

## SECURITIES AND EXCHANGE COMMISSION

### 17 CFR Part 230

[Release No. 33–8049; File No. S7–19–98]

RIN 3235–AH31

### Options Disclosure Document

**AGENCY:** Securities and Exchange Commission.

**ACTION:** Final rule.

**SUMMARY:** We are adopting a revision to a rule under the Securities Act of 1933 to clarify that an options disclosure document prepared in accordance with our rules under the Securities Exchange Act of 1934 is not a prospectus and is not subject to civil liability under Section 12(a)(2) of the Securities Act. This amendment codifies a long-standing interpretive position taken by the Division of Corporation Finance soon after we adopted the current registration and disclosure system applicable to standardized options in 1982. We are codifying this position to reduce the legal uncertainty regarding the liability issue.

**EFFECTIVE DATE:** February 1, 2002.

**FOR FURTHER INFORMATION CONTACT:** Ray Be, Special Counsel, at (202) 942–2910, Division of Corporation Finance, U.S. Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0312.

**SUPPLEMENTARY INFORMATION:** We are adopting a revision to Rule 135b<sup>1</sup> under the Securities Act of 1933.<sup>2</sup>

### I. Background

In 1998, we issued a release proposing an amendment to Rule 135b under the Securities Act to clarify that an options disclosure document prepared in accordance with Rule 9b–1 under the Securities Exchange Act of 1934 is not a prospectus and, accordingly, is not subject to civil liability under Section 12(a)(2) of the Securities Act.<sup>3</sup>

This clarification is consistent with the original intent of the simplified registration and disclosure system for standardized options that we adopted in 1982.<sup>4</sup> Under this system, the issuer of

the standardized options, generally a clearing corporation, may register the options under the Securities Act on Form S–20.<sup>5</sup> This form is quite streamlined. The Form S–20 prospectus includes limited information about the clearing corporation issuer and the options being registered.<sup>6</sup> The registration statement includes additional information about the issuer's directors and executive officers and legal proceedings as well as its financial statements.

Investors are informed about the general characteristics of standardized options and the rules of options trading through a separate disclosure document we refer to as the “options disclosure document” or the “ODD.” The ODD must meet the informational requirements of Rule 9b–1 under the Exchange Act. In addition to setting forth what information must be disclosed in the ODD, Rule 9b–1 requires brokers and dealers to furnish a copy of the ODD to a customer before or at the time they approve that customer's account or accept the customer's order to trade options covered by the ODD. The exchanges on which the registered options trade work closely with the clearing corporation to prepare and update the ODD.<sup>7</sup>

We adopted the simplified registration and disclosure system applicable to standardized options primarily to reduce the expense of preparing and updating a detailed prospectus, and to provide investors with a document that is easier to read and understand than a traditional options prospectus.<sup>8</sup> Securities Act Rule 135b and its adopting release provide that an ODD prepared in accordance with Rule 9b–1 under the Exchange Act “shall not be deemed to constitute an offer to sell or offer to buy any security” for purposes only of Section 5 of the Securities Act.<sup>9</sup> In that adopting release, we stated that “[f]or purposes of

dates and exercise prices, or such other securities as the Commission may, by order, designate.”

<sup>5</sup> 17 CFR 239.20.

<sup>6</sup> Rule 153b [17 CFR 230.153b] allows the issuer to satisfy its Securities Act Section 5(b)(2) [15 U.S.C. 77e(b)(2)] prospectus delivery requirement by delivering copies of the prospectus to each exchange on which the options are traded. The exchange then must deliver the prospectus to options customers upon request.

<sup>7</sup> See Release No. 34–43461 (Oct. 19, 2000) [65 FR 64137].

<sup>8</sup> Release No. 33–6426, see note 3 above; see also Release No. 33–6494, n.2 (Oct. 27, 1983) [48 FR 51328] (discussing the Commission's 1979 Special Study of the Options Market, recommending the simplified registration and disclosure scheme).

