

longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street N.W., Washington, D.C. 20549. 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, 450 Fifth Street N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of NSCC. All submissions should refer to File No. SR-NSCC-96-08 and should be submitted by July 18, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37339; File No. SR-PSE-96-11]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1, 2, and 3 to the Proposed Rule Change by the Pacific Stock Exchange, Incorporated, Relating to FLEX Equity Options

June 19, 1996.

#### I. Introduction

On April 5, 1996, the Pacific Stock Exchange Incorporated ("PSE" or "Exchange") filed a proposed rule change with the Securities and

Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to make certain revisions to Exchange rules relating to FLEX Equity Options.

Notice of the proposal was published for comment and appeared in the Federal Register on April 26, 1996.<sup>3</sup> The Exchange filed Amendment Nos. 1,<sup>4</sup> 2,<sup>5</sup> and 3<sup>6</sup> to the proposal on April 27, 1996, May 20, 1996, and May 28, 1996, respectively. No comment letters were received on the proposed rule change. This order approves the Exchange's proposal, as amended.

#### II. Description of the Proposal

On February 14, 1996, the Commission approved an Exchange proposal to list and trade FLEX Equity Options.<sup>7</sup> FLEX Equity Options permit market participants to designate certain contract terms for options of such securities, including: exercise price; exercise style (i.e., American, European or capped); expiration date; and option type (i.e., put, call or spread).

PSE Rule 8.109(a) currently provides for the selection of "FLEX Qualified Market Makers," i.e., market makers whom the Exchange deems to be qualified to trade FLEX Equity Options based on the following factors: (1) the

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 37133 (April 19, 1996), 61 FR 18636.

<sup>4</sup> In Amendment No. 1, the Exchange proposes to: (1) permit FLEX Equity Options trading on any options-eligible security, regardless of whether Non-FLEX Equity Options overlie that security and trade on the Exchange; and (2) provide for a guaranteed minimum right of participation of at least 25% of the trade for Submitting Members indicating an intent to cross and responding to the Request for Quotes with a price better than the BBO. See Letter from Michael Pierson, Senior Attorney, Market Regulation, PSE, to John Ayanian, Attorney, Office of Market Supervision ("OMS"), Division of Market Regulation ("Market Regulation"), Commission, dated April 26, 1996 ("Amendment No. 1").

<sup>5</sup> In Amendment No. 2, the Exchange makes several non-substantive corrections to PSE Rule 8.103(e)(3), as described more fully herein. See Letter from Michael Pierson, Senior Attorney, Market Regulation, PSE, to John Ayanian, Attorney, OMS, Market Regulation, Commission, dated May 17, 1996 ("Amendment No. 2").

<sup>6</sup> In Amendment No. 3, the Exchange proposes to amend PSE Rule 8.101(a) to allow FLEX transactions during normal Exchange options trading hours on any business day; provided however, that the Board of Governors, in its discretion at any time, may determine to narrow or otherwise restrict the time set for FLEX options trading. See Letter from Michael Pierson, Senior Attorney, Market Regulation, PSE, to John Ayanian, Attorney, OMS, Market Regulation, Commission, dated May 23, 1996 ("Amendment No. 3").

<sup>7</sup> See Securities Exchange Act Release No. 36841 (February 14, 1996), 61 FR 6666 (February 21, 1996).

preference of the registrants; (2) the maintenance and enhancement of competition among market makers; and (3) the assurance that the market maker will have adequate financial resources.<sup>8</sup> In addition, pursuant to Rule 8.115(a), FLEX Qualified Market Makers may not effect any transactions in FLEX Equity Options unless one or more letter(s) of guarantee has been issued by a clearing member and filed with the Exchange pursuant to Rule 6.36(a). In connection with these letters of guarantee, a clearing member must accept financial responsibility for all FLEX transactions made by such market makers.

