

staff to produce documents not in the investigative file, nor does a Respondent have the right to require Exchange employees to appear as witnesses at a hearing.

The rule change provides that if the Exchange, a member, or a person associated with a member will not voluntarily produce non-privileged documents or hearing witnesses the Respondent has requested, the Respondent may submit a written request to the Panel asking the Panel to enter an order compelling the production of such non-privileged documents, or compelling the testimony of the member, associated person, or a person within the Exchange's control. In order to obtain such an order, a Respondent must demonstrate that the witnesses or documents requested are relevant and material to the Respondent's case. Exchange staff has the opportunity to argue why no such order should be issued. In making a decision whether to issue the requested order, the hearing Panel would have to weigh the probative value of the evidence against considerations such as undue delay, waste of time, confusion, unfair prejudice, or needless presentation of cumulative evidence. The hearing Panel could require the Respondent who requested the order to pay the witness's travel expenses or other costs of complying with the order.

F. Witness List

Rule 17.6(b) presently provides that no less than five business days in advance of a hearing, each party will furnish the Panel and the other parties copies of all documentary evidence such party intends to present at a hearing. The rule change approved today requires the parties to provide a list of witnesses they intend to present at a hearing.

III. Conclusion

The Commission finds that the rule change is consistent with the provisions of Section 6(b)(7) of the Act. The rule change is designed to improve the speed, fairness, and efficiency of disciplinary hearings, thereby promoting a fair procedure for the disciplining of members and persons associated with members.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change SR-CBOE-96-45 be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁶

Margaret H. McFarland,

Deputy Director.

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Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Listing and Trading of FLEX Index and FLEX Equity Options

September 17, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on August 21, 1996, the Philadelphia Stock Exchange, Inc., ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Sec" or "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 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 Phlx, pursuant to Rule 19b-4 of the Act, proposes to adopt Rule 1079, Index and Equity FLEXTM 1 Options, to govern the trading of customized or flexible ("FLEX") index and equity options on the Exchange. Specifically, the Exchange proposes to trade FLEX options on the following two broad-based (market) index options currently traded on the Phlx: Value Line Composite Index ("VLE") and National Over-the-Counter Index ("XOC"). The Phlx also proposes to trade FLEX industry (narrow-based) index options pursuant to the proposed rule on the following four industry index options currently traded on the Phlx: Bank Index ("BKX"), Gold/Silver Index ("XAU"), Semiconductor Index ("SOX") and Utility Index ("UTY"). In addition, the Phlx is proposing to trade equity FLEX options on securities which are options-eligible pursuant to Rule 1009, with the Options Committee designating the specific issues.

Proposed Rule 1079 contains the characteristics, trading procedure and other provisions applicable to trading FLEX options. All FLEX options would trade in the trading crowd of the corresponding non-FLEX option. The Exchange notes that the Automated

Options Market ("AUTOM") system will not be available for Phlx options. Proposed Rule 1079 also states that although FLEX options are generally subject to the rules in the options section, to the extent that the provisions of Rule 1079 are inconsistent with other applicable Exchange rules, Rule 1079 takes precedence with respect to FLEX options.

Because FLEX options would not be continuously quoted, nor are series pre-established, the variable terms of FLEX options shall be established by the following process. In order to initiate a transaction, a Requesting Member submits a Request-for-Quote ("RFQ") to the appropriate trading crowd, announcing the terms of the quote sought. The characteristics, including which terms and to what degree customization will be available, are outlined in Rule 1079(a).² For example, the exercise strike price respecting index FLEX options can be specified at the time the quote is requested in terms of a specific index value number (e.g., 553.5), a method for fixing such number (e.g., 10 basis points over the index value at a certain time, or with the future trading at a certain price), or a percentage of index value calculated as of the open or close of trading on the Exchange on the trade date (e.g., 5% above the close). Similarly, respecting equity FLEX options, the exercise strike price can be specified in terms of a specific dollar amount rounded to the nearest one-eighth of a dollar, or a percentage of the underlying security rounded to the nearest tick.

