manipulator engaging in any actual stock transactions. He might prevent a move in the stock price or move the price merely by placing a large order just above or below the market which could momentarily influence the price of the stock in the opposite direction.

(2) Capping and Pegging

Effecting stock transactions to depress or prevent a rise in the price of a stock in order to prevent near-the-money, at-the-money, or slightly in-the-money call options from being exercised, and to protect a previously received premium, is referred to as capping. Similarly, effecting stock transactions to prevent a decline in the price of a stock, in order to assure that put options written on the stock will not be exercised and that premiums previously received will be protected, is referred to as pegging. These practices are most likely to occur just before expiration of the options series, when the probability of exercise is highest. Capping and pegging are forms of minimanipulation.

In one Commission administrative proceeding involving capping, 65/ an options specialist held a large short position (over 2,800 contracts) 66/ in slightly in-the-money calls. Near expiration, he began to sell substantial amounts (approximately 25,000 shares) of the underlying stock short, generally without noting on his order tickets that the stock was being sold short,

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65/ See, In the Matter of J. Newman & Co., et al. (Exchange Act Release No. 14384), January 17, 1978.

66/ Under the position limit rule of the AMEX, the specialist had obtained an exemption from the limit of 1,000 contracts on one side of the market.

thus avoiding the prohibition against short sales on "down ticks" 67/ designed to prevent the acceleration of a price decline. These sales had the effect of depressing the market price of the stock. The Commission, in ordering sanctions against the options specialist, found that these short sales were timed to satisfy and thus counteract buying pressure which would drive the price of the stock up and that on some occasions the respondents withdrew their orders or instructed their broker to lower the limits of their previously entered sell orders when other sellers appeared in the market. As a result of the specialist's short sales, the price of the underlying stock declined to the options' strike price at the expiration of the series and the options specialist did not receive assignments against his short options position. He thereby protected the premium income he had earned in establishing the short call position and also avoided the costs he would have had to incur to acquire or borrow the underlying stock to satisfy an exercise notice.

(3) Statutory prohibition of manipulation

Section 9(a)(2) of the Exchange Act makes it unlawful

> [t]o effect, alone or with one or more other persons, a series of transactions in *any security* registered on a national securities exchange creating actual or apparent active trading *in such security*, or raising or depressing the price of *such security*, for the purpose of inducing the purchase or sale of *such security* by others. (Emphasis added.)

67/ *See* 17 CFR 240.10a-1. The term "down tick" is used to describe a transaction at a price lower than the last previous transaction.

The underscored language has raised questions whether the antimanipulative prohibitions of Section 9(a)(2) apply to trading in both an option and the underlying stock in different markets, referred to as intermarket manipulation.

Rather than rely on Section 9(a)(2), other sections of the Exchange Act have been cited as prohibiting intermarket manipulative trading, including Section 10(b) which prohibits the use of "any manipulative or deceptive device or contrivance" and Rule 10b-5 thereunder which makes it unlawful "to employ any device, scheme, or artifice to defraud, . . . or to engage in any act, practice or course of business which operates or would operate as a fraud or deceit . . . , in connection with the purchase or sale of any security". 68/

The Commission, for example, has proceeded against intermarket manipulation on the basis of Rule 10b-5. 69/ Similarly, in an educational circular on the subject of manipulation, the CBOE took the position that conduct

> will be considered to be in violation of SEC Rule 10b-5 and CBOE rules if it involves inter-market manipulation, whether options to stock, stock to options, options series to options series, etc. 70/

68/ CBOE Education Circular No. 22 (September 15, 1978).

69/ See, *In the Matter of J. Newman & Co.*, *et al*. (Exchange Act Release No. 14384), January 17, 1978.

70/ CBOE Education Circular No. 22 (September 15, 1978).

Neither the Commission nor the courts, however, has resolved the ambiguity in the language of Section 9(a)(2) to make clear that intermarket manipulation, including stock-options manipulation, is prohibited by that Section. The Options Study believes such resolution should be made. Accordingly, the Options Study recommends:

> THE COMMISSION SHOULD ISSUE AN INTERPRETIVE RELEASE OR INITIATE RULEMAKING PROCEEDINGS SPECIFICALLY TO CLARIFY THAT INTERMARKET MANIPULATIVE TRADING ACTIVITY INVOLVING OPTIONS AND THEIR UNDERLYING SECURITIES MAY VIOLATE SECTION 9.

