, qualify for classification as butterfly or box spreads, and consequently are eligible for the proposed cash and margin treatments. The Commission believes that it is important for the Exchange to clearly define which options strategies are eligible for the proposed margin treatment.

The Commission also believes that it is reasonable for the Amex to revise its definition of ''current market value'' and ''current market price'' in Amex Rule 462(d) to conform to Regulation T of the Federal Reserve Board. A linkage to the Regulation T definition should keep the Exchange's definition equivalent to Regulation T without requiring a rule filing if the Federal Reserve Board revises its definition of Regulation T of the Federal Reserve Board. In addition, the Commission believes that it is reasonable for the Amex to define an ''escrow agreement'' in respect of cash settled options or warrants,[63] and to

[57] However, for long box spreads made up of European-style options, the margin requirement is 50% of the aggregate difference in the two exercise prices.

[58] For example, for an investor who is long 100 shares of XYZ @ 52 and long 1 XYZ Jan 50 Put @ 2, the margin required under the proposal would be \$700—the lesser of ((10% × 50) + (100% × 2) = 7) or (25% × 52 = 13). In contrast, the current margin requirement would be \$1,300, a difference of \$600. *See* CBOE Approval Order, *supra* note 18, at footnote 63.

[59] *See* CBOE Approval Order, *supra* note 18.

[60] In this regard, the Commission notes that proposed Amex Rule 462(F) (which is currently Amex Rule 462(K)) permits the Exchange, at any time, to impose higher margin requirements than those set forth in this rule in respect to any option position(s) when it deems such higher margin requirements are appropriate.

[61] *See supra* note 8.

[62] *See supra* note 9.

[63] *See* Amendment No. 2, *supra* note 5.

revise the definition of ''escrow agreement'' in connection with non-cash settled options,[64] to establish clear requirements for these types of escrow agreements. The Commission also believes that it is reasonable for the Amex to define the term ''underlying stock basket'' [65] so that Amex Rule 462 can clarify when an underlying stock basket may serve as an offset or as a cover for an option or warrant on a market index carried short in a customer account.[66] It is also reasonable for the Exchange to codify a definition of ''OTC Margin Bond'' in its rule since this definition has been deleted from Regulation T by the Federal Reserve Board as of April 1, 1998. The Commission also believe that the Exchange's codification of the term ''listed'' [67] is appropriate in order to permit the Exchange to refer to this term, rather than specifying its meaning each time the term is used. It is also reasonable for the Exchange to move the definition of ''cash equivalent'' from Commentary .03(c) of Amex Rule 462 to Amex Rule 462(d). The Commission believes that this will make it easier for Exchange members to refer to the definition section of the Exchange margin rule because all the definition provisions will be set forth in Amex Rule 462(d).

The Commission believes that it is appropriate for the Exchange to revise Exchange Rule 462, ''Determination of Value for Margin Purposes,'' to allow the market value of certain long term stock options, stock index options, and stock index warrants to be considered for margin equity purposes. Under the current terms of Exchange Rule 462, options contracts are not deemed to have market value. Because the Exchange's proposal will allow extensions of credit on long term options and warrants, Exchange Rule 462 must be revised to permit such marginable options and warrants to have market value for margin purposes. The Commission notes that unless Exchange Rule 462 were revised to recognize the market value of the marginable options and warrants, the Exchange's loan value proposal would be ineffective (*i.e.,* the market value of an appreciated marginable security would not be recognized or allowed to offset any loss in value of other securities held in the margin account.)

The Commission believes that it is reasonable for the Exchange to codify as part of its rules the current margin requirements for short options on securities that have been delisted due to a merger or acquisition. Under the provision, if an underlying security ceases to trade due to a merger or acquisition, and a cash settlement price has been announced by the issuer of the option, margin would be required only for in-the-money options and would be set at 100 percent of the in-the-money amount. The Commission believes that it is appropriate for the Exchange not to require margin for out-of-the-money short options. Given that a fixed settlement price will have been announced by the issuer of the option (*e.g.,* The OCC) and trading in the delisted security will have stopped, the Commission believes that margin for the out-of-the-money short option contract is unnecessary because the intrinsic value of the option contract will not appreciate or vary such that the seller risks assignments (*i.e.,* the intrinsic value will remain nil). The Commission believes that because the intrinsic value of short in-the-money options will similarly remain fixed, it is reasonable to require margin that corresponds to 100 percent of the aggregate in-the-money amount.

