Margaret H. McFarland,
Deputy Secretary.
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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39460; International Series Release No. 1109; File No. SR–Phlx–97–22]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change, as Amended, and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Trading of Customized Foreign Currency Options on the Mexican Peso

December 17, 1997.

I. Introduction

On May 2, 1997, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') a proposed rule change to amend its rules to accommodate the trading of customized foreign currency options (''FCOs'') on the Mexican peso.[3] On May 21, 1997, the Phlx submitted to the Commission Amendment No. 1 to the proposal.[4] Notice of the proposal was published for comment and appeared in the **Federal Register** on May 30, 1997.[5] On July 15, 1997, the Phlx submitted to the Commission Amendment No. 2 to the proposal.[6] On December 12, 1997, the Phlx submitted to the Commission Amendment No. 3 to the proposal.[7] No comment letters were received on the proposed rule change. This order approves the Exchange's proposal, as amended.

II. Description of the Proposal

The Phlx proposes to amend its rules to accommodate the trading of customized foreign currency options on the Mexican peso. Currently, the Phlx offers listed FCOs on the British pound, French franc, Swiss franc, Japanese yen, Canadian dollar, Australian dollar, German mark and the European Currency Unit. Since November 1994, the Exchange has offered the ability to trade customized contracts on all of the above currencies in relation to the U.S. dollar or in relation to each other.[8] In 1995, the Exchange listed for trading customized options on the Italian Lira and the Spanish peseta.[9] The Exchange is proposing to list and trade customized options on the Mexican peso pursuant to Phlx Rule 1069. The Exchange is requesting approval to trade the peso only against the U.S. dollar and the Canadian dollar. In making this proposal, the Exchange states that it wants to capitalize upon Mexico's position near the forefront of the world's emerging markets, as well as the increased activity in Mexican equities and derivative securities based on Mexican markets.

Because the peso would only trade as a customized contract, there would be no continuously quoted series of peso contracts. Phlx Rule 1069(a)(1) provides that customized options contracts may be traded on any approved underlying foreign currency pursuant to Phlx Rule 1009. Therefore, the Exchange proposes to amend Phlx Rule 1009 to add the Mexican peso to the list of approved underlying foreign currencies. Pursuant to Phlx Rule 1069(a)(1)(B), users would be able to trade customized contracts between the Mexican peso (''MXP'') and the U.S. dollar (''USD'') in U.S. terms (USD/MXP), or as an inverse contract (MXP/USD) (*i.e.*, the trading currency is Mexican pesos and the underlying currency is U.S. dollars). The contract size for the customized contract in U.S. terms would be 250,000 MXP.[10] The premium will be .00001 USD per unit or 2.50 USD for an option contract having a unit of trading of 250,000 MXP. The contract size for the inverse would be 50,000 USD. The premium will be .0001 MXP per unit or 5.00 MXP for an option contract having a unit of trading of 50,000 USD.

No cross rate FCO on the peso will be offered at this time except for the Mexican peso against the Canadian dollar (''CAD''). The contract size for the cross-rate (CAD/MXP) would be 250,000 MXP. The premium will be .00001 CAD per unit or 2.50 CAD for an option contract having a unit of trading of 250,000 MXP. The contract size for the cross-rate (MXP/CAD) would be 50,000 CAD. The premium will be .0001 MXP per unit or 5.00 MXP for an option contract having a unit of trading of 50,000 CAD.

Consistent with Exchange Rule 1069(j), no quote spread parameters will apply to these contracts. The Exchange also proposes to amend Rules 1033 and 1034 to explain how premiums will be quoted and what the minimum fractional change will be for USD/MXP.

