

PART TWO—BACKGROUND: FACTUAL SETTING⁴ AND PRIOR LAW AND PRACTICE

The option to purchase or sell specified property at a stated price for a given period of time has long been used for planning in many fields of endeavor. One variation of this device which has become standard in the securities field is the combination of an option to buy and an option to sell a specified amount of a certain security at a fixed price for a stated period of time. This combination of an option to buy and an option to sell is known as a "straddle".⁵ Normally, the price at which either or both of the options in a straddle may be exercised is the market price of the stock at the time the straddle is written.⁶

The person who issues (or grants) a straddle is known as the "writer." Straddles are normally granted to brokers or dealers who specialize in such transactions and who almost always sell the component parts of the straddles to different purchasers.⁷ The rights granted in each option are normally exercised, if at all, shortly before the end of the term for which the straddle is written.⁸ Which component option is exercised will depend upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written.⁹ The "call" (the option to purchase from the straddle writer) is likely to be exercised if the market in that security has risen, while the "put" (the option to sell to the straddle writer) is likely to be exercised if the market has fallen. In rare cases,¹⁰ where the price of a security has fluctuated to a great extent, both component options may be exercised. Where the market price of the security at the end of the option term is approximately the same as the price for which the option was granted, it may happen that neither component of the straddle will be exercised.

The majority of puts and calls originate as straddles.¹¹ Although the use of puts and calls is not a new development in the securities field,¹² the total number of shares covered by options sold in any one year from 1937 through 1960 rarely exceeded 1 percent of the total number of shares sold on the New York Stock Exchange that year.¹³ The number of shares covered by options sold in June 1959 constituted only 2.2 percent of the total number of shares sold on the New York and American Stock Exchanges of the 50 issues as to which the most options were written in June 1959.¹⁴ Options appear to be an even smaller factor in the market for less active issues.¹⁵

⁴ Much of the material presented in this part was derived from the "Report on Put and Call Options," a report published in August 1961 by the Securities and Exchange Commission, on the basis of an extensive study by the SEC's Division of Trading and Exchanges; hereinafter referred to as "SEC Report."

⁵ During June 1959, the period selected in the SEC Report for its intensive study, "more straddles were written than any other type of option." SEC Report, p. 6; see pp. 15, 31, 32, 33.

⁶ SEC Report, p. 9.

⁷ SEC Report, pp. 6, 10-14, 15-17, 56, 59, 65.

⁸ SEC Report, pp. 6, 47-49, 51.

⁹ SEC Report, pp. 47, 50.

¹⁰ Less than 1 percent, according to SEC Report, p. 52. (See p. 15.)

¹¹ Straddles supplied 66 percent of the puts and 60 percent of the calls during June 1959. SEC Report, pp. 31-33.

¹² The use of puts and calls originated in Europe more than 200 years ago. SEC Report, p. 9.

¹³ SEC Report, pp. 19, 20, 22.

¹⁴ SEC Report, p. 35-37.

¹⁵ In June 1959 the 87 most active issues on the New York Stock Exchange accounted for 57.2 percent of the option volume in NYSE stocks but only 39.7 percent of the total trading volume. In contrast, the 500 least active issues accounted for only 3.6 percent of the option volume, but 9.7 percent of the total trading volume. SEC Report pp. 43-44.