The exercise style can be either American or European,³ regardless of the exercise style of the listed option.⁴ The expiration date can also be customized, specifying any business day (non-holiday)—any month, day and year within five years for index flex options and three years for equity FLEX options. However, FLEX options may not expire on any day that falls on, or within two business days of (prior or subsequent to) a mid-month expiration day for a non-FLEX option on the same underlying index or security (other than a quarterly expiring index option). In addition, a

² The Exchange notes that Rule 1079 generally parallels the provisions of Rule 1069 governing foreign currency options.

³ An American style option may be exercised at any time up to its expiration, while a European style option can only be exercised on its expiration day. See Phlx Rule 1000(b)(35).

⁴ European style equity FLEX options may be adjusted to require the delivery upon exercise of a fixed amount of cash. See proposed amendments to the Options Clearing Corporation ("OCC") By-Law, Article IV, Section 11, Interpretation and Policy .08 in Securities Exchange Act Release No. 37318 (June 18, 1996) (SR-OCC-96-03).

¹ The term "FLEX" is a trademark of the Chicago Board Options Exchange, Inc. ("CBOE").

⁶ 17 CFR 200.30-3(a)(12).

new series cannot be opened on the day of exercise.

With respect to the minimum size of market index FLEX option quotes, if there is no open interest in the particular series when an RFQ is submitted, the minimum value size of an RFQ is \$10 million underlying equivalent value; if there is open interest, the minimum value size of an RFQ is \$1 million underlying equivalent value, or the remaining underlying equivalent value on a closing transaction, whichever is less. The underlying equivalent value is defined as the aggregate underlying value of an index FLEX option (index multiplier times the current index value) multiplied by the number of index FLEX options. The minimum value size for a responsive quote in market index FLEX options is \$1 million underlying equivalent value, or the remaining underlying equivalent value on a closing transaction, whichever is less.

With respect to the minimum size of industry index FLEX option quotes, if there is no open interest in the particular series when an RFQ is submitted, the minimum value size of an RFQ is \$5 million underlying equivalent value; this amount is one-half of the minimum size proposed by the Phlx and currently in place on other options exchanges for flexible broad-based index options. Where there is open interest, the minimum value size of an RFQ is \$1 million underlying equivalent value, or the remaining underlying equivalent value on a closing transaction, whichever is less. The minimum value size for a responsive quote is \$1 million underlying equivalent value, or the remaining underlying equivalent value on a closing transaction, whichever is less.

With respect to the minimum size of equity FLEX option quotes, if there is no open interest in the particular series when an RFQ is submitted, the minimum value size of an RFQ is 250 contracts; if there is open interest, the minimum value size of an RFQ is 100 contracts, or the remaining size on a closing transaction, whichever is less. The minimum value size for a responsive quote in equity FLEX options is 100 contracts, or the remaining size on a closing transaction, whichever is less.

However, assigned Registered Options Traders ("ROT's") and an assigned Specialist are required to respond to each RFQ with a certain minimum size. Respecting broad-based index FLEX options, assigned ROTs and the assigned Specialist are each required to respond with at least \$10 million

underlying equivalent value or the dollar amount requested in the RFQ, whichever is less. Respecting narrow-based index FLEX options, assigned ROTs and an assigned Specialist are each required to respond with at least \$5 million underlying equivalent value or the dollar amount requested in the RFQ, whichever is less. Respecting equity FLEX options, assigned ROTs and the assigned Specialist are each required to respond with a market of at least 250 contracts or the dollar amount requested in the RFQ, whichever is less.

The settlement value for index FLEX options may be specified as the value reported at the: (i) close of trading (P.M.-settled), (ii) opening (A.M.-settled) of trading on the Exchange, or (iii) as an average over a specified period of time, within parameters established by the Exchange. For example, the third category includes the average of the index's opening and closing settlement values on the expiration date, the average of the index's high and low values on the expiration date, or the average of the index's opening, closing, high and low values on the expiration date. However, American style index FLEX options exercised prior to the expiration date can only settle based on the closing value on the exercise date. Index FLEX options may be designated for settlement in U.S. dollars, British pounds, Canadian dollars, Deutsche marks, European Currency Units, French francs, Japanese yen or Swiss francs. With respect to the settlement process applicable to equity FLEX options, exercise settlement shall be by physical delivery of the underlying security pursuant to Rule 1044. Also, equity FLEX options will be subject to the exercise-by-exception procedures of OCC.⁵

