

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57413; File No. SR-FINRA-2008-007)

March 3, 2008

Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change to Make Permanent a Pilot Program That Increases Options Position and Exercise Limits

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 28, 2008, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by FINRA. FINRA has designated this proposal as non-controversial under Section 19(b)(3)(A)(iii) of the Act³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposed rule change effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

FINRA seeks to amend NASD Rule 2860 (Options) to make permanent a pilot program that increases options position and exercise limits. In addition, FINRA proposes to amend NASD IM-2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the proposed permanent position limits. The text of the proposed rule change

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(6).

is available on FINRA's Web site (<http://www.finra.org>), at FINRA's principal office, and at the Commission's Public Reference Room.

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

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

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

1. Purpose

FINRA is proposing amendments to its options position and exercise limits in NASD Rule 2860 to make permanent a pilot program that increases position and exercise limits for both standardized and conventional options.⁵ In addition, FINRA proposes to amend NASD IM-

⁵ A "conventional option" is an option contract not issued, or subject to issuance by, the Options Clearing Corporation. See NASD Rule 2860(b)(2)(O). Currently, position limits for standardized and conventional options are the same with respect to the same underlying security. The proposed rule change would maintain this parity between standardized and conventional options. FINRA has maintained parity between conventional and standardized options since 1999. See Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930, 2931 (January 19, 1999) (SR-NASD-98-92). Before 1999, position limits on conventional options were three times greater than the limits for standardized options. See Securities Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23).

FINRA's limits on standardized equity options are applicable only to those members that are not also members of the exchange on which the option is traded; the limits on conventional options are applicable to all FINRA members. NASD Rule 2860(b)(1)(A); see also Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930, 2931 (January 19, 1999) (SR-NASD-98-92).

2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the proposed permanent position limits.

NASD Rule 2860(b)(3) subjects standardized and conventional options to one of five different position limits. Options exercise limits, which are set forth in NASD Rule 2860(b)(4), and which incorporate by reference the position limits in Rule 2860(b)(3), also would increase. The original pilot program became effective on March 30, 2005, and has been extended five times. It was scheduled to expire on March 1, 2008.⁶ FINRA is proposing to make the pilot program permanent in order to preserve the benefits to the marketplace from the higher levels. The proposed rule change also is substantively identical to a proposal by the Chicago Board Options Exchange, Inc. recently approved by the Commission.⁷ FINRA anticipates all other self-regulatory organizations (“SROs”) with the pilot program also will seek to make their program permanent. Thus, the proposed rule change will ensure that FINRA’s position limits are consistent with those of other SROs.

Position and Exercise Limits

The standard position limits were last increased nine years ago, on December 31, 1998.⁸ Since that time, there has been a steady increase in the number of accounts that approach the position limit or have been granted an exemption to the applicable position limit. To the best of

⁶ See Securities Exchange Act Release Nos. 52271 (August 16, 2005), 70 FR 49344 (August 23, 2005) (SR-NASD-2005-097); 53346 (February 22, 2006), 71 FR 10580 (March 1, 2006) (SR-NASD-2006-025); 54334 (August 18, 2006), 71 FR 50961 (August 28, 2006) (SR-NASD-2006-097); 55225 (February 1, 2007), 72 FR 6634 (February 12, 2007) (SR-NASD-2007-007); and 56265 (August 15, 2007), 72 FR 47102 (August 22, 2007) (SR-FINRA-2007-002).

⁷ See Securities Exchange Act Release No. 57352 (February 19, 2008), 73 FR 10076 (February 25, 2008) (SR-CBOE-2008-07).

⁸ See Securities Exchange Act Release No. 40875 (December 31, 1998), 64 FR 1842 (January 12, 1999).

FINRA's knowledge, during the operation of the pilot program, there have been very few violations of the position limits or exercise limits and none of these violations were deemed to be a result of manipulative activities.

Growth in Options Market

Since the last position limit increase, there has been an exponential increase in the overall volume in options trading. Part of this volume is attributable to a corresponding increase in the number of overall market participants. This growth in market participants has in turn brought about additional depth and increased liquidity in options trading. FINRA has no reason to believe that the current trading volume in equity options will not continue. Rather, FINRA expects continued options volume growth as opportunities for investors to participate in the options markets increase and evolve. FINRA believes that the non-pilot position and exercise limits might constrain liquidity in the options markets.

Manipulation

Since the last position limit increase, and throughout the duration of the pilot program, FINRA has not encountered any significant regulatory issues regarding the applicable position limits. Moreover, FINRA believes that there is a lack of evidence of market manipulation schemes, which justifies the proposed permanent approval of the pilot program. FINRA believes that its existing surveillance procedures and reporting requirements are reasonably designed to detect unusual and/or illegal trading activity. FINRA represents that its surveillance and reporting mechanisms (which have been significantly enhanced since the last position limit increase in 1999) will serve to adequately address any concerns the Commission may have with respect to account(s) engaging in any manipulative schemes resulting from position limit violations.

No Adverse Consequences from Past Increases

Equity option position limits have been gradually expanded from 1,000 contracts in 1973 to the current level of 75,000 contracts for the largest and most actively traded equity options. To date, FINRA is unaware of any adverse effects on the markets as a result of these past increases in the limits for equity option contracts.

2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,⁹ which requires, among other things, that FINRA rules must be 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. The proposed rule change would make permanent a pilot program increasing options position and exercise limits. FINRA's experience administering the higher limits of the pilot program over the past three years has not revealed any adverse concerns or any other reasons to suggest that such limits should not be made permanent.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

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

FINRA has designated the proposed rule change as one that: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant

⁹ 15 U.S.C. 78o-3(b)(6).

burden on competition; and (3) does not become operative for 30 days from the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. Therefore, the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹¹ FINRA notes that the proposed rule change is based on a similar proposal recently approved by the Commission.¹² FINRA has asked the Commission to waive the operative delay to permit the proposed rule change to become operative prior to the 30th day after filing.

The pilot program expanding position and exercise limits on standardized and conventional options was scheduled to expire on March 1, 2008. The Commission believes that waiving the 30-day operative delay of FINRA's proposal is consistent with the protection of investors and the public interest because it will allow the position and exercise limits to remain at consistent levels during the transition from the pilot program to permanent status.¹³ Therefore, the Commission designates the proposal to be operative upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. FINRA has fulfilled this requirement.

¹² See Securities Exchange Act Release No. 57352 (February 19, 2008), 73 FR 10076 (February 25, 2008) (order granting accelerated approval to SR-CBOE-2008-07).

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File No. SR-FINRA-2008-007 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR- FINRA-2008-007. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commissions Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00

¹³ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

p.m. Copies of such filing also will be available for inspection and copying at the principal office of FINRA. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-FINRA-2008-007 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁴

Florence E. Harmon
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).