(4) Problems of proof and the need for data

In discussing the problem of proof of a manipulative purpose under Section 9(a), the Commission has stated

> since it is impossible to probe into the depths of a man's mind, it is necessary in the usual case (that is, absent an admission) that the findings of manipulative purpose be based on inferences drawn from circumstantial evidence. 71/

The classic stock manipulation typically involved a security with a relatively small number of shares held by public customers. A manipulator would slowly acquire a substantial number of shares over a fairly extended time period to constrict the supply of the stock. Then, by creating rumors or favorable recommendations about the company, or by effecting a small number of carefully timed purchases, the manipulator would cause a substantial increase in the market price of the stock. A sharp price rise would induce more investors to

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71/ The Federal Corporation, 25 SEC 227, 230 (1947).

purchase the stock and this trading activity would cause a further price rise. When the price had risen sufficiently, the manipulator would complete the manipulative scheme by selling his securities at the artificially higher prices for a substantial profit.

Options were often found to be an integral part of the classic manipulative schemes which occurred in the 1920's and which gave rise, in part, to the introduction of legislation which became the Exchange Act. In those instances, options (generally granted by the issuer of the underlying securities) were purchased by the manipulator to provide him, on exercise, with a ready supply of the underlying stock, which he could then profitably sell into the market at the inflated prices resulting from his manipulative activities. Due to the lack of any secondary trading market for options, there was no attempt by the manipulator to profit by selling the option itself. The existence of options was used as circumstantial evidence of the manipulative intent of the manipulator. In an early case, the Commission stated

> The very existence of an option when coupled with buying on the market by those having an interest in its exercise is an indication of purpose to raise the market price, to increase market activity and thus to distribute profitably the stock covered by the option. 72/

Modern-day stock/options minimanipulations may be of a quite different character from traditional stock manipulations, and because

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72/ Charles C. Wright, 3 SEC 190, 206 (1938), rev'd on other grounds sub. nom. Wright v. SEC, 112 F.2d 89 (CA 2, 1940).

many legitimate strategies involve stock and options transactions, manipulative intent cannot be demonstrated simply by showing that a person held both options and related stock. The manipulator may have established his options position in the course of legitimate trading and thereafter decided to effect stock transactions in order to profit from the options position. Since the minimanipulation requires only a small change in price of the underlying stock for a brief period, and because of the present difficulty of precisely reconstructing the actual timing of related stock and options transactions, 73/ manipulative transactions become very difficult to distinguish from the legitimate activities of market professionals who are continuously trading stock and options in quantities sufficient to affect prices of both securities.

The circumstantial evidence necessary to support a charge of minimanipulation, moreover, is often difficult to establish because of the existence of several options series in each class and the likelihood of a market professional holding long and short positions simultaneously in different series. Transactions which appear to be done with the intent of benefiting a position in one options series may be explained as necessary to carry out some legitimate trading strategy. The trader may claim, for example, that the apparent manipulative transaction was part of a legitimate hedging strategy entered into solely to limit

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73/ See Chapter IV with respect to the difficulties of reconstructing stock trading on NYSE.

market risk in another series. Indeed, surveillance officials at one exchange indicated that "if we feel there is a logical explanation [of questionable stock/options trading] we won't bring the case." This, of course, is not dispositive of whether there has, in fact, been a manipulation.

The following example of possible minimanipulation demonstrates a situation in which a trade may be either a manipulation or a legitimate hedging transaction, depending upon the actual intent of the trader. A firm's proprietary account was long 147 July 45 call options, short 167 July 50 call options and short 3,400 shares of the underlying stock. The firm sold 10,000 shares of stock at 49-7/8 and 50 and then bought 141 July 50 calls to substantially close its short options position. While the stock sales may have been part of a manipulation to permit the firm to close out the short position in the July 50 series at a favorable price, the firm said its short stock sales were designed to hedge the long position in the July 45s against a price decline.

Because of the difficulty in proving alleged minimanipulations, and the absence of well-defined legal standards in this area, it appears desirable to examine stock/option trading patterns in greater detail than has been possible for the Options Study and to determine if certain trading patterns should be prohibited by rules adopted by the self-regulatory organizations or by the Commission.