With respect to the quote format of FLEX options, a bid and/or offer in the form of a specific dollar amount reflected as a fractional price (e.g. $\frac{1}{8}$, $\frac{1}{4}$), or a percentage of the underlying security or underlying equivalent value, rounded to the nearest minimum tick shall be acceptable. The option type may be a put, call or hedge order.⁶

The quoting and trading procedure for FLEX options, beginning with RFQ, is enumerated in Rule 1079(b). Submitting an RFO in the appropriate trading crowd is the first step in quoting FLEX

options. The Requesting Member must announce and submit an RFQ ticket containing the following: (1) Underlying index or security, (2) type, (3) exercise style, (4) expiration date, (5) exercise price, and (6) settlement value (A.M. or P.M.) and currency for index FLEX options. On receipt of an RFQ in proper form, the assigned Specialist, or if none, the Requesting Member shall cause the terms of the RFQ to be disseminated as an administrative text message through the Options Price Reporting Authority ("OPRA").⁷ RFQs, responsive quotes and completed trades will be promptly reported to OPRA and disseminated as an administrative text message.

Following the RFQ announcement, a preset response time will begin, during which members may provide responsive quotes. As stated in paragraph (b)(2), the response time, between two and 15 minutes, will be determined by the Options Committee, which may depend on the complexity of the RFQ.⁸ During the response time, qualified members may provide responsive quotes to the RFQ, which may be entered, modified or withdrawn during such response time.

At the end of the response time, the assigned Specialist, or if none, the Requesting Member shall determine the best bid and offer ("BBO"), in accordance with Rule 1014, disseminating such market with reference to the corresponding RFQ. However, where two or more bids/offers are at parity, priority will be afforded to bids/offers submitted by assigned ROTs and the assigned Specialist.

Following the determination of the BBO, a BBO Improvement Interval may be invoked if the Requesting Member rejects the BBO or the BBO is for less than the entire size requested. The BBO Improvement Interval is a two minute time period during which the BBO may be matched or improved. As a result of the Improvement Interval, a new BBO is established, which is disseminated with reference to the corresponding RFQ. An assigned ROT and the assigned Specialist who responded with a market during the response time may immediately join the new BBO.

A trade in FLEX options cannot be executed until the end of the response time or BBO Improvement Interval. Once the response time or BBO

⁵ OCC Rule 805 provides for automatic exercise of in-the-money options at expiration without the submission of an exercise notice to OCC if the price of the security underlying the option is at or above a certain price (for calls) or at or below a certain price (for puts); and the non-exercise of an option at expiration if the price of the security underlying the option does not satisfy such price levels.

⁶ See Rules 1000(b)(7) and 1066(f).

⁷ Operationally, the Requesting Member provides this information to a key puncher, who enters it into Exchange systems.

⁸ Initially, the Options Committee has established a response time of 10 minutes. Although this Committee will be authorized to change the response time within the permissible range, any such change will be preceded by notice to the Exchange membership.

Improvement Interval ends, the Requesting Member is given the first opportunity to trade on the market by voicing a bid/offer in the trading crowd. The Requesting Member has no obligation to accept any bid or offer for a FLEX option. If the Requesting Member rejects the BBO or the BBO size exceeds the entire size requested, another member may accept such BBO or the unfilled balance of the BBO. Acceptance of a bid/offer creates a binding contract under Exchange rules.

Once the BBO is established, it remains open that trading day. Because the market remains open, a member may re-quote the market without submitting an additional RFQ. An assigned ROT or assigned Specialist who responded may immediately join that market, thus matching for parity purposes. However, markets remaining open are not firm, as defined in Rule 1033(a).

Further, there will be a limit order book for FLEX options. The Specialist in the listed non-FLEX equity or index option, whether or not assigned in FLEX options, must accept FLEX orders on the FLEX book. Customers day limit orders may be placed on the index FLEX or equity FLEX option book. Booked orders expire at the end of each trading day. The limit price and size must be written on the RFQ ticket and submitted for dissemination. In order to trade with the book, an executing member must quote the market and announce the trade. The executing member has priority over other members, including assigned ROTs and the assigned Specialist, seeking to trade with the booked order.

