

its escrow program, certain changes to OCC Rules 610 and 1801 are necessary. In general, the changes will accommodate the deposit of any combination of cash and short-term government securities⁵ for short positions in put contracts, will provide for the valuation and substitution of deposited assets, and in the event of the value of the property declines below a specified amount, will permit OCC to disregard the escrow deposit and require the clearing member to deposit margin upon notice.

Second, OCC is eliminating its batch ERD system for processing escrow receipts. OCC contemplated the eventual replacement of the batch ERD system with its on-line ERD system. OCC believes that all its clearing members and custodian banks now have completed their transition to the on-line system because the batch ERD system is no longer used. Therefore OCC is eliminating references to escrow receipts in Rule 610 and 1801 and to the batch processing system described in Rule 613(a).

Third, OCC is amending Rule 613 to modify the time at which it releases escrow deposits. OCC currently releases an escrow deposit on the second business day following the expiration of the short position covered by the deposit, and thereafter if assigned, collects margin for the position formerly covered by the deposit until the next business day after the exercise settlement date. With this proposed rule change OCC will hold an escrow deposit covering a short position to which an exercise has been allocated until the business day after the exercise settlement date and will no longer collect margin.

Fourth, OCC is amending Rule 610 to eliminate bulk deposits of underlying securities for call options and the deposit of Treasury bills for put options because these capabilities have been rarely, if ever, used by clearing members. Furthermore, the provisions for depositing Treasury bills for put options is being superseded by the new provisions for providing escrow deposits for put option contracts.

Finally, OCC is modifying rules that relate to the suspension and liquidation of a clearing member to conform to OCC's escrow deposit program described above. Specifically, OCC is amending Rule 1106(b)(2) to make explicit that OCC would make timely settlement on an exercise assigned to a

covered short position of a suspended clearing member even if the depository had not turned over the deposited property to OCC at the time of settlement. OCC would be entitled to reimburse itself for the cost of effecting such settlement from the deposited property when such property is remitted to OCC. Similarly, Rule 1107(b)(2) is being amended to reflect the same principles to assignments pending at the time of a clearing member's suspension. Also, OCC amended its Restated On-Line Escrow Deposit Agreement which is to be executed between OCC and each approved escrow deposit bank. The amended agreement parallels the principal purposes of the filing, which are to provide for the expansion of the program to include escrow deposits for short positions in stock and stock index put options, the elimination of hard copy receipts, and the modification of the time at which escrow deposits are released.

II. Discussion

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).⁶ Section 17A(b)(3)(F) requires that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible. The Commission believes that OCC's proposed rule change meets these requirements by establishing a framework in which existing OCC systems, rules, and procedures are extended to allow escrow deposits for short positions in stock put option contracts and stock index put option contracts. The elimination of the batch ERD system and the designation of the on-line ERD system as the means of processing escrow deposits should make processing such deposits more efficient and should promote the safeguarding of the deposits in the possession of OCC or for which it is responsible. By expanding the escrow receipt framework to include short positions in stock put and stock index put option contracts and by eliminating unnecessary steps in the escrow receipt process (e.g., release of deposits followed by margin collection and bulk deposits for put options), OCC is creating more efficient procedures in order to streamline the processing of escrow receipts. As a result, the prompt

and accurate clearance and settlement of securities transactions should be promoted.

III. Conclusion

The Commission finds that the proposal is consistent with the requirements of the Act, particularly with Section 17A(b)(3)(F) of the Act, and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-95-17) be, and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37603; File No. SR-OCC-95-20]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving a Proposed Rule Change Relating to the Issuance, Clearance, and Settlement of Buy-Write Options Unitary Derivatives

August 26, 1996.

On December 27, 1995, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-OCC-95-20) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").¹ On February 5, 1996, OCC filed Amendment No. 1 to the proposed rule change.² Notice of the proposed rule change, as amended, was published in the Federal Register on March 20, 1996.³ No comment letters were received. On March 20, 1996, OCC filed Amendment No. 2.⁴ Notice of the amendment was published in the Federal Register on May 15, 1996.⁵ No comment letters were received. For the reasons discussed below, the

⁷ 17 CFR 200.30-3(a)(12) (1995).

¹ 15 U.S.C. § 78s(b)(1) (1988).

² Letter from James C. Yong, First Vice President and General Counsel, OCC, to Jerry W. Carpenter, Assistant Director, Division of Market Regulation ("Division"), Commission (February 5, 1996).

³ Securities Exchange Act Release No. 36960 (March 13, 1996), 61 FR 11458.

⁴ Letter from James C. Yong, First Vice President and General Counsel, OCC, to Jerry W. Carpenter, Esq., Assistant Director, Division, Commission (March 19, 1996).

