

requirement solely for non-specialty options. Nevertheless, Phlx believes that specialist/ROTs warrant market maker status because they are subject to market making obligations. For instance, such ROTs could be requested to provide markets pursuant to Rule 1014. The Exchange recognizes that, although specialist are constrained from departing from the trading crowd of their specialty options, specialist/ROTs may provide markets where requested by way of Floor Broker representation. The Exchange may also assign an ROT to a particular option, pursuant to Rule 1014, Commentary .05. Thus, the proposed changes to specialist/ROT trading requirements preserve the obligation to provide markets in assigned options.

Phlx believes that this proposal is necessary to permit specialist/ROTs to retain their ROT status and, in turn, provide liquidity in Phlx options. Specifically, specialist/ROTs utilizing Floor Brokers to enter orders to facilitate customer interest play a crucial role in providing liquidity. Specifically, units often possess the large capital required to trade large sizes, where liquidity is most often needed. The Exchange believes that specialist /ROTs regularly improve the size, and sometime the price, of markets made on the Phlx floor. This proposal is a reasonable effort to accommodate the needs of specialist/ROTs to meet their market making responsibilities.

In approving changes to trading requirements, the Commission has previously stated that trading requirements reduce the extent to which traders can effectively function as privileged investors by entering the trading floor long enough to drop off orders with a Floor Broker, without actually making competitive quotations or otherwise affirmatively functioning as market makers.⁴ The Exchange does not believe that this proposal raises such concerns, because specialist/ROTs have specialist-related requirements to be present on the trading floor. Thus, the Exchange believes that the proposal balances the need to protect against misuse of market maker status with the liquidity-providing role that specialist/ROTs play in today's marketplace. The Exchange emphasizes that specialist/ROTs will continue to be subject to market making obligations, including the requirement to contribute to the maintenance of a fair and orderly market. The existence of substantive obligations should ensure that

specialist/ROTs act as bona fide market makers and do not otherwise use the Exchange floor.

2. Statutory Basis

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),⁵ in that it is designed to promote just and equitable principles of trade, and protect investors and the public interest, by supporting the liquidity-providing role of specialist/ROTs without diminishing market maker status.

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

The Exchange 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 publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such 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 the 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Phlx-97-19 and should be submitted by July 18, 1997.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38752; File No. SR-Phlx-97-16]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to Option Quote Spread Parameters

June 20, 1997.

I. Introduction

On April 2, 1997, the Philadelphia Stock Exchange, Inc., ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder² a proposed rule change relating to option quote spread parameters. The proposed rule change was published for comment in Securities Exchange Act Release No. 38576 (May 6, 1997), 62 FR 25985 (May 12, 1997). The Commission received no comment letters in response to the proposal.

II. Description of the Proposal

The purpose of the proposed rule change is to update the Exchange's equity and index option quote spread parameters, in view of the parameters applicable on other options exchanges. First, the Exchange is proposing to eliminate the maximum quote spread of $\frac{1}{8}$, currently applicable to options where the bid is less than \$.50, such that the maximum quote spread for options where the bid is less than \$2.00 will be $\frac{1}{4}$. This is identical to the quote

⁴ Securities Exchange Act Release No. 35786 (May 31, 1995), 60 FR 30122 (June 7, 1995) (SR-Amex-94-514).

⁵ 15 U.S.C. 78f(b)(5).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

spread parameters of the other options exchanges.³

Second, the proposal is intended to recognize that in certain market conditions, the existing parameters are too restrictive and should not apply. Specifically, for equity options only, the maximum quote spread for in-the-money series⁴ where the market for the underlying security is wider, the applicable parameter may be as wide as the quotation for the underlying security on the primary market. For instance, where the market for the underlying security is 20–21, and the bid for an in-the-money options series is \$7, the applicable maximum quote spread is 1/2, but under the proposed language, the parameter would be \$1, which is the spread in the underlying security.