Generally, on the Phlx options floor, a cross may take place in accordance with Rule 1064. With respect to FLEX options, after the BBO has been determined, the Requesting Member intending to cross must bid (or offer) at or better than the BBO. Whenever a Requesting Member intends to cross, after the BBO is determined, with or without a BBO Improvement Interval, the Requesting Member must announce an intention to cross and bid and offer at or better than the BBO. If the Requesting Member's bid/offer is at the BBO, the Requesting Member may execute 25% or a fair split, whichever is greater, of the contra-side of the order that is the subject of the RFQ. For instance, if there are two members on parity at the BBO, the Requesting Member and an assigned ROT, the Requesting Member is entitled to receive 50% of the contra-side contracts, which is a fair split, not just 25%. The remainder of the contra-side is split in accordance with the parity/priority provision set forth in proposed Rule 1079(b)(3).

If the Requesting Member's bid/offer improves the existing BBO, an assigned ROT or assigned Specialist who responded with a market during the response time or BBO Improvement Interval, may immediately join the Requesting Member's improved bid or offer, thus matching for parity purposes. However, the Requesting Member may execute 25% or a fair split, whichever is greater, of the contra-side of the order that is the subject of the RFQ. The remainder of the contra-side is split in accordance with the parity/priority provision set forth in proposed Rule 1079(b)(3).

The Exchange notes that an ROT and Specialist may trade FLEX options as an assigned ROT/Specialist or as a non-assigned ROT/Specialist. ROTs and Specialists must apply on the appropriate Exchange form to be assigned in FLEX options. An assigned ROT or assigned Specialist may choose to be assigned in a particular FLEX option, but must respond with a market respecting any FLEX option upon request by a Floor Official.

Assigned ROTs and the assigned Specialist will be subject to certain obligations respecting the trading of FLEX options. For example, the affirmative and negative market making obligations of Rule 1014(c) apply. Further, assigned ROTs and the assigned Specialist are required by paragraph (b)(ii) to respond with a market of the minimum size.⁹ At least two ROTs and/or a Specialist shall be assigned to each FLEX option. Because of these obligations, assigned ROTs and the assigned Specialist are afforded priority over other bids/offers at parity during the response time. Further, assigned ROTs and the assigned Specialist who responded with a market during the response time may join a new bid/offer voiced during the Improvement Interval, provided they do so immediately. Enabling assigned ROTs and the assigned Specialist to join such new bid/offer affords them parity at that new BBO.

There will be no trading rotations in FLEX options, either at the opening or at the close of trading. Unless otherwise determined by the Exchange, transactions in FLEX options may be effected each trading day from 10:00 A.M. to: (1) 4:15 P.M. respecting market index FLEX options; and (2) 4:10 P.M. respecting industry index FLEX and equity FLEX options.

⁹ However, assigned ROTs and assigned Specialists are not required to provide continuous quotes or markets at a certain minimum bid-ask differential (quote spread parameter).

Generally, FLEX option positions are not taken into account when calculating position limits for non-FLEX options on the same index.¹⁰ Accordingly, broad-based index FLEX options will be subject to a separate position limit of 200,000 contracts on the same side of the market. Narrow-based index FLEX options will be subject to a position limit of four times the current position limit—24,000, 36,000 or 48,000 contracts on the same side of the market. Respecting equity FLEX options, the position limit will be three times the current limit applicable to the listed equity option—75,000, 60,000, 31,500, 22,500 or 13,500 contracts on the same side of the market. The Exchange notes that both the market index FLEX option limit as well as the equity FLEX option limits are the same as the provisions of other exchanges.¹¹ The Exchange also notes that because the market index FLEX option limit is eight times the non-FLEX limit and the equity FLEX option limit is three times the non-FLEX limit, the Exchange believes that four times the non-FLEX limit is an appropriate limit for industry index FLEX options.

A separate exercise limit would also apply, equivalent to the applicable position limit. The minimum exercise size would be the lesser of \$1 million or the remaining size of the position respecting index options, and the lesser of 100 contracts or the remaining size of the position respecting equity options.