The Commission also believes that it is reasonable for the Exchange to update and reorganize its margin provisions within Exchange Rule 462 so that Exchange members and other market participants will find the Exchange margin provisions easier to locate and use. The Commission believes that it is reasonable for the Exchange to rephrase and update some of the margin provisions that have been relocated. The margin revisions are designed to ensure consistency among exchanges margin rules (for example, between the Amex's, the CBOE's and the NYSE's margin rules). In some instances, changes proposed to one particular margin requirement impacted the requirements for other positions and products. In other instances, the Exchange simply revised language to clarify the meaning of a provision.

The revisions to the Exchange's margin rules will significantly impact the way Exchange members calculate margin for options customers. The Commission believes that it is important for the Exchange to be adequately prepared to implement and monitor the revised margin requirements. To best accommodate the transition, the Commission believes that a phase-in period is appropriate. Therefore, the approved margin requirements shall not become effective until the earlier of February 27, 2001 or such date as the Exchange represents in writing to the Commission and to its members that the Exchange is prepared to fully implement and monitor the approved margin requirements.

The Commission expects the Exchange to issue an information memorandum to members that discusses the revised margin provisions and provides guidance to members regarding their regulatory responsibilities. The Commission also believes that it would be helpful for the Exchange to publicly disseminate (*i.e.,* via web site posting) a summary of the most significant aspects of the new margin rules and provide clear examples of how various options positions will be margined under the provisions.

The Commission finds good cause for approving proposed Amendment Nos. 1 and 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register.**

Changes proposed in Amendment Nos. 1 and 2 will strengthen the proposal by making it consistent with the margin requirements supported by the 431 Committee. Because the changes conform the Amex's rule to existing rule recently adopted by the CBOE and NYSE,[68] the changes raise no new material regulatory basis.

Based on the above, the Commission finds that good cause exists, consistent with Section 19(b) of the Act,[69] to accelerate approval of Amendment Nos. 1 and 2 to the proposed rule change.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2, including whether Amendment Nos. 1 and 2 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., 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 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 Room. Copies of such filing will also be available for inspection and copying at

[64] *Id.*

[65] *See supra* note 14.

[66] *See* proposed Amex Rules 462(d)(I)(ii)(a), 462(d)(10)(B)(iii) and (iv).

[67] *See supra* note 13.

[68] *See* CBOE Approval Order, *supra* note 18, and *see* NYSE Approval Order, *supra* note 50.

[69] 15 U.S.C. 78s(b).

the principal office of the Amex. All submissions should refer to file number SR–Amex–99–27 and should be submitted by December 20, 2000.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[70] that the proposed rule change (SR–Amex–99–27), as amended, is approved. The approved margin requirements shall become effective the earlier of February 27, 2001 or such date the Exchange represents in writing to the Commission that the Exchange is prepared to fully implement and monitor the approved margin requirements.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[71]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–30378 Filed 11–28–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43588; File No. SR–Amex–00–46]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the American Stock Exchange LLC Adopting Commentary to Section 713 that Defines ''Public Offering'' for Purposes of Shareholder Approval Rules

November 17, 2000.

On August 16, 2000, the American Stock Exchange LLC (''Amex'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''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[3] adopting commentary to Section 713 that defines ''Public Offering'' for purposes of shareholder approval rules.[4] The proposed rule change was noticed in the **Federal Register**.[5] On October 13, 2000, the Amex filed Amendment No. 2 to the proposed rule change.[6] No comments were received on the proposed rule change. This order approves the proposed rule change, as amended.