The Exchange proposes to apply customer margin ''add-on'' percentage of 17% for customized MXP contracts.[11] In no event will the Exchange reduce the margin levels for customized FCOs involving the peso below the 17% level without the prior approval of the Commission pursuant to Section 19(b) of the Act. Whenever the customer margin levels for customized FCOs on the peso are changed, the Exchange will promptly notify the Exchange's membership and the public. The Exchange represents that this margin level covers at least 99% of all five day price movements over the last three years.[12]

As with customized FCOs currently being listed by the Phlx. The Options

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Customized FCOs provide investors with the ability, within specified limits, to trade FCOs with customized strike prices, cross-rate FCOs on any two approved currencies, and FCOs where the U.S. dollar is the underlying currency. In addition, FCO participants may express quotes for customized FCOs as a percentage of the underlying currency, in addition to quoting in terms of the base currency per unit of the underlying currency. *See* Securities Exchange Act Release No. 34925 (November 1, 1994), 59 FR 55720 (November 8, 1995) (''Release No. 34–34925'').

[4] In Amendment No. 1, the Phlx clarified the contract specifications for the U.S. dollar/Mexican Peso contract, the inverse contract (Mexican Peso/U.S. dollar), and the Canadian dollar cross-rates, as described more fully herein. *See* Letter from Nandita Yagnik, Phlx, to Margaret Blake, Office of Market Supervision (''OMS''), Division of Market Regulation (''Market Regulation''), Commission, dated May 21, 1997.

[5] *See* Securities Exchange Act Release No. 38667 (May 22, 1997), 62 FR 29385.

[6] In Amendment No. 2, the Phlx proposes to set the position limit for the Mexican Peso at 100,000 contracts. *See* Letter from Nandita Yagnik, Phlx, to Margaret Blake, OMS, Market Regulation, Commission, dated July 11, 1997 (''Amendment No. 2'').

[7] In Amendment No. 3, the Phlx proposes to increase the proposed customer margin for FCOs on the Mexican Peso from 8% to 17%. Further, the Phlx states that the margin level of 17% will remain in effect until the Phlx receives Commission approval for the new customer margining system which will be filed with the Commission after it is approved by the Phlx Board of Directors. If approved by the Commission, margin for options on the Mexican peso would then be set at levels established by the new margining system. *See* Letter from Nandita Yagnik, Phlx, to John Ayanian, OMS, Market Regulation, Commission, dated December 10, 1997.

[8] *See* Securities Exchange Act Release No. 34925 (November 1, 1994), 59 FR 55720 (November 8, 1994).

[9] *See* Securities Exchange Act Release No. 36255 (September 20, 1995), 60 FR 50229 (September 28, 1995).

[10] Based on an exchange rate of 8.1070 Mexican peso/U.S. dollars on December 9, 1997, as published in The Wall Street Journal, this would correspond to an opening position for a Mexican peso FCO transaction (*i.e.*, 100 contracts) valued at approximately $3,083,000.

[11] For these purposes, ''add-on'' is the percentage of the current market value of the currency a Customized FCO that the holder of a ''short'' position must pay in addition to the current market value of each Customized FCO. The 17% add-on applies to both initial and maintenance margin positions in Mexican peso options.

[12] *See* Amendment No. 3, *supra* note 7.

Clearing Corporation (''OCC'') will clear and settle all trades in customized FCOs involving the peso. Because quotes in these options will not be continuously updated or otherwise priced by the Phlx, OCC will generate a theoretical price based on the prices and quotes of the customized FCOs and the closing value of the relevant underlying currency. OCC will use this price to market the customized FCO contracts involving the peso daily and to calculate margin requirements.[13]

III. Commission Finding and Conclusions

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, and, in particular, the requirements of Section 6(b)(5) of the Act.[14] First, the Commission believes that the trading of listed customized FCOs on the peso should provide investors with a hedging and risk transfer vehicle that will reflect the overall movement of the peso in relation to the U.S. dollar and the Canadian dollar. In this regard, customized FCOs on the peso should provide investors with an efficient and effective means of managing risk associated with the peso.[15]