The proposal requires any ROT and Specialist to submit a Letter of Guarantee¹² issued by a clearing member organization, specifically accepting financial responsibility for all FLEX option transactions made by such person. Moreover, a minimum of \$100,000 in net liquid assets is required to be maintained by assigned ROTs and assigned Specialists. Floor Brokers must maintain a minimum of \$50,000 in net capital to qualify to trade FLEX options. Assigned ROTs, the assigned Specialist and Floor Brokers must immediately notify the Exchange's Examinations Department upon failure to be in compliance with these requirements.

The Exchange also proposes to adopt Floor Procedure Advice ("Advice") F-28, Trading Index and Equity FLEX Options, to parallel most of the

¹⁰ However, positions in P.M.-settled customized index options shall be aggregated with positions in quarterly expiring options ("QIXs") on the same index, if the customized option expires at the close of trading on or within two business days of the last trading day in a quarter. The Exchange is authorized to trade QIXs pursuant to Rule 1101A(b)(iv), although none currently trade.

¹¹ See e.g., CBOE Rule 24A.7(b).

¹² See Phlx Rule 703.

provisions of Rule 1079(b), including those pertaining to requesting quotations, response, determining the BBO, the BBO Improvement Interval, executing a trade and crossing. Advice F-28 is not proposed to contain a fine schedule, such that it does not require inclusion in the Exchange's minor rule violation enforcement and reporting plan. The text of the proposed rule change is available at the Office of the Secretary, the Exchange, and at the Commission.

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.

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

The purpose of the proposal is to trade options with flexible characteristics in an exchange auction environment. The Phlx is specifically proposing to trade flexible index and equity options, with several different contract specifications available for customization, including the exercise price, exercise style, expiration date and method for determining the exercise settlement value.

The Exchange believes that flexible options will provide important trading opportunities, which may currently be unavailable due to pre-set expiration dates, exercise prices and exercise styles. For example, although the VLE is European style, a flexible VLE contract could be crafted pursuant to Rule 1079 as an American style option. Thus, customization offers new trading potential respecting existing securities.

Currently, there exists an active over-the-counter ("OTC") market in options, where basic option features can be customized. Customizing option terms enables an investor to more closely tailor investment strategies to option products. These customized options are often traded by institutional investors with specific trading needs. In response, the Exchange seeks to trade FLEX options in an exchange auction market environment, with the Options Clearing

Corporation ("OCC") as issuer and guarantor.¹³ Thus, FLEX options are structured with a minimum size reflecting the larger-sized trades of these institutional users.¹⁴

The proposed rule, Rule 1079, is based upon the Exchange's Rule 1069, Customized Foreign Currency Options, and Exchange experience with trading this product since November, 1994.¹⁵ Generally, FLEX options shall be traded in accordance with many existing equity option and index option rules; however, Rule 1079 contains certain new trading procedures unique to FLEX options. In addition, the proposal is similar to the rule and proposals by other exchanges respecting flexible options.¹⁶

Several of the proposed provisions are intended to ensure orderly trading. For example, FLEX options will begin trading at 10:00 A.M., one half hour after the normal opening of options trading on the exchange, in order to limit the burden on the trading crowd. Industry index and equity FLEX options will trade until 4:10 P.M., to correspond to the non-FLEX option, similar to market index FLEX options, which would trade until 4:15 P.M. The Exchange may establish other trading times, including coordinating with FLEX trading hours on other exchanges and reflecting new trading hours for non-FLEX options.

As another example, the RFQ process, which allows a set period of time for bids and offers to be determined, is also designed to create an orderly trading environment, recognizing that greater variation in option terms requires sufficient time to respond with a quote. The response time and the BBO Improvement Interval should thus promote depth and liquidity as well.

In order to provide adequate liquidity in FLEX options, two assigned members, whether ROTs or Specialists, are required for each FLEX option, and must be present for a trade to occur.¹⁷

¹³ For a discussion of clearance and settlement procedure for FLEX options, see Securities Exchange Act Release No. 37318 (June 18, 1996) (SR-OCC-96-03). For example, OCC may depart from regular expiration date procedures and deadlines in the case of equity FLEX options, pursuant to OCC Rule 805, Interpretation and Policy .03.

¹⁴ The Exchange notes that the Commission has previously designated index and equity FLEX options as standardized options for the purposes of the options disclosure framework established under Rule 9b-1 of the Act. See Securities Exchange Act Release No. 31910 (February 23, 1993).