Proscriptive rules in this area should be tailored to avoid unnecessary impact upon legitimate trading activity. The Options Study understands that the NYSE and options exchanges have agreed to exchange information which will provide an integrated data base of stock and options transactions. Such a data base is essential to a proper analysis of stock and option trading patterns. This information can be used to determine the need for and the exact nature of any rules to regulate patterns of related stock and option trading. In addition, the self-regulatory organizations have collected new information which may help the Commission and the self-regulatory organizations to identify trading patterns that may be appropriate subjects of antimanipulative rules. Accordingly, the Options Study recommends:

THE SELF-REGULATORY ORGANIZATIONS SHOULD USE THE INTEGRATED SURVEILLANCE DATA BASE THAT THEY ARE ESTABLISHING FOR STOCK AND OPTIONS TRADING TO DETECT UNLAWFUL TRADING ACTIVITIES AND CONDUCT APPROPRIATE ENFORCEMENT ACTIONS AND TO IDENTIFY PATTERNS OF STOCK AND OPTIONS TRADING THAT SHOULD BE REGULATED OR PROHIBITED. THE COMMISSION AND THE SELF-REGULATORY ORGANIZATIONS SHOULD WORK TOGETHER TO ESTABLISH PRIORITIES FOR THESE STUDIES AND THE SELF-REGULATORY ORGANIZATIONS SHOULD REGULARLY REPORT THE RESULTS OF THE STUDIES THAT THEY CONDUCT TO THE COMMISSION.

Additionally, the Options Study recommends:

THE DIVISION OF MARKET REGULATION SHOULD OBTAIN AND REVIEW ALL INSTANCES OF OPTION AND STOCK TRADING WHICH ARE OR HAVE BEEN THE SUBJECT OF INFORMAL OR FORMAL INVESTIGATIONS BY THE SELF-REGULATORY ORGANIZATIONS. THE DIVISION OF MARKET REGULATION SHOULD REVIEW THIS DATA WITH A VIEW TOWARD PROPOSING ANTI-MANIPULATIVE OPTIONS AND STOCK TRADING RULES, WHERE APPROPRIATE.

e. Front-running

The leverage offered by options, which permits substantial percentage gains on a small capital investment, and the existence of a liquid market for options have created new opportunities for profitable options trading based on non-public market information. One method of taking advantage of this information is "front-running" which the Commission has defined as the practice of trading a security while in possession of unreported information concerning a block transaction in the same or related security." 74/ The Commission has stated that such conduct constitutes an unfair use of non-public market information and is prohibited, at a minimum, by exchange rules which prohibit conduct inconsistent with just and equitable principles of trade.

The following is an example of front-running. A block positioner obtains market information concerning a potential block transaction in the normal course of his business as a result of an institutional customer's inquiry concerning a contemplated sale of stock. If a block positioner is aware of a forthcoming block sale which will be reported at less than the current market and writes calls before the price of the calls reflects the block transaction, he would receive a greater premium than if he had written those calls after their price moved to reflect the effect of the block sale on the price of stock and related options. For example, assume XYZ stock

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74/ Securities Exchange Act Release No. 14156, November 19, 1977, (Letter from George A. Fitzsimmons, Secretary, Securities and Exchange Commission to Joseph W. Sullivan, President, CBOE).

is trading at 50 and a call option with a strike price of 50 and with one or two months to expiration is trading at 2. Assume further that a block positioner, knowing that he is going to bid 49 for a block of 30,000 shares of XYZ stock, sells 300 XYZ 50 calls at 2 and subsequently executes the equity block transaction at 49. The purchasers of the calls, however, would not have paid $2 if they knew that a block of the underlying stock was going to trade at 49, which would likely have caused a drop in the price of the option.

While option trading based on such market information may permit a block positioner to hedge his risk and thus make a better bid to a customer, it gives the block positioner a market information advantage over other market participants. Trading based on that market information is inconsistent with the notion of fair and honest markets and just and equitable principles of trade. 75/

75/ In the above example, the block positioner was trading on the basis of his customer's stock orders. It would, of course, also be possible for a market participant to trade options after deciding to purchase or sell a substantial amount of the underlying stock for his own account but before effecting the stock transactions. The Commission has not yet specifically considered whether "self-front-running" is inconsistent with just and equitable principles of trade or the antifraud provisions of the Exchange Act. Nonetheless, "such behavior on the part of persons with knowledge of imminent transactions which will likely affect the price of the derivative security [may constitute] an unfair use of such knowledge." Securities Exchange Act Release No. 14156, *supra*.