<sup>9</sup> 15 U.S.C. 77e. However, as stated in the release proposing Rule 135b, the ODD is subject to liability under the antifraud provisions of the federal securities laws. See Release No. 33–6411 (June 24, 1982) [47 FR 28688].

clarification, it should be noted that if the disclosure document is deemed not to be an offer to sell or buy, it cannot be deemed to be a prospectus.”<sup>10</sup> In addition, we stated that Rule 135b “is intended to relieve the preparers of the disclosure document from liability under Section 12(1) [now Section 12(a)(1)] of the [Securities] Act for distributing a disclosure document to investors which might, absent such relief, violate Section 5 of the [Securities] Act.”<sup>11</sup>

However, Rule 135b and its adopting release both are silent as to whether the ODD is subject to liability under Section 12(a)(2) of the Securities Act. Section 12(a)(2) generally imposes civil liability on a person using a prospectus that contains material misstatements or omissions to offer or sell a security.<sup>12</sup>

Shortly after we adopted Rule 135b, the Options Clearing Corporation, commonly known as the OCC, requested interpretive advice from the Division of Corporation Finance regarding the applicability of Section 12(a)(2) liability to an ODD. After considering the rule's adopting release, the Division advised the OCC that in its view, an ODD “is not a prospectus within the meaning of Section 2(10) [now Section 2(a)(10)] of the Securities Act and, thus, is not subject to liability under Section 12(2) [now Section 12(a)(2)] of the Securities Act.”<sup>13</sup> In 1998, we proposed and sought comment on a revision to Rule 135b to clarify that the ODD is not subject to Section 12(a)(2) liability.<sup>14</sup>

### II. Discussion

Despite this long-standing interpretive position, some uncertainty continues to exist about the applicability of Section

<sup>10</sup> Release No. 33–6426, see note 3 above.

<sup>11</sup> Release No. 33–6426, see note 3 above. Because Rule 135b states that Section 5 does not apply to distribution of the ODD, it is clear that Section 12(a)(1) liability is inapplicable because that section provides recourse only for offers or sales made in violation of Section 5. See 15 U.S.C. 77(a)(1).

<sup>12</sup> Section 12(a)(2) also imposes civil liability for oral communications containing material misstatements or omissions. 15 U.S.C. 77(a)(2).

<sup>13</sup> Letter dated September 23, 1982, from then Division of Corporation Finance Director, Lee B. Spencer, Jr. to Marc L. Berman, then Senior Vice President and General Counsel, of the Options Clearing Corporation. On its face, the text of Rule 135b does not address the applicability of Section 12 liability. In its interpretive letter, the Division noted that the limiting language “for purposes only of Section 5 of the Act” appearing in Rule 135b is intended to clarify that the ODD would be subject to the antifraud provisions of Section 17(a) of the Securities Act [15 U.S.C. 77q(a)] and Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)], but is not intended to suggest that the ODD remains subject to Section 12(a)(2) liability.

<sup>14</sup> Release No. 33–7550 (July 1, 1998) [63 FR 36136].

<sup>1</sup> 17 CFR 230.135b.

<sup>2</sup> 15 U.S.C. 77a *et seq.*

<sup>3</sup> Release No. 33–7550 (July 1, 1998) [63 FR 36136].

<sup>4</sup> Release No. 33–6426 (Sept. 16, 1982) [47 FR 41950]. Rule 9b–1(a)(4) [17 CFR 240.9b–1(a)(4)] under the Securities Exchange Act of 1934 [15 U.S.C. 78a *et seq.*] defines standardized options as “options contracts trading on a national securities exchange, an automated quotations system of a registered securities association, or a foreign securities exchange which relate to options classes the terms of which are limited to specific expiration

12(a)(2) liability to an ODD.<sup>15</sup> In response to informal requests from the Chicago Board Options Exchange and the OCC, we intend to reduce uncertainty in this area. We received two letters of comment on the 1998 proposal to amend Rule 135b.<sup>16</sup> Both letters supported clarification of the Section 12(a)(2) liability issue.