¹⁵ Securities Exchange Act Release No. 34925 (November 1, 1994) (SR-Phlx-94-18).

¹⁶ See, e.g., CBOE Rules 24A. 1-24A.17; Amex Rules, Section 15, Rules 900G, et. seq.; and PSE Rules 8.100-8.115.

¹⁷ See Floor Procedure Advises A-10, Specialist Trading with Book, and C-1, Ascertaining the

In addition, the minimum size requirements are intended to attract depth and liquidity to FLEX options.

Other FLEX provisions are intended to minimize the market impact of this product. For one, the expiration date may not fall on, or within two business days before or after the normal mid-month Friday expiration for options. Because the expiration date of FLEX options may not correspond to a non-FLEX expiration, FLEX options should not affect the market for the underlying security at the same time, thereby not placing added pressure on that security at the same time. This, in turn, minimizes the impact of FLEX options on the marketplace.

Second, position and exercise limits will apply to FLEX options, although separate from those applicable to non-FLEX options. The Exchange believes that separate, higher limits and non-aggregation are appropriate for FLEX options, which are intended to compete with OTC options that are not subject to such limits. The higher limits reflect the institutional nature and resulting larger size of FLEX options.

In order to enhance customer protection, certain financial standards will apply, including a capital requirement and a Letter of Guarantee from a clearing firm respecting FLEX options trading. The existence of separate position and exercise limits serves a customer protection function as well, by reducing systemic risk.

Not only will FLEX options combine variable terms with an auction marketplace and OCC guarantee, but FLEX options will also offer transparency of quotes and trades, because the proposal requires prompt and complete quotation and transaction reporting. Although flexible options will not be continuously quoted, once an RFQ is received, its terms, as well as the responding quotes, will be disseminated by Exchange systems. The terms of any resulting trade will also be disseminated. Specifically, the assigned Specialist, or if none, the Requesting Member will ensure immediate dissemination to OPRA, which will, in turn, disseminate the information to subscribing vendors in the form of an administrative test message.

The Exchange expects to implement a separate computer system to handle index and equity FLEX options, similar to the system utilized for customized foreign currency options. The Exchange expects that initially FLEX options will

Presence of ROTs in a Trading crowd, which require that, in addition to the Specialist, a ROT be present during a transaction.

be entered into this system at a limited number of locations on the trading floor.

The Exchange proposes to utilize a limit order book for FLEX options. The purpose of the book is to accommodate customers who have specified a limit price for a FLEX option order that is away from the market established during the RFQ process. The order book will be limited to customer day limit order, which must be accepted by the Specialist, whether or not that Specialist is assigned in FLEX options. As such, the Specialist is responsible for the execution of booked orders. The Exchange is requiring all Specialists to maintain a FLEX book for consistency and to prevent investor confusion. The Exchange believes that the FLEX order book should serve as a useful tool for customers, as does the current limit order book respecting non-FLEX options. With respect to booked orders for the same FLEX option (identical terms), Rule 1014 will apply to determine priority and parity among such orders.¹⁸ When trading with a booked order, a member, after re-quoting the market, receives priority over other members, including assigned ROTs and the assigned Specialist. This provision is intended to encourage members to step forward to trade with booked orders, recognizing that any member, including an assigned ROT or assigned Specialist, could have done so. It also encourages members to monitor changes that may render a booked limit order executable, similar to non-FLEX options.

The Exchange also proposes that the markets resulting from an RFQ remain open that trading day, as opposed to expiring immediately. As with non-FLEX options, before attempting to trade with an existing BBO, the market should be re-quoted. The variable terms integral to this product combined with the larger minimum size aimed at institutional trading needs render it difficult to sustain a firm quote in a constantly changing market. Thus, open markets are not firm, not subject to the guarantees of Rule 1033(a), and must be re-quoted. The advantage of markets remaining open is that such a re-quote does not require the submission of a new RFQ, thereby avoiding the delay of a new response time. Because an option that was quoted earlier in the trading day does not require a new response time, the Exchange believes that it would be burdensome to repeat the RFQ

process. Instead, markets remaining open streamlines FLEX trading and eliminates unnecessary delays. Any time a market is re-quoted that day, the new BBO and any resulting trade are disseminated with reference to the original RFQ.