Previously, the other options exchanges adopted rules to allow the quote spread for in-the-money series to reflect the quote spread for the underlying security on the primary market.⁵ Phlx recently determined that the increase in the number of multiply-traded options necessitated amending Exchange rules to achieve consistency with the rules of the other exchanges and to promote competition in multiply-traded options.⁶ The Exchange believes that this proposal is a reasonable response to such market conditions and consistent with the rules of other exchanges.

The Exchange notes that a violation of the maximum quote spread parameter may result in a fine pursuant to Options Floor Procedure Advice ("Advice") F-6.⁷ Because the Exchange is proposing to amend an Advice to which a fine pursuant to the minor rule plan applies, it follows that the minor rule plan will incorporate this amendment.⁸

³ See Amex Rule 958(c)(i); CBOE Rule 8.7(b)(iv); NYSE Rule 758(b)(i)(c)(1); and PSE Rule 6.37(b)(1).

⁴ In-the-money series are defined as those series where, in the case of a call option, the current market price of the stock is *higher* than the strike price, or, in the case of a put, the current market price of the stock is *lower* than the strike price.

⁵ See Securities Exchange Act release Nos. 26924 (June 13, 1989), 54 FR 26284; 27235 (September 11, 1989), 54 FR 38580; 27471 (November 24, 1989), 54 FR 50299; 28218 (July 18, 1990), 55 FR 30058 (orders approving proposed rule changes by the Chicago Board Options Exchange, American Stock Exchange, Pacific Stock Exchange, and New York Stock Exchange, respectively, relating to certain options bid/ask differentials).

⁶ Telephone conversation with Edith Hallihan, Phlx, and Peggy Blake, Division of Market Regulation, Commission (June 17, 1997).

⁷ Violations of Advice F-6 may result in the issuance of a fine pursuant to the Exchange's minor rule violation enforcement and reporting plan ("minor rule plan"). For fine schedule, see Exhibit B of File No. SR-PHLX-97-16.

⁸ The Phlx's minor rule plan, codified in Phlx Rule 970, contains floor procedure advices, such as Advice F-6, with accompanying fine schedules.

It should be noted, however, that quote spread parameters are not applicable during fast market conditions, pursuant to Floor Procedure Advice F-10, Extraordinary Market Conditions, and different quote spread parameters during such fast market conditions are not a violation of Advice F-6.⁹

The Exchange believes that the proposed rule change is necessary in light of competitive conditions, and consistent with Section 6(b)(5) of the Act,¹⁰ 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.

Specifically, the Exchange believes the proposal should facilitate the market making function by adjusting the quote spread parameter to reflect the market for the underlying security and current market conditions, thereby promoting just and equitable principles of trade. Although the proposed quote spread parameters may result in wider quotes in certain circumstances, the Exchange believes that such quote spread parameters are nevertheless reasonable, in line with other options exchanges, and continue to perform a regulatory function in the options marketplace, consistent with the objectives of the Act, by preventing fraudulent and manipulative acts and practices and protecting investors and the public interest.

III. Discussion

The Commission believes Phlx's proposed rule change is consistent with Section 6(b)(5) of the Act.¹¹ Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, perfect the mechanism of a free and open national market system, and, in general—to further investor protection and the public interest.¹²

Exchange Act Rule 19d-1(c)(2) authorizes national securities exchanges to adopt minor rule violation plans for summary discipline and abbreviated reporting; Exchange Act Rule 19d-1(c)(1) requires prompt filing with the Commission of any final disciplinary actions. However, minor rule violations not exceeding \$2,500 are deemed not final, thereby permitting periodic, as opposed to immediate, reporting.

⁹ Advice F-10 states that, in the interest of a fair and orderly market, two floor officials may declare a "fast market," during which displayed quotes are not firm and the volume guarantees of Advice A-11 are not applicable; nevertheless, best efforts are required to display quotes and fill orders.

¹⁰ 15 U.S.C. § 78f(b)(5).

¹¹ 15 U.S.C. § 78f(b)(5).