As noted above, the ODD informs investors of the general characteristics of standardized options and the rules of options trading. Because of the general nature of this document, the ODD does not encourage investors to invest in any particular standardized option. Rather, the ODD merely provides background information about standardized options. Therefore, we believe that the ODD is neither an offer under the Securities Act nor a prospectus and therefore is not subject to Section 12(a)(2) liability.<sup>17</sup>

Accordingly, we are adopting the proposed change to Rule 135b to codify the Division of Corporation Finance's position that an ODD prepared in accordance with Exchange Act Rule 9b-1 is not subject to liability under Securities Act Section 12(a)(2).<sup>18</sup>

### III. Costs and Benefits

We solicited comment to assist us in our evaluation of the costs and benefits associated with the change to Rule 135b. In response, we received two comment

letters from affected parties, the Philadelphia Stock Exchange and the OCC. Both commenters supported the amendment. The OCC noted that the amendment would eliminate uncertainty in this area of the law, which would be beneficial to all parties. The amendment will not result in any new costs because it simply codifies the long-standing interpretive position of the Division of Corporation Finance that an ODD prepared in accordance with Exchange Act Rule 9b-1 is not a prospectus and thus is not subject to liability under Section 12(a)(2) of the Securities Act. By reducing any uncertainty in the courts concerning the applicability of Section 12(a)(2) liability to an ODD, we anticipate that the amendment will reduce the time and money spent by plaintiffs, the options exchanges, the OCC and the courts in pursuing, defending and dismissing such claims.

As stated above, at least one federal district court has ruled that a claim may exist under Section 12(a)(2) even though the Division's interpretive position was in place.<sup>19</sup> This type of conflicting ruling has added to the cost of defending and adjudicating claims and added uncertainty regarding the Section 12(a)(2) liability issue. In addition, the OCC has informed us of another suit currently pending in which the plaintiffs have claimed that the ODD is subject to Section 12(a)(2) liability. We also contacted the OCC to help estimate the dollar cost of the uncertainty, which includes the cost of legal services. They were not able to provide dollar estimates because of the difficulty of separating the costs of defending one claim among a number of claims. Although it is not possible to quantify the extent to which plaintiffs would bring such suits in the future absent the amendment, we expect the rule clarification to result in cost savings to plaintiffs, defendants and courts by reducing any further need for these parties to address this issue.

### IV. Effects on Efficiency, Competition and Capital Formation

We sought and received no comments on the amendment's effects on efficiency, competition and capital formation. The amendment to Rule 135b is intended to reduce the OCC's and the exchanges' risk of Section 12(a)(2) liability for the contents of the ODD. We do not expect this rule to have a negative impact on efficiency, competition and capital formation for the following reasons:

This amendment reduces the legal risks to the OCC as issuer. But the OCC does not receive the proceeds from the sale of these securities. Rather, it acts as the clearing agent between the buyers and sellers of the securities. As such, the risk to the seller is unchanged by this rule and will not impact the economic incentives of buyers and seller to transact. This rule therefore should have no impact on capital formation.

To the extent that this rule reduces the risk of legal actions against the OCC and the exchanges on the basis of differences of interpretation in Section 12(a)(2) liability, this rule will reduce the resources spent by the OCC and exchanges addressing suits. This rule therefore should increase the efficiency of the OCC and exchanges.

We do not expect the amendment to have a significant impact on competition because the OCC is currently the only clearing corporation for standardized options trading on exchanges in the United States. Any new clearing corporations in the United States would benefit from the clarification equally with the OCC. Similarly, the exchanges will equally benefit from the clarification. However, to the extent that the options exchanges and the OCC compete with foreign markets for the trading of standardized options, by improving the efficiency of these entities, the amendment will have some positive effect on the exchanges' and the OCC's ability to compete in this market.

### V. Regulatory Flexibility Act Certification

Pursuant to Section 605(b) of the Regulatory Flexibility Act, 5 U.S.C. 605(b), the Chairman of the Commission has certified that the amendment will not have a significant economic impact on a substantial number of small entities. This certification, including the reasons supporting the certification, was attached to the proposing release, Release No. 33-7550, as Appendix A. We solicited comments on the potential impact of the amendment on small entities, but received no comments.