Although the most obvious instances of front-running occur after all the terms of the block transaction have been agreed to, front-running may profitably occur at an earlier time. For example, knowledge that there is either a buyer or a seller of a block may provide a front-running opportunity even without definite knowledge of the price at which the block will trade. Block trades initiated by buyers and sellers have been found to accompany a change in the market price of the underlying stock by about one percent upward and downward, respectively (as measured from the previous close to the close on the day of the block transaction). 76/ Accordingly, while the propriety of such transactions can best be evaluated on a case-by-case basis, it would appear that front-running can and should be found to have occurred in instances where the firm effecting the options transactions has sufficient market information concerning a particular potential block transaction to permit it a material advantage over other market participants.

76/ Institutional Investor Study, Volume 4, p. 1825. (1971). The findings of the Institutional Investor Study predate the commencement of listed option trading. Listed option trading may have reduced somewhat the amount of price movement associated with stock transactions in underlying stocks because of the ability of block positioners to reduce risk by using options, although no conclusive evidence is yet available.

Broker-dealers follow disparate practices regarding their treatment of front-running. After the CBOE filed its proposed front-running rule in 1976, 77/ some firms adopted "in-house" rules (generally unwritten) prohibiting front-running. These rules vary as to the timing of the option transaction relative to the dissemination of information regarding the stock transaction, the method of disseminating the information regarding an impending block transaction, the definition of a block, and the price of the block in relation to the current market for the stock. This lack of uniformity highlights the need for a regulatory prohibition against front-running which applies the same standards to all market participants.

To date no disciplinary actions have been completed by any options exchange in the area of front-running, although instances of possible front-running have been detected by the exchanges through their existing surveillance programs. Inaction by some self-regulatory organizations seems to have been either a result of a difference of opinion regarding the unfairness of front-running activities, inadequate exchange rules, or lack of a precise definition in this area. For example, in the past the AMEX has not initiated disciplinary actions against its members when instances of apparent front-running have been detected. Rather, they have accepted the argument that the option transaction, when executed prior to the block transaction, is an appropriate hedging strategy

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77/ Securities Exchange Act Release No. 12400 (May 3, 1976).

by the block positioner. The AMEX, however, has recently revised its policy on the subject of front-running and no longer views the hedging argument as a valid rationale for a members' front-running conduct. Although its by-laws prohibit conduct which is inconsistent with just and equitable principles of trade, 78/ the PHLX, prior to the Commission's release in November, 1977, 79/ failed to proceed against front-running on the theory that its rules only prohibit members' trading based on non-public market information obtained on the floor 80/ and the market information regarding a pending block is invariably obtained upstairs as a result of an institutional customer's inquiry. This rationale, however, should no longer prevent the initiation of enforcement procedings in the area of front-running.

The CBOE, which also detected instances of front-running by its members, first attempted to proceed against the practice by rulemaking. After an initial rule filing with the Commission, and receipt of the Commission's comments, the CBOE withdrew its proposed rule and issued an educational circular for its members concerning the applicability to front-running of existing CBOE Rule 4.1, which prohibits conduct by members which is inconsistent with just and equitable principles of trade. 81/ The educational circular contains a discussion and

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78/ See PHLX By-Laws, Section 18-7.

79/ See note 74, supra.

80/ See PHLX rule 1016.

81/ CBOE Educational Circular No. 23 (October 10, 1978).

examples of conduct involving front-running of blocks that the CBOE considers to be a violation of its Rule 4.1. The circular also makes it clear that, while it concentrates on members' proprietary trading, certain situations, such as where a member passes on non-public information concerning block transactions to a customer who then trades on the basis of the information, may also result in a violation of the CBOE's prohibition against conduct which is inconsistent with just and equitable principles of trade.

The CBOE circular states that front-running may be based upon knowledge of less than all the terms of the transaction, if there is knowledge that all the material terms of the transaction have been or will be imminently agreed upon. Transactions over 10,000 shares are conclusively deemed to be blocks and transactions of less than 10,000 shares may be deemed blocks in appropriate cases.

The issuance of an educational circular, such as the CBOE circular, is an appropriate first step by a self-regulator to provide guidance for its members on the subject of front-running. Front-running is an appropriate subject for regulatory attention and definition in order to put market participants on notice regarding the bounds of permissible conduct.