I. Background

Section 713 of the Amex Company Guide requires shareholder approval for stock issuances of 20 percent or more of an issuer's total shares outstanding, offered at less than the greater of book or market value. The applicable rules further provide, however, that shareholder approval is not required for a ''public offering,'' although that term is not defined in the rules. The Exchange proposes to adopt Commentary .01 to Section 713, to clarify the definition of ''public offering'' for issuers and interested parties. According to the Amex, a number of issuers have recently inquired as to whether certain large, below-market offerings were ''public offerings'' because the transactions were registered with the Commission prior to closing the transactions.[7] The Exchange notes that historically, for purposes of assessing the applicability of the shareholder approval rules, it has interpreted ''public offering'' as a broadly distributed, registered offering based on a firm commitment underwriting. Conversely, the Exchange does not consider a transaction to be a ''public offering'' for these purposes when the transaction is of limited distribution and/or is not based on a firm commitment underwriting, even if the offering was registered. Because the offerings described above had limited distributions and, in some cases, offerees that were pre-determined by the issuer, the Exchange believes that these transactions were not ''public offerings'' for purposes of the shareholder approval rules.

The Amex expects that proposed Commentary .01 will help to ensure issuer understanding of how Amex determines whether a transaction is a ''public offering'' for purposes of shareholder approval rules. The proposed Commentary identifies a number of factors that will be considered in establishing the existence of a ''public offering.'' Such factors include the type of offering; the marketing of the offering; the extent of the offering's distribution; the offering price; and the extent to which the issuer controls the offering and its distribution. Decisions as to whether a transaction is a ''public offering'' for purposes of these rules will be based on the facts and circumstances surrounding each particular transaction.

II. Discussion

The Commission finds that the proposed rule change is consistent with Section 6(b) of the Act[8] in general, and furthers the objectives of Section 6(b)(5)[9] in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.[10] The Commission believes that the proposed Commentary to Section 713 is designed to educate issuers and other interested parties as to how the Exchange defines a ''public offering'' and ensure that issuers recognize which transactions require shareholder approval under the Exchange's rules, thus promoting just and equitable principles of trade and protecting investors and the public interest.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[11] that the proposal, SR–Amex–00–46, as amended, be and hereby is approved.

For the Commission, by the Division of Market Regualtion, pursuant to delegated authority.[12]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–30381 Filed 11–28–00; 8:45 am]

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[70] 15 U.S.C. 78s(b)(2).

[71] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The National Association of Securities Dealers, Inc., through its wholly owned subsidiary The Nasdaq Stock Market, Inc., filed a similar proposed rule change (SR–NASD–00–50). *See* Securities Exchange Act Release No. 43420 (Oct. 6, 2000), 65 FR 61011 (Oct. 13, 2000).

[4] The Amex filed its proposed rule change on August 16, 2000. On September 29, 2000, the Amex filed Amendment No. 1 that entirely replaced the original rule filing. *See* Letter from Michael J. Ryan, Senior Vice President, Chief of Staff and Senior Legal Officer, Amex, to Katherine A. England, Assistant Director, Division of Market Regulation (''Division''), Commission (September 29, 2000) (''Amendment No. 1''). In Amendment No. 1, the Amex also designated SR–Amex–00–46 as a proposed rule change under Section 19(b)(2) of the Act. 15 U.S.C. 78s(b)(2).

[5] Securities Exchange Act Release No. 43419 (Oct. 6, 2000), 65 FR 61206 (Oct. 16, 2000).

[6] Amendment No. 2 made a minor technical change to the proposal. *See* Letter from Claudia Crowley, Assistant General Counsel, Amex, to Florence Harmon, Esq., Senior Special Counsel, Division, SEC (Oct. 10, 2000). Because the amendment is technical, it does not need to be published for comment.

[7] The Commission believes that this activity is not appropriate under Section 5 of the Securities Act of 1933. *See* 15 U.S.C. 77e.

[8] 15 U.S.C. 78f(b).

[9] 15 U.S.C. 78f(b)(5).

[10] In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[11] 15 U.S.C. 78s(b)(2).

[12] 17 CFR 200.30–3(a)(12).