Second, customized FCOs on the peso will trade within the Exchange's existing framework for customized FCOs, unless otherwise amended herein, which the Commission has previously found to adequately address the Commission's regulatory concerns.[16] Specifically, this framework includes, among other things, rules pertaining to: obligations of specialists and registered options traders (Rule 1014); position limits (Rule 1001);[17] exercise limits (Rule 1002); bids and offers (Rule 1033); minimum fractional changes (Rule 1034); and trading rotations, halts, and suspensions (Rule 1047).[18]

Third, the Commission believes it is reasonable for the Phlx to set a position limit of 100,000 contracts for options on the Mexican peso because the total U.S. dollar value position limit is similar to those approved for the Spanish peseta and the Italian lira. For example, the total U.S. dollar value position limit for FCOs on the Italian lira when approved was $3,096,000,000.[19] Currently, the total U.S. dollar value position limit for FCOs on the Mexican peso is approximately $3,083,000,000.[20] Additionally, the Commission notes that the proposed position limit of 100,000 contracts for customized FCOs (including customized cross-rates with the Canadian dollar) involving the Mexican peso imposes more restrictive limits than Phlx Rule 1001 would otherwise provide.[21]

Fourth, the Exchange has proposed adequate customer margin requirements for customized FCOs on the Mexican peso. The proposed add-on margin (i.e., 17%) provides sufficient coverage to account for historical and potential volatility in the peso in relation to the U.S. dollar. Moreover, customized cross-rates involving the peso and the Canadian dollar will be margined at the 17% margin add-on level. As a result, the Commission believes that the proposed customer margin levels will result in adequate coverage of contract obligations and are designed to reduce risks arising from inadequate margin levels for customized FCOs involving the Mexican peso.

The Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. As noted above, in proposed Amendment No. 2, the Phlx sets a position limit that, in total U.S. dollar value terms, is similar to position limits approved for options on the Spanish peseta and the Italian lira. In addition, the Phlx's proposal to set similar position limits for options on the Spanish peseta and the Italian lira was published in the **Federal Register** for the full 21-day comment period without any comments being received by the Commission.

Second, the proposal in Amendment No. 3 to increase the margin level for customized FCOs (including customized cross-rates with the Canadian dollar) involving the Mexican peso serves an investor protection purpose by reducing the risks that can arise from inadequate margin levels. Additionally, the Commission notes that the changes set forth in Amendment No. 3 impose more restrictive standards than those contained in the original proposal which was published in the **Federal Register** for the full 21-day comment period without any comments being received by the Commission.

Accordingly, the Commission believes that Amendment Nos. 2 and 3 are consistent with Section 6(b)(5) of the Act and that good cause exists to approve these amendments on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 2 and 3. 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 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 the Phlx. All submissions should refer to SR–Phlx–97–22 and should be submitted by January 14, 1998.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[22] that the proposed rule change (File No. SR–Phlx–97–22) is approved, as amended.

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

Margaret H. McFarland,

Deputy Secretary.

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[13] Telephone conversation between Nandita Yagnik, Phlx, and John Ayanian, OMS, Market Regulation, Commission, on December 17, 1997.

[14] 15 U.S.C. 78f(b)(5).

[15] 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).

[16] *See* Release No. 34–34925, *supra* note 3.

[17] Phlx Rule 1001 generally provides for position limits of 200,000 contracts on the same side of the market relating to the same foreign currency, unless otherwise noted in the text of the rule. In Amendment No. 2, the Phlx proposed lower position limits of 100,000 contracts for options on the Mexican peso. *See* Phlx Rule 1001, commentary .05(b).

[18] *Id.*

[19] Based on an exchange rate of 1,1615 Italian lira/U.S. dollar on August 23, 1995, as published in The Wall Street Journal. Based on an exchange rate of 1,753 Italian lira/U.S. dollar on December 9, 1997, as published in The Wall Street Journal, the total U.S. dollar value position limit was approximately $2,852,000,000.

[20] Based on an exchange rate of 8.1070 Mexican peso/U.S. dollar on December 9, 1997, as published in The Wall Street Journal.

[21] *See supra* note 17.

[22] 15 U.S.C. 78s(b)(2).

[23] 17 CFR 200.30–3(a)(12).