PSE Rule 8.109(a) currently provides that the Exchange shall appoint five or more FLEX Qualified Market Makers to each FLEX Equity Option prior to its listing.<sup>9</sup> The Exchange proposes to reduce the minimum number of FLEX Qualified Market Makers required under Rule 8.109(a) from five to three. The Exchange is proposing this change in order to enhance its ability to trade FLEX Equity Options on the Exchange. The Exchange believes that no undue financial risk to the Exchange would result from this change because each transaction of FLEX Qualified Market Makers will be backed by a clearing member, which will accept financial responsibility for all FLEX transactions made by such market makers pursuant to a letter of guarantee.<sup>10</sup> The Exchange also believes that three FLEX Qualified Market Makers will be a sufficient number of traders to provide quotations in response to requests for quotes because the Exchange expects the FLEX Equity Options will be traded in the same trading crowd as Non-FLEX Options on the same underlying securities. In this regard, the Exchange notes that under the current rules, two FLEX Appointed Market Makers may be designated in lieu of five FLEX Qualified Market Makers to trade FLEX Equity Options.<sup>11</sup>

<sup>8</sup> By contrast, under Rules 8.100 *et seq.*, "FLEX Appointed Market Makers" are those individuals who have been designated by the Exchange to trade FLEX options on a specific underlying index ("FLEX Index Option") that has been approved by the Commission for FLEX Options trading. See PSE Rules 8.100(a)(1) and 8.109(a).

<sup>9</sup> With respect to FLEX Index Options, two FLEX Appointed Market Makers must be approved to trade FLEX Options on a given index before the Exchange may list FLEX Options on that index. FLEX Appointed Market Makers must also meet the capital requirements of Rule 8.114 (i.e., they must maintain \$1 million net liquidating equity and/or \$1 million net capital (as defined by SEC Rule 15c3-1 under the Act)), and they must also meet the account equity requirements of Rule 8.113(a) (i.e., the net liquidating equity maintained in their individual or joint accounts must be at least \$100,000).

<sup>10</sup> See PSE Rule 8.115(a).

<sup>11</sup> See PSE Rule 8.109(a).

<sup>6</sup> 17 CFR 200.30-3(a)(12) (1995).

Under PSE Rule 8.102(f)(1), only those qualified and approved underlying securities that are the subject of Non-FLEX Equity Option trading on the Exchange may serve as underlying securities of FLEX Equity Options traded on the Exchange. In this respect, Rule 8.102(f)(1) differs from the rules proposed by the American Stock Exchange ("Amex") and the Philadelphia Stock Exchange ("Phlx") in respect of FLEX Equity Option trading on those exchanges.<sup>12</sup> Proposed Amex Rule 903G(c) and proposed Phlx Rule 1069A(a)(1)(B) are substantively identical in that any options-eligible security, regardless of whether the security is the subject of Non-FLEX Equity Options traded on the exchange, may underlie a FLEX Equity Option. The Exchange proposes to amend PSE Rule 8.102(f)(1) to conform to similar rules proposed by the exchanges mentioned above, to permit FLEX Equity Options trading on any options-eligible security regardless of whether Non-FLEX Equity Options overlie that security and trade on the Exchange.<sup>13</sup>

Additionally, the Exchange proposes to amend PSE Rule 8.103(e)(3) in order to provide a minimum right of participation to Exchange members who initiate Requests for Quotes ("RFQ") in respect of FLEX Equity Options and indicate an intention to cross or act as principal on the trade.<sup>14</sup> The proposed rule change will provide that a member who submits a Request for Quotes in respect of a FLEX Equity Option and indicates an intention to cross or act as principal on the trade, and who improves the BBO during the BBO Improvement Interval, has a priority right to execute the contra side of the trade for at least twenty-five percent (25%) of the trade.<sup>15</sup>

Finally, the Exchange proposes to amend PSE Rule 8.101(a) to allow FLEX transaction during normal Exchange options trading hours on any business day; provided however, that the Board of Governors, in its discretion at any time, may determine to narrow or otherwise restrict the time set for FLEX options trading. The Exchange believes that this proposed rule change is consistent with the other options exchanges FLEX Options rules.<sup>16</sup>

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general and furthers the objectives of Section 6(b)(5) in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

### III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Moreover, the Commission believes that the proposed rule change is reasonable in that it promotes fair competition among exchanges, and will serve to protect investors and the public interest in accordance with Sections 6(b)(5) and 11A of the Act.