¹² In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

Phlx is proposing to eliminate the maximum quote spread of 1/8 for equity and index options where the bid is less than \$.50, resulting in a maximum quote spread of 1/4 of such options where the bid is less than \$2.00. The Commission believes the proposed rule change will reduce investor confusion by bringing Phlx's rules into conformity with the quote spread parameter rules of other options exchange. The Commission believes such uniformity will result in less competitive disparity among the options exchanges, thereby promoting just and equitable principles of trade.

The Commission also believes it is reasonable to permit in-the-money options quotations to reflect the quote spread for the underlying security on the primary market. The other options exchanges have such rules in place and the Commission believes that Phlx's adoption of an identical rule will create consistency, eliminate confusion in trading of equity options, and does not present any novel or unique regulatory issues. Furthermore, the Commission believes that such a rule is appropriate as it will facilitate Phlx's ability to compete in trading of multiply-traded options by allowing Phlx the same opportunity as the other options exchanges to widen quote spread parameters in equity options to reflect the market in the underlying security. The Commission notes that the proposal establishes maximum allowable quote spread and this portion of the proposal applies solely to in-the-money equity options. The Commission expects Phlx's to allow the use of the maximum quote spreads only where market conditions justify their application. Further, the Commission notes that under Phlx Rule 1014, Obligations and Restrictions Applicable to Specialists and Registered Options Traders, specialists' transactions should constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. Accordingly, the Commission expects the Phlx to monitor trading in in-the-money equity options affected by the proposal to ensure that market makers are meeting their obligations to maintain fair and orderly markets.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (File No. SR-Phlx-97-16) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁴

¹³ 15 U.S.C. § 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-16913 Filed 6-26-97; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38750; File No. SR-PHLX-97-04]

Self-Regulatory Organizations; Order Granting Partial Approval to a Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Modifying the Index Exercise Cut-Off Time

June 20, 1997.

I. Introduction

On January 8, 1997, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² On January 29, 1997, the Exchange filed Amendment No. 1 to the rule proposal.³ On April 4, 1997, the Exchange filed Amendment No. 2 to the proposed rule change.⁴ On April 23, the Exchange filed Amendment No. 3 to the proposed rule change.⁵ On May 23, 1997, the Commission partially approved the proposed rule change, including Amendment Nos. 1 and 2, thereby establishing a 4:02 p.m. close of trading for equity options and narrow-based index options, and modifying certain option trading rotation procedures.⁶

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Theresa McCloskey, Exchange, to Janice Mitnick, Commission, dated January 29, 1997. Amendment No. 1 was a technical amendment.

⁴ Letter from Philip H. Becker, Exchange, to Michael A. Walinskas, Commission, dated April 4, 1997. Amendment No. 2 proposed a 4:02 p.m. close of trading for narrow-based index options and modified option trading rotation procedures. Amendment No. 2 originally contained a proposal modifying Exchange index option exercise cut-off procedures. However, this proposal was resubmitted in Amendment No. 3, constituting a withdrawal of such proposal from Amendment No. 2.

⁵ File No. SR-PHLX-97-04, Amendment No. 3, dated April 22, 1997. Amendment No. 3 proposes to amend rule 1042A and Floor Procedure Advice G-1 to change the index option exercise cut-off time from 4:30 p.m. (of 15 minutes after the close of trading if trading is closed at a time other than the regular close of trading) to five minutes after the close of trading. The proposal also deletes the current requirement that member organizations must accept exercise instructions until 4:15 p.m. each business day.

⁶ Release No. 34-38554 (May 23, 1997), 62 FR 29756 (June 2, 1997).

Notice of the substance of Amendment No. 3 was provided by issuance of a release⁷ and by publication in the **Federal Register**.⁸ Two comment letters were received.⁹ This order approves the Amendment No. 3, permitting a change to the index option exercise cut-off time from 4:30 p.m. (or 15 minutes after the close of trading if trading is closed at a time other than the regular close of trading) to five minutes after the close of trading. As a result of the rule change, the exercise cut-off time applicable to narrow-based (industry) index options (which close at 4:02 p.m.) will be 4:07 p.m., and the cut-off time applicable to broad-based (market) index options (which close at 4:15 p.m.) will be 4:20 p.m. The order also approves a deletion of the current requirement that member organizations must accept exercise instructions until 4:15 p.m. each business day.