Accordingly, the Options Study recommends:

> ALL SELF-REGULATORY ORGANIZATIONS SHOULD (1) ISSUE INTERPRETATIONS OF THEIR RULES TO MAKE CLEAR THAT FRONT-RUNNING IS INCONSISTENT WITH JUST AND EQUITABLE PRINCIPLES OF TRADE BY ITS MEMBERS AND, (2) TAKE PROMPT DISCIPLINARY ACTION AGAINST THOSE MEMBERS WHO HAVE BEEN FOUND TO HAVE ENGAGED IN FRONT-RUNNING.

Another method of taking advantage of market information regarding the underlying stock through transactions in the options markets is referred to as tape racing, which refers to the trading of options based on last sale information regarding the underlying stock before such information has been disseminated over the consolidated transaction reporting system. Tape racing is made possible by inefficiencies in the system by which information regarding executed trades in underlying stock is transmitted from the floor of the exchange (generally the NYSE) where the underlying stocks are traded. Persons who observe trades or have access to last sale information before it is disseminated may be able to transmit options orders reflecting that information to the floors of option exchanges and have such orders executed at favorable prices prior to the availability of the last sale information on the consolidated transaction reporting system.

Tape racing appears to have been largely eliminated by speeding the process of entering transaction information into the consolidated transaction reporting system and the availability of last sale information from the NYSE.

5. TRADING RULES

a. Position limit rules

Each options exchange has rules which prohibit any account from having a position in excess of 1,000 contracts on the same

side of the market. 82/ These rules were adopted by the options exchanges primarily to minimize manipulative potential and to prevent the accumulation of large options positions that, if exercised against uncovered writers, would cause them to buy the underlying stock which would likely affect the price of the underlying stock. The position limit rules have the additional effect of limiting the financial exposure of market participants.

The present position limit rules prevent certain larger investors (primarily institutions) from writing calls or buying puts against more than 100,000 shares of stock. As a result, the managers of certain large portfolios do not presently use options because writing options up to existing position limits does not provide significant risk limiting capabilities for such large portfolios. To the extent that large investors own the stock underlying the options they write they need not purchase stock to deliver on exercise of the calls they write or the puts they buy and, therefore, may not need to effect transactions which will substantially affect stock prices. As a result, a significant portion of the theory underlying the position limit rules may not be applicable to such covered investors.

82/ CBOE rule 4.11, which is typical of these rules, prohibits a member from making an opening transaction for any account in which it has an interest or for the account of any customer if the transaction would result in "an aggregate position in excess of 1,000 option contracts (whether long or short) of the put class and the call class on the same side of the market covering the same underlying security."

Further, market liquidity may be adversely effected by the present level of position limits. For example, proprietary option trading by member firms is limited to the extent that positions in excess of 1,000 option contracts on any side of the market cannot be established. Since other proprietary option business may be conducted by the firm at the same time, its position limits may be "used up" through different option activities, including hedging block transactions or arbitrage, thus precluding other options transactions.

In addition, numerous market participants, including professional traders, institutional investors, and self-regulatory organizations, have maintained that the position limit rules should generally be liberalized or otherwise modified. Further, the ability of some self-regulatory organizations to grant their marketmakers exceptions from this rule and the manner and frequency with which exceptions have been granted, has raised concern that the rule currently has an unequal impact on members of different self-regulatory organizations. It has been suggested that either the rules be made uniform for all market participants or that the self-regulatory organizations be permitted to liberally grant exceptions, especially in instances where a marketmaker might otherwise violate the rule when fulfilling his obligation to trade with public customers.

There are a number of approaches which might be followed if modification or position limit rules is deemed appropriate. One

would be to completely eliminate such restrictions, thereby permitting option positions to be established without limitation. Another would be to increase the level of position limits to 2,000 contracts (or some other amount). Alternatively, a sliding scale position limit rule could be imposed based on the liquidity, trading volume or price of the underlying security. Different position limits for hedged positions as opposed to unhedged positions 83/ might be employed on the theory that the former offers less manipulative potential than the latter. 84/ Finally, consideration could be given to establishing position limits based on a financial integrity standard, *i.e.*, well-capitalized firms might have a lesser restriction than dealers whose capitalization is below some specified amount.