### VI. Statutory Basis

We are adopting the amendment to Securities Act Rule 135b pursuant to Sections 2(a)(10), 2(b), 7, 10, 19(a) and 28 of the Securities Act, as amended.

### List of Subjects in 17 CFR Part 230

Reporting and recordkeeping requirements, Securities.

<sup>15</sup> See, for example, *Spicer v. Chicago Board Options Exchange*, No. 88 C 2139 (N.D. Ill. Oct. 24, 1990) (deciding that an ODD could be subject to Section 12(a)(2) liability), *motion to reconsider denied* (Jan. 24, 1991), *summary judgment granted* (Dec. 9, 1992) (finding in favor of the OCC on the Section 12(a)(2) claim on other grounds). We have never considered inclusion of the statement referring to the ODD that is required by Form S-20 as having the effect of incorporating the ODD by reference into the Form S-20 prospectus. Accordingly, we have added language to Rule 135b stating that the ODD shall not be deemed a prospectus for purposes of Sections 2(a)(10) and 12(a)(2) (15 U.S.C. 77b(a)(10) and 771(a)(2)) of the Act, even if it is referred to in, deemed to be incorporated by reference into, or otherwise in any manner deemed to be a part of a Form S-20 prospectus.

<sup>16</sup> See the comment letters from Options Clearing Corporation (Aug. 26, 1998) and the Philadelphia Stock Exchange (Aug. 28, 1998). The comments we received are available in our Public Reference Room at 450 Fifth Street, NW., Washington, DC 20549, in File No. S7-19-98.

<sup>17</sup> We note that this amendment is consistent with Congress' exemption of security futures products from Section 12(a)(2) liability. Congress generally intended that we treat standardized options and securities futures products similarly. See, for example, Exchange Act Section 6(b)(3)(C) [15 U.S.C. 78f(b)(3)(C)].

<sup>18</sup> Of course, the document would continue to be subject to the antifraud liability provisions of Section 17(a) of the Securities Act [15 U.S.C. 77q(a)], Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)], and Rule 10b-5 under the Exchange Act [17 CFR 240.10b-5]. Thus, we believe that the rule, if amended as proposed, would continue to be consistent with protection of investors.

<sup>19</sup> See *Spicer v. Chicago Board Options Exchange* in note 15 above.

**Text of the Rule Amendment**

■ In accordance with the foregoing, Title 17, chapter II of the Code of Federal Regulations is amended as follows:

**PART 230—GENERAL RULES AND REGULATIONS, SECURITIES ACT OF 1933**

■ 1. The general authority citation for Part 230 is revised to read as follows:

**Authority:** 15 U.S.C. 77b, 77c, 77d, 77f, 77g, 77h, 77j, 77r, 77s, 77sss, 77z-3, 78c, 78d, 78l, 78m, 78n, 78o, 78t, 78w, 78ll(d), 78mm,

79t, 80a-8, 80a-24, 80a-28, 80a-29, 80a-30, and 80a-37, unless otherwise noted.

\* \* \* \* \*

2. Revise § 230.135b to read as follows:

**§ 230.135b Materials not deemed an offer to sell or offer to buy nor a prospectus.**

Materials meeting the requirements of § 240.9b-1 of this chapter shall not be deemed an offer to sell or offer to buy a security for purposes solely of Section 5 (15 U.S.C. 77e) of the Act, nor shall such materials be deemed a prospectus

for purposes of Sections 2(a)(10) and 12(a)(2) (15 U.S.C. 77b(a)(10) and 77l(a)(2)) of the Act, even if such materials are referred to in, deemed to be incorporated by reference into, or otherwise in any manner deemed to be a part of a Form S-20 prospectus.

By the Commission.

Dated: December 21, 2001.

**Margaret H. McFarland,**

*Deputy Secretary.*

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