II. Description of the Proposal

The Exchange proposes to amend Rule 1042A and Floor Procedure Advice G-1 to change the index option exercise cut-off time from 4:30 p.m. (or 15 minutes after the close of trading if trading is closed at a time other than the regular close of trading) to five minutes after the close of trading. The proposal would result in an exercise cut-off time applicable to narrow-based index options (which close at 4:02 p.m.) of 4:07 p.m., and cut-off time applicable to broad-based index options (which close at 4:15 p.m.) of 4:20 p.m.

Currently, Rule 1042A requires that a memorandum to exercise any American-style index option must be received or prepared by the Exchange member organization no later than 4:30 p.m., or 15 minutes after the close of trading if the close occurs at a time other than the regular close of trading.¹⁰ Further, Rule 1042A(a)(ii) currently requires the submission of an Exercise Advice Form to the Exchange when exercising

⁷ Securities Exchange Act Release No. 38554 (April 29, 1997).

⁸ 62 FR 24529 (May 29, 1997).

⁹ Letter from Michael Schwartz, Committee On Options Proposals, to Jonathan Katz, Commission, dated January 10, 1997 ("CO-OP Letter") (referencing Chicago Board Options Exchange, Inc. ("CBOE"), American Stock Exchange, Inc. ("Amex"), and Pacific Exchange, Inc. ("PCX") proposals to establish a 4:02 p.m. trading close for equity and narrow-based index options); letter from Gerald D. O'Connell, Susquehanna Investment Group, Michael Walinskas, Commission, dated May 28, 1997 ("Susquehanna Letter").

¹⁰ Release No. 34-37077 (April 5, 1996), 61 FR 16156 (April 11, 1996) (Order approving SR-PHLX-95-86).

American-style index option contracts.¹¹

The Exchange states that in the process of reviewing and amending its rules to provide for a 4:02 p.m. close for narrow-based index options, it re-examined the reference in Rule 1042A to a 4:30 p.m. exercise cut-off time. As a result of this re-examination, the Exchange has proposed an exercise cut-off time for five minutes after the close of trading to establish a cut-off time similar to that of the other options exchanges.¹²

The proposal also would amend Rule 1042A to delete the requirement that member organizations must accept exercise instructions until 4:15 p.m. each business day. Under the proposal, member organizations could establish earlier cut-off times. The Exchange states that the purpose of this change is to eliminate a restriction in its rules which the CBOE and Amex do not have in their rules. The Exchange also states it believes that it is appropriate for member organizations to determine how best to comply with the Exchange's exercise cut-off time.

The Commission received two comment letters regarding the proposal to change the index option exercise cut-off.¹³ The CO-OP Letter supported a change in the Exchange's exercise cut-off, in order to conform its rules with those of the other options exchanges. The commenter suggested that such a change to the Exchange's exercise cut-off would assist in ensuring that the Exchange's rule did not appear to give professionals an advantage over public customers.

The Susquehanna Letter objected to the proposed reduction of the exercise cut-off time from 4:30 p.m. to 4:07 p.m. The commenter stated that such a change would have a negative impact on market makers' ability to facilitate orders received near the close of trading. The commenter also argued that the proposal would hinder market makers' ability to effect the exercises necessary to control their risk and stabilize their positions in preparation for the next day's trading. Finally, the commenter argued that the change will provide an unfair competitive advantage to broad-based index products.

The Exchange responded to the comment letter, stating that

¹¹ These requirements are currently not in effect on the last business day before expiration, pursuant to Rule 1042A(b). Nor are they applicable to European-style index options, which by definition cannot be exercised prior to expiration.

¹² See Amex Rule 980C(a)(i); CBOE Rule 11.1, Interpretations and Policies .03(b); and PCX Rule 7.15.

¹³ CO-OP Letter and Susquehanna Letter, *supra* n.9.