Accordingly, the Options Study recommends:

THE DIVISION OF MARKET REGULATION SHOULD UNDERTAKE A COMPLETE REVIEW OF THE POSITION LIMIT RULES OF THE OPTIONS EXCHANGES. THIS REVIEW SHOULD INCLUDE: (1) THE POSSIBILITY OF ELIMINATING POSITION LIMIT RULES, (2) THE FEASIBILITY OF RELAXING POSITION LIMIT RULES FOR (a) ALL MARKET PARTICIPANTS, (b) FOR ACCOUNTS WHICH HOLD FULLY PAID, FREELY TRANSFERABLE SECURITIES OR (c) FOR "HEDGED" POSITIONS, AND (3) WHETHER EXCEPTIONS FROM THE RULES SHOULD BE GRANTED TO OPTIONS SPECIALISTS AND, IF SO, UNDER WHAT CIRCUMSTANCES.

83/ Under the rules promulgated by the Commodities Futures Trading Commission, positions which are deemed to be bona fide hedging transactions (as defined) are exempted from position limit rules, *see*, *e.g.*, 17 CFR 150.1 (c)(i).

84/ The manner in which hedged positions may be established and eliminated may, however, present questions with respect to self-front-running. *See* note 75, *supra*.

b. <u>Restricted options rules</u>

As a result of concerns raised by the Commission shortly after listed options trading began, the options exchanges adopted so-called "restricted option rules" which were designed to prevent unwarranted speculation in deep-out-of-the-money options. The rules prohibit customers and firms from entering any order for an opening transaction (purchasing or writing) in any option which is more than $5 out-of-the-money and is trading for less than $.50 per unit of trading. There are certain exceptions for covered writing transactions, spreads and marketmaker transactions. 85/

The rules are premised on a belief that as options become deep-out-of-the-money, they may be improperly sold to public customers who do not understand the high probability that the options will expire worthless. In view of its findings, as described in the Chapters V and VI, the Options Study concurs in these concerns. Nonetheless, as the options trading markets have expanded, new uses for restricted options have been developed. Numerous market professionals have advised the Options Study that currently restricted options could be utilized in a variety of ways.

For instance, although spreads in which an equal number of options contracts are purchased and sold are excepted from the restricted options rules, it is not possible to alter the risk/reward parameters

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85/ *See, e.g.*, CBOE rule 4.17(b) and (c).

of such spreads by purchasing or selling additional restricted options. One commentator, an investment advisor who uses options extensively, described a spread involving the purchase of an out-of-the-money option which might be restricted and the sale of a lower strike price option and stated:

> A potentially more rewarding, as well as prudent strategy would be to buy several of the restricted options for every single lower strike price option sold. 86/

Further, the restricted options rules result in pricing inefficiencies and a loss of liquidity. When a previously unrestricted option becomes restricted, a holder of such option is left with a limited market because a large number of potential buyers is barred from the marketplace. This lack of liquidity has also affected potential buyers. The trader at one large investment advisor to a number of investment companies told the Options Study that:

> we have occasionally encountered difficulty in repurchasing a substantial number of [restricted] options because the dealer is unable to position such options because of the restricted option rule. 87/

In addition, a recent study demonstrates that the purchase of deep-out-of-the-money options with a small portion of an investor's capital while placing the remainder in money market instruments is a relatively conservative strategy which would have proved viable over the 12 year

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86/ Letter dated September 20, 1978 from F. Martin Koeing, Chase Investors Management Corporation New York, in response to Securities Exchange Act Release No. 14854 at 11.

87/ Letter dated August 18, 1978 from Richard F. Palmer, Colonial Management Associates, Inc. to Kenneth S. Spirer, Assistant Director, Options Study.

period tested. 88/ However, the general strategy of buying calls in connection with the purchase of money market instruments has been infrequently used by public investors. 89/

The regulatory concerns underlying the restricted options rules relate in large part to desires to protect investors who may not fully appreciate the risk involved in purchasing deep-out-of-the-money options. The Options Study has made a number of recommendations designed to insure that options customers will understand the risks of option trading and to improve the internal procedures of broker-dealers in furtherance of this objective. 90/

The Options Study believes that improvements in the customer suitability area may, at a future date, allow the elimination of the restricted options rules. Accordingly, the Options Study recommends:

THE DIVISION OF MARKET REGULATION SHOULD CONSIDER THE ELIMINATION OF THE RESTRICTED OPTIONS RULES AS SOON AS THE OVERALL EFFECTIVENESS OF THE OPTIONS STUDY'S SUITABILITY RECOMMENDATIONS CAN BE EVALUATED.

88/ Merton, Robert C., Scholes, Myron S., and Gladstein, Matthew L., "The Returns and Risk of Alternative Call Option Portfolio Investment Strategies," The Journal of Business, April 1978.

89/ See note 54, supra.

90/ See Chapter II.