The Commission believes that the Exchange's proposal to reduce the minimum number of FLEX Qualified Market Makers required under Rule 8.109(a) from five to three is consistent with the Act. The Commission notes that the Exchange's rules currently provide a framework that encourages FLEX Qualified Market-Makers, specifically guaranteed by a clearing member,<sup>17</sup> to actively make responsive quotes to provide liquidity in FLEX Equity Options. A FLEX Post Official may call upon a FLEX Qualified Market-Maker to make responsive quotes in the interests of a fair and orderly market.<sup>18</sup> Moreover, a FLEX Post Official must call upon a FLEX Qualified Market-Maker to make a quote in response to a Request for Quotes if no quotes are made in response to the RFQ. Based on these requirements, the Commission agrees with the PSE that a minimum of three FLEX Qualified Market-Makers should be sufficient to provide quotations in response to a request for quotes and generally accommodate FLEX Equity Options trading.

The Commission also believes that the proposed minimum guaranteed right of participation of at least 25% of the trade to Exchange members who initiate Requests for Quotes in respect of FLEX Equity Options, (improves the BBO), and indicate an intention to cross or act as principal on the trade, is consistent

with Act. In addition, under PSE rules, such transactions must, in all cases, be in compliance with the priority, parity, and precedence requirements of Section 11(a) of the Act,<sup>19</sup> and Rule 11a1-1(T)<sup>20</sup> promulgated thereunder. These provisions set forth, among other things, the conditions in which members must yield priority to public customers' bids and offers at the same price.

The Commission believes that the Exchange's proposal to permit FLEX Equity Options trading on any options-eligible security regardless of whether Non-FLEX Equity Options overlie that security and trade on the Exchange is reasonable, in that it promotes fair competition among exchanges, consistent with Section 11A of the Act, and will perfect the mechanism of a free and open market and serve to protect investors and the public interest in accordance with Section 6(b)(5) of the Act.

As originally approved, the PSE determined to restrict the trading of FLEX Equity Options to those options which were traded on the Exchange as Non-FLEX Equity Options. The PSE rationale for this restriction was reasonable and the Commission therefore approved the restriction as consistent with the Act. The Commission believes, however, that the restriction is not mandated by the Act and that it is reasonable for the PSE to conform its rules to those proposed by other competing markets seeking to establish FLEX Equity Options trading. The Commission notes that PSE FLEX Equity Options must still meet the eligibility requirements and criteria set forth in PSE Rule 3.6. The change should also promote fair competition among exchange markets trading FLEX Equity Options by allowing PSE to trade and compete for FLEX Equity Options order flow on more options eligible securities.

Finally, the Commission believes it is consistent with Section 6(b)(5) of the Act for the PSE to establish the same trading hours for FLEX Options that currently exist for PSE's normal options trading hours. The Commission also believes that because of the nature of the FLEX market, in contrast to the Non-FLEX market, it is reasonable to permit the Board, in its discretion, to narrow or restrict trading hours for FLEX Options, so long as such trading hours occur within the normal options trading hours of the Exchange.

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the

<sup>12</sup> See Securities Exchange Act Release Nos. 37053 (March 29, 1996), 61 FR 15537 (April 8, 1996) (File No. SR-Amex-95-57), and 37048 (March 29, 1996), 61 FR 15549 (File No. SR-Phlx-96-08). See also File No. SR-CBOE-96-28 (proposing the same amendment).

<sup>13</sup> See Amendment No. 1, *supra* note 4.

<sup>14</sup> See Amendment No. 1, *supra* note 4; see also Amendment No. 2, *supra* note 5.

<sup>15</sup> See Amendment No. 1, *supra* note 4.

<sup>16</sup> See Amendment No. 3, *supra* note 6.

<sup>17</sup> The Commission notes that FLEX Qualified Market Makers are still required under Exchange rules to obtain a specific Letter of Guarantee from a clearing member.

