

gain (instead of ordinary income). This permits it to be netted against any capital loss which may result from the exercise of the other option in the straddle while retaining what in most respects is ordinary income treatment for any excess of net short-term capital gain over net long-term capital loss.

This bill is reported unanimously by your committee and the Treasury Department has indicated that it does not object to its enactment.

II. NATURE OF STRADDLES¹

Straddles are one form of an option; namely, an offer both to purchase and to sell a specified amount of property at a stated price for a limited period of time. Options to sell securities are known as "puts"—i.e., the purchaser of the option can "put" his shares to the writer or issuer of the option at the stated price. Options to purchase are known as "calls"—i.e., the purchaser of the option can "call" the shares from the writer at the stated price. A "straddle" is a combination of a put and call, with respect to the same security, for the same quantity, at the same purchase or sale price and available for the same period of time.

Straddles are likely to be written by persons with holdings of a security who believe that in the long run, the price of the stock will not vary greatly from its present price. Their inducement for writing the straddle is the receipt of a premium. Straddles generally are granted to brokers or dealers who, in turn, customarily sell the put and call components to different purchasers. The majority of puts and calls originate in straddles. While the use of puts and calls is not a new development in the securities markets, their significance in the securities markets is relatively limited; for example, the total number of shares covered by options sold in recent years on the New York Stock Exchange has rarely exceeded 1 percent of the total shares sold.

Normally either (not both) the put or the call component of the straddle is exercised by the purchaser shortly before the end of the term for which the straddle is written. Frequently this is 6 months and 10 days after the straddle is issued. Which component of the straddle is exercised depends upon the market conditions at the time of exercise vis-a-vis market conditions at the time the straddle was written. If the market in that security has risen, the securities are likely to be "called" from the writer; if the market has fallen, the stock is likely to be "put" to the writer. While in the great majority of the cases, one component of the straddle is exercised and the other is allowed to lapse, occasionally (perhaps 10 to 15 percent of the time) neither option is exercised and in a few other cases (less than 1 percent of the cases) both components of the straddle are exercised.

Although options are purchased for hedging and other similar purposes by some investors, their primary use probably is as a method of investing by individuals with small amounts of money.

¹ 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.