Unlike the provisions of other exchanges,¹⁹ discretionary transactions would not be permitted in FLEX index and equity options. Thus, the existing provisions of Rule 1065 will apply to prohibit such transactions. The Exchange also notes that there may not be a specialist in FLEX options. Only the assigned Specialist in the non-FLEX (listed) option may apply to be an assigned Specialist in the FLEX option, but is not required to do so in order to participate. The current responsibilities of a Specialist to determine a market based on the bids and offers voiced as well as to disseminate bids/offers and trades may be handled by the Requesting Member, where there is no assigned Specialist in that FLEX option. If a trade occurs where the Requesting Member is not a participant and there is no assigned Specialist, the responsibility to submit the trade falls upon the seller or largest participant, in accordance with existing trading procedure.²⁰ The Exchange has also determined that FLEX options will trade in the crowd of the non-FLEX option in order to facilitate participation by assigned ROTs who will most likely be located in that crowd. Encouraging market making activity, whether or not assigned, should foster liquidity in FLEX options.

Further, the proposed crossing procedure differs from that of other exchanges.²¹ A guaranteed minimum right of participation of 25%, or a fair split, whichever is greater, applies to crosses in both index and equity FLEX options. The purpose of the split is to attract interest in Exchange-traded FLEX options by guaranteeing members who bring FLEX orders to the Phlx a part of the contra-side participation on that trade when matching or improving the BBO. Nevertheless, this procedure prevents other market participants who are obligated to provide markets, from being excluded from FLEX option

crosses. This, in turn, should prevent assigned ROTs and assigned Specialists from being discouraged from assuming the obligations of FLEX options assignment. Thus, the Phlx believes that this crossing procedure should promote deep and liquid markets for FLEX options.

In determining the BBO after the response time ends, where two or more bids/offers are at parity, priority is afforded to bids/offers submitted by assigned ROTs or the assigned Specialist. In addition, after the BBO Improvement Interval, an assigned ROT or assigned Specialist who responded with a market during the response time, even though that market did not constitute the BBO and even though such trader may not have responded during the Improvement Interval, may immediately join the new BBO. These procedures affording to assigned traders priority during the response time and parity during the Improvement Interval are intended to attract market maker interest, and thus liquidity, to FLEX options trading. In summary, the purpose of these provisions is to encourage assignment and reward those who actively make markets.

In view of the obligations of assigned ROTs and Specialists to make a market of a certain minimum size as well as that each FLEX option traded must have at least two assigned ROTs or assigned Specialists, the Exchange believes this ability to match is critical to the success of the product. The Exchange notes that the priority that an assigned ROT or assigned Specialist has over non-assigned market participants in voicing bids/offers and determining the BBO is similar to that of other exchanges.²² This priority is limited to voicing bids/offers to establish a BBO; for purposes of joining bids/offers during the Improvement Interval or crossing procedure, parity, not priority, is afforded to assigned ROTs and the assigned Specialist. Priority for assigned ROTs and the assigned Specialist is also based on the need to offset the obligations of assigned ROTs and the assigned Specialist.

The Exchange notes that non-assigned ROTs and Specialists may trade FLEX options, but without the obligations or concomitant advantages of assignment. The Exchange also notes that trading in FLEX options will count toward the in-person and in-assigned trading requirements of Rule 1014 and Advice B-3. In addition, the purpose of adopting new Advice F-28 is to incorporate it into the Floor Procedure

¹⁹ See e.g., CBOE Rule 24A.6.

²⁰ See Floor Procedure Advice F-2, Time Stamping, Matching and Access to Matched Trades.

²¹ Pursuant to CBOE Rule 24A.5(e)(iii), Submitting Members representing index FLEX crosses, after indicating an intention to cross or act as principal, are entitled to a one-half split on the BBO and a two-thirds split if improving the BBO. With respect to equity FLEX option crosses, there is a right to a 25% split on both the CBOE and the Amex, and on the PSE is improving the BBO. See e.g., Securities Exchange Act Release No. 37051 (March 29, 1996) (SR-CBOE-96-20).

²² See e.g., CBOE Rule 24A.5(e)(i) and (ii).