<sup>18</sup> See PSE Rule 8.109(b).

<sup>19</sup> 15 U.S.C. 78k(a).

<sup>20</sup> 17 CFR 240.11a1-1(T).

thirtieth day after the date of publication of notice thereof in the Federal Register. Specifically, Amendment No. 1 proposes a minimum guaranteed right of participation of at least 25% of the trade to Exchange members who initiate Request for Quotes in respect of FLEX Equity Options, as described above. The Commission believes that the amendment is similar to existing provisions in the Exchange rules regarding FLEX Index Options and raises no new regulatory issues.

Furthermore, Amendment No. 1 proposes to conform the PSE's rules concerning the selection of underlying securities for FLEX Equity Option trading, as described above, to the proposed rules of other exchanges on the same subject, and raises no new regulatory issues. Additionally, the Amex and Phlx proposals were subject to a full notice and comment period, and no comments were received. Accordingly, the Commission believes, consistent with Section 6(b)(5) of the Act, that good cause exists, to approve Amendment No. 1 to the proposed rule change, on an accelerated basis.

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. Specifically, Amendment No. 2 proposes certain non-substantive amendments to PSE Rule 8.103(e)(3) to clearly distinguish which particular guaranteed minimum right of participation is available to a FLEX Equity Option and which is available to FLEX Index Option. The Commission believes that Amendment No. 2 is a non-substantive amendment and raises no new regulatory issues. Moreover, the Commission believes that the amendment clarifies and strengthens the proposed rule change and the Exchange's FLEX Option rules, generally.

Accordingly, the Commission believes, consistent with Section 6(b)(5) of the Act, that good cause exists, to approve Amendment No. 2 to the proposed rule change, on an accelerated basis.

The Commission finds good cause for approving Amendment No. 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register. Specifically, the Exchange proposes to amend PSE Rule 8.101(a) to allow FLEX transactions during normal Exchange options trading hours on any business day; provided however, that the Board of Governors, in its discretion at any time, may, with

normal trading hours, determine to narrow or otherwise restrict the time set for FLEX options trading. The Commission believes that the Exchange's proposal to allow FLEX transactions during normal Exchange options trading hours on any business day, as described above, is similar to that provided under other options exchanges' rules regarding FLEX trading hours and raises no new regulatory issues.

Accordingly, the Commission believes, consistent with Section 6(b)(5) of the Act, that good cause exists, to approve Amendment No. 3 to the proposed rule change, on an accelerated basis.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 1, 2, and 3 to the proposed rule change. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of PSE. All submissions should refer to File No. SR-PSE-96-11 and should be submitted by July 18, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>21</sup> that the proposed rule change (File No. SR-PSE-96-11), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>22</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-37335; File No. SR-PSE-96-09]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Stock Exchange Incorporated Relating to the Options Book Pilot Program

June 19, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on April 1, 1996, the Pacific Stock Exchange Incorporated ("PSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Exchange filed Amendment No. 1 to the proposed rule change on June 4, 1996.<sup>2</sup> 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

The PSE proposes to establish a pilot program under which its Lead Market Makers ("LMMs") would be able to assume operational responsibility for the options public limit order book ("Book") in certain issues.

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

In its filing with the Commission, the self-regulatory organization 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. The self-regulatory organization has prepared summaries, set forth in Sections (A), (B), and (C) below, of the most significant aspects of such statements.

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> Amendment No. 1 adds a provision to proposed PSE Rule 6.82, Commentary .05 stating that no Market Maker Cooperatives may participate as LMMs in the pilot program. Amendment No. 1 also replaces a PSE Rule 6.82, Commentary .05 reference to "April 1, 1997" as the proposed expiration date for the pilot program, with a reference to "[Date]". Letter from Michael D. Pierson, Senior Attorney, Market Regulation, PSE, to Michael Walinskas, Special Counsel, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated June 4, 1996 ("Amendment No. 1").

<sup>21</sup> 15 U.S.C. 78s(b)(2).

<sup>22</sup> 17 CFR 200.30-3(a)(12).