

to the proposed rule change, and none have been received.

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

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of Section 17A(b)(3)(F) <sup>5</sup> of the Act. Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds that are in the custody or control of the clearing agency or for which it is responsible. The Commission finds that the proposed rule change is consistent with this obligation because it will facilitate a more consistent and predictable marking price methodology for the purposes of calculating premium margin as well as providing a more accurate assessment of risk. Specifically, the rule change should enable OCC to avoid the market risk associated with volatile jumps in marking prices when a change in the volume-leading exchange occurs. Moreover, the last sale methodology might lead to inconsistent marking as the exchange with the highest volume in an option series may not be the one on which the last sale is made. Thus, the rule change should reduce OCC's market risk and therefore should help it to safeguard securities and funds in its custody or control or for which it is responsible.

OCC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing because such approval will allow OCC to immediately amend its rules so that the rules accurately reflect OCC's practice of setting options' marking prices for purposes of calculating premium margin and to implement its new method of setting options marking prices as soon as its systems are ready.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange

Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 OCC's principal office. All submissions should refer to File No. SR-OCC-2001-08 and be submitted by September 7, 2001.

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-2001-08) be, and hereby is, approved on an accelerated basis.

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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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44680; File No. SR-PCX-00-45]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to the Expansion of Equity Hedge Exemptions From Position and Exercise Limits

August 10, 2001.

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> notice is hereby given that on December 11, 2000, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

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

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

### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The PCX proposes to expand its current equity hedge exemptions by eliminating position and exercise limits for certain designated hedge strategies. The current reporting procedures to identify and document hedged positions would remain in place. The text of the proposed rule change is set forth below. Proposed additions are *italicized* and proposed deletions are in brackets.

\* \* \* \* \*

¶4769—Position Limits

Rule 6.8(a)—No change.

Commentary:

.01—.06—No change.

.07—Equity Hedge Exemption. *The following qualified hedging transactions and positions are exempt from the established position and exercise limits prescribed under Commentary .06 above.*

(a) *Where each option contract is "hedged" or "covered" by 100 shares of the underlying security or securities convertible into such underlying security, or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract: (i) long call and short stock; (ii) short call and long stock; (iii) long put and long stock; (iv) short put and short stock.*

(b) *A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock ("reverse conversion").*

(c) *A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock ("conversion").*

(d) *A short call position accompanied by a long put position, where the short call expires with the long put, and the strike price of the short call equals or exceeds the long put, and where each short call and long put position is hedged with 100 shares of the underlying security (or other adjusted number of shares). Neither side of the short call/long put position can be in-the-money at the time the position is established ("collar").*

(e) *A long call position accompanied by a short put position with the same*

<sup>5</sup> 15 U.S.C. 78q-1(b)(3)(F).

strike price and a short call position accompanied by a long put position with a different strike price ("box spread").

(f) A listed option position hedged on a one-for-one basis with an over-the-counter ("OTC") option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike of each other and no more than one expiration month apart.

(g) For those strategies described under (b), (c) and (d) above, one component of the option strategy can be an OTC option contract guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.

(h) An OTC option contract is defined as an option contract that is not listed on a National Securities Exchange or cleared at the Options Clearing Corporation.

[The Exchange may exempt position and exercise limits for options on underlying stocks in the following positions where each option contract is "hedged" by 100 shares of the underlying stock or securities convertible into such stock or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract:

- (i) Long Stock and Short Call
- (ii) Long Stock and Long Put
- (iii) Short Stock and Long Call
- (iv) Short Stock and Short Put.

Position limits for any class of options on underlying stocks may not exceed three times the established position limits for such class. This restriction also applies to positions for which an exemption has been granted pursuant to Rule 6.8 commentaries .03 or .04.]

\* \* \* \* \*

## 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 PCX 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

#### 1. Purpose

The Exchange is proposing to eliminate position and exercise limits for certain qualified hedged equity option positions by expanding the definition of a "qualified" hedged position. The PCX believes that the proposed rule change expands position and exercise limits to meet the hedging needs of investors for market neutral strategies. The PCX represents that the proposal is in large part adopted from a proposed rule change by the Chicago Board Options Exchange, Inc. ("CBOE").<sup>3</sup> The following qualified hedge strategies are proposed to be exempt from the established position and exercise limits:

(i) Where each option contract is "hedged" or "covered" by 100 shares of the underlying security or securities convertible into the underlying security, or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract: (a) Long call and short stock; (b) short call and long stock; (c) long put and long stock; and (d) short put and short stock;

(ii) A long call position accompanied by a short put position, where the long call expires with the short put, and the strike price of the long call and short put is equal, and where each long call and short put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock ("reverse conversion");<sup>4</sup>

(iii) A short call position accompanied by a long put position where the short call expires with the long put, and the strike price of the short call and long put is equal, and where each short call and long put position is hedged with 100 shares (or other adjusted number of shares) of the underlying security or securities convertible into such stock ("conversion");<sup>5</sup>

<sup>3</sup> Securities Exchange Act Release No. 44681 (August 10, 2001) (File No. SR-CBOE-00-12). The CBOE's proposed qualified hedge strategies, which are identical to the PCX's proposal, contain examples of these strategies. See Amendment No. 1 to SR-CBOE-00-12. The PCX has represented that it agrees with those examples for its proposed qualified hedge strategies. Telephone conversation between Cindy Sink, Senior Attorney, Regulatory Policy, PCX, and Susie Cho, Special Counsel, Division of Market Regulation ("Division"), Commission, June 26, 2001.