¹⁸ The Exchange notes that although Rule 1014's principles of price and time priority, as well as simultaneous bids/offers at parity, apply to FLEX options trading, the enhanced specialist participation of sub-paragraphs (g) (ii) and (iii) are not applicable to FLEX options.

Advice Handbook for easy reference on the trading floor.

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act in general, and in particular, with Section 6(b)(5), in that it is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, as well as to protect investors and the public interest, in creating a FLEX options trading procedure in proposed Rule 1079 to enable the trading of flexible index and equity options. The Exchange believes that the proposed trading procedure, crafted in consideration of the complexity of variable terms and the larger sizes reflective of institutional users, should ensure that just and equitable principles of trade govern FLEX options trading. The Exchange also believes that the financial requirements and assigned ROT and assigned Specialist obligations should promote liquidity, as well as the protection of investors trading FLEX options. Furthermore, the customization of option features and terms should enable investors to better manage trading and investment risk as well as more closely tailor Exchange-traded options to their specific investment strategies and objectives. Thus, FLEX Options unite certain attributes of negotiated transactions with the many benefits of an exchange auction marketplace, including transparency and OCC as guarantor. Because the proposed procedure is designed to minimize market impact and contains important customer protection provisions, it should prevent fraudulent and manipulative acts and practices. The Exchange also believes that the proposal is consistent with Section 11A, because FLEX options enable the Exchange to compete fairly with other exchanges as well as the OTC market.

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

The Phlx does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to

90 days or such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Phlx 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, NW, Washington, DC 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, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR-Phlx-96-38 and should be submitted by October 15, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²³

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 96-24367 Filed 9-23-96; 8:45 am]
BILLING CODE 8010-01-M

[Investment Advisers Act Release No. 1579; 803-102]

Technology Funding Partners III, L.P., et al.; Notice of Application

September 17, 1996.

AGENCY: Securities and Exchange Commission ("SEC").

ACTION: Notice of application for an order under the Investment Advisers Act of 1940 (the "Advisers Act").

APPLICANTS: Technology Fund Partners III, L.P. ("P3"); Technology Funding Venture Partners IV, An Aggressive Growth Fund, L.P. ("VP4"); Technology

Funding Venture Partners V, An Aggressive Growth Fund L.P. ("VP5"); Technology Funding Medical Partners I, L.P. ("MP1"); Technology Funding Inc. ("TFI"); and Technology Funding Ltd. ("TFL").

RELEVANT ADVISERS ACT SECTIONS: Order requested under section 206A of the Advisers Act for an exemption from section 205(a)(1) of the Advisers Act.

SUMMARY OF APPLICATION: Applicants request an order that would permit certain business development companies ("BDCs") to make in-kind distributions of portfolio securities and deem gains or losses on such securities to be realized upon such distributions to partners of such BDCs. The order would apply only to in-kind distributions of portfolio securities for which market quotations are available and are traded publicly on any nationally recognized exchange or market ("Exchange Traded Securities").

FILING DATE: The application was filed on July 15, 1996.

HEARING OR NOTIFICATION OF HEARING: An order granting the application will be issued unless the SEC orders a hearing. Interested persons may request a hearing by writing to the SEC's Secretary and serving applicants with a copy of the request, personally or by mail. Hearing requests should be received by the SEC by 5:30 p.m. on October 15, 1996, and should be accompanied by proof of service on applicants, in the form of an affidavit, or, for lawyers, a certificate of service. Hearing requests should state the nature of the writer's interest, the reason for the request, and the issues contested. Persons may request notification of a hearing by writing to the SEC's Secretary.

ADDRESSES: Secretary, SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. Applicants, 2000 Alameda de las Pulgas, San Mateo, California 94403.

FOR FURTHER INFORMATION CONTACT: Marianne H. Khawly, Staff Attorney, at (202) 942-0562, or Alison E. Baur, Branch Chief, at (202) 942-0564 (Division of Investment Management, Office of Investment Company Regulation).

SUPPLEMENTARY INFORMATION: The following is a summary of the application. The complete application may be obtained for a fee from the SEC's Public Reference Branch.

Applicants' Representations

1. P3, VP4, VP5, and MP1 are Delaware limited partnerships registered as BDCs under the Investment Company Act of 1940 (the "Act"). Each

²³ 17 CFR 200.30-3(a)(12).