<sup>4</sup> For this strategy one of the option components can be an OTC option guaranteed or endorsed by the firm maintaining the proprietary position or carrying the customer account.

<sup>5</sup> *Id.*

(iv) A short call position accompanied by a long put position, where the short call expires with the long put, and the strike price of the short call equals or exceeds the long put, and where each short call and long put position is hedged with 100 shares of the underlying security (or other adjusted number of shares). Neither side of the short call/long put position can be in-the-money at the time the position is established ("collar");<sup>6</sup>

(v) A long call position accompanied by a short put position with the same strike price and a short call position accompanied by a long put position with a different strike price ("box spread"); and

(vi) A listed option position hedged on a one-for-one basis with an over-the-counter ("OTC") option position on the same underlying security. The strike price of the listed option position and corresponding OTC option position must be within one strike of each other and no more than one expiration month apart.

Within the list of proposed hedge strategies eligible for an equity hedge exemption, the Exchange proposes that the option component of a reversal, conversion, or collar position be treated as one contract rather than as two contracts. All three strategies serve to hedge a related stock portfolio. Because these strategies require the contemporaneous<sup>7</sup> purchase/sale of both a call and put component against the appropriate number of shares underlying the option (generally 100 shares), the Exchange believes that the position should be treated as one contract for hedging purposes.

Under the proposed rule change, the existing standard position and exercise limits will remain in place for unhedged equity option positions. Once an account nears or reaches the standard limit, positions identified as one or more of the proposed qualified hedge strategies will be exempted from limit calculations. The exemption will be automatic (*i.e.*, does not require preapproval from the Exchange) to the extent that the member identifies that a pre-existing qualified hedge strategy is in place or is employed from the point that an account's position reaches the standard limit and provides the required supporting documentation to the Exchange.

The exemption will remain in effect to the extent that the exempted position remains intact and that the Exchange is provided with any required supporting documentation. Procedures to

<sup>6</sup> *Id.*

<sup>7</sup> At or about the same time.

demonstrate that the option position remains qualified will be similar to those currently in place for equity hedge exemptions. Currently a qualified account must report hedge information each time the option position changes. Hedge information for member firm and customer accounts are reported to the Exchange electronically, via the Large Options Position Report. Market maker account information is also reported to the Exchange electronically by the member's clearing firm. For those option positions that do not change, a filing is generally required on a weekly basis. Finally, the existing requirement imposed on member firms to report hedge information for proprietary and customer accounts that maintain an options position in excess of 10,000 contracts will remain in place.

The Exchange believes that all of the proposed qualified strategies are market neutral with the exemption of covered stock positions. According to the Exchange, we covered stock transactions (long stock/short call; short stock/short put) are not market neutral, the market exposure resides with the stock position where no limit is imposed. The Exchange believes that the short option premium mitigates the stock exposure and therefore no limit should be imposed on this strategy.

The Exchange believes that the proposed strategies do not lend themselves to market manipulation and should be exempt from position limits. The Exchange represents that the reporting requirements under PCX Rule 6.6 and internal surveillance procedures for hedged positions will enable the Exchange to closely monitor sizable option position and corresponding hedge.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>9</sup> in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were not solicited or received with respect to the proposed rule change.

### **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 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 Exchange 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, including whether the proposal is consistent with the Act. The Commission is especially interested in receiving written, data, views and arguments concerning the use of a listed option position hedged on a one-for-one basis with an OTC option position on the same underlying security. In particular, the Commission staff has concerns that such exemption would grant members the ability to sell OTC options and hedge such positions on the exchange with listed options on an unlimited basis. This potentially raises manipulation concerns. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. 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 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. 522, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of such filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-00-45

and should be submitted by September 7, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-44672; File No. SR-Phlx-2001-67]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 by the Philadelphia Stock Exchange, Inc. Relating to Automatic Price Improvement for Equities Trading in Decimals**

August 9, 2001.

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> notice is hereby given that on July 24, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" 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 Exchange. On August 7, 2001, the Exchange amended the proposal.<sup>3</sup> The Exchange filed another amendment on August 9, 2001.<sup>4</sup> The Exchange filed this proposal under section 19(b)(3)(A) of the Act,<sup>5</sup> and Rule 19b-(f)(6)<sup>6</sup> thereunder, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule

<sup>10</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See August 6, 2001 letter from Jurij Trypupenko, Esquire, Phlx to Alton S. Harvey, Division of Market Regulation ("Division"), Commission and attachments ("Amendment No. 1"). In Amendment No. 1, the Phlx clarified that the only proposed substantive change to the pilot program was to extend its operation through November 5, 2001. Amendment No. 1 also provided a clear explanation of proposed technical changes to rule language to conform the language to prior filings.

<sup>4</sup> See August 8, 2001 letter from Jurij Trypupenko, Esquire, Phlx to Alton S. Harvey, Division, Commission ("Amendment No. 2"). In Amendment No. 2, the Phlx amended the proposed rule language to clarify that the pilot will operate through November 5, 2001.

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>6</sup> 17 CFR 240.19b-4(f)(6). The Phlx requested that the Commission waive the 5-day prefiling notice requirement, and the 30-day operative delay.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(4).