⁵ Securities Exchange Act Release No. 37203 (May 10, 1996), 61 FR 24955.

⁵ As defined in Rule 610, proposed Interpretation .02, short-term government securities is defined as securities with a fixed principal amount issued or guaranteed by the United States and having one year or less to maturity.

⁶ 15 U.S.C. § 78q-1(b)(3)(F) (1988).

Commission is approving the proposed rule change.

I. Description of the Proposal

The purpose of the proposed rule change is to amend certain OCC By-Laws and Rules and to add new sections to OCC's By-Laws and Rules to provide for the issuance, clearance, and settlement of a new equity derivatives product referred to as Buy-Write Options Unitary Derivatives ("BOUNDS"). The Commission recently approved proposed rule changes filed by the American Stock Exchange ("Amex"), the Chicago Board Options Exchange ("CBOE"), and the Pacific Stock Exchange ("PSE") (collectively referred to as the "exchanges") to list and trade BOUNDS.⁶

The purchase of a BOUND is intended to be substantially equivalent to a buy-write transaction (*i.e.*, the simultaneous writing of a call option and purchase of the underlying stock). However, unlike an actual buy-write transaction, the purchase of a BOUND is effected in a single exchange transaction. As with all OCC issued options, BOUNDS will be created when an opening buy and an opening sell order are executed. The execution of every such order will increase the open interest in BOUNDS.⁷

The exchanges have indicated that BOUNDS will be listed on the same securities on which Long-Term Equity Options Series ("LEAPS")⁸ are listed because the criteria used for stocks underlying BOUNDS will be the same criteria that is used for stocks underlying LEAPS. The exchanges expect that BOUNDS will be listed with a duration equal to that of LEAPS, which is currently thirty-nine months from the date of issuance.

A BOUND holder will be in essentially the same economic position as a covered writer of a European-style call option. BOUND holders will profit from the stock's movement up to the strike price and will receive payments equivalent to any cash dividends paid on the underlying stocks ("dividend equivalent"). Non-cash distributions may be reflected either through the

delivery of the distributed property or by means of adjustments in the terms of the BOUNDS. The right of a BOUND holder to receive and the obligation of a BOUND writer to pay or deliver a dividend equivalent will be fixed at the close of trading on the business day preceding the ex dividend date. The actual payment of the dividend equivalent may occur days or weeks later to coincide with the payable date for the corresponding dividend on the underlying stock.⁹

BOUNDS are European style options because the holder cannot exercise a BOUND prior to expiration. In contrast, LEAPS are American style options, which can be exercised at any time prior to expiration. At the expiration of a BOUND, either delivery of the underlying stock or payment of the strike price is always required, and notice of exercise is not required. Therefore, the concepts of exercise and assignment are not used in relation to BOUNDS.

Under the proposed rule change, the expiration settlement date of a BOUND contract is the third business day following the expiration date. The expiration settlement date for a particular BOUND contract will not depend on whether the contract is to be settled by cash or by the delivery of stock. BOUNDS to be settled in cash will be settled through OCC's cash settlement system. BOUNDS that are to be settled by delivery of stock ordinarily will be settled in the same manner that exercised stock options are settled (*i.e.*, through stock clearing corporations).¹⁰

Like put and call stock options, BOUNDS ordinarily will trade in standardized contract units of one hundred shares of underlying stock per BOUND contract. Positions in BOUNDS will be included in the formula to determine a clearing member's stock clearing fund contribution, and BOUNDS will be included with stock options for purposes of margin calculations. The clearing fund pool for BOUNDS will be the same fund pool used for stock options, and the rule change amends the definition of a

"stock clearing member" to be a clearing member approved to clear transactions in stock options and BOUNDS.

Accordingly, stock clearing members will be qualified automatically to engage in transactions in BOUNDS without any additional qualification.

At expiration, if on the last day of trading the underlying stock closes at or below the strike price, BOUND holders will receive one hundred shares of the underlying stock for each BOUND contract held, and BOUND writers will be required to deliver one hundred shares of the underlying stock for each BOUND contract written. If at expiration the underlying stock closes above the strike price, the BOUND holder will receive a payment equal to one hundred times the BOUND's strike price for each BOUND contract held, and BOUND writers will be required to make payment equal to one hundred times the BOUND's strike price for each BOUND contract written. In either case, the BOUND holder ordinarily will be left in the same economic position as a covered call writer that holds the position until the expiration of the call option.

Technically, there is no premium in a BOUND transaction because that term generally is used to denote the purchase price of an option. However, in order to accommodate transactions in BOUNDS, the proposed rule change amends the definition of the term "premium" to permit the term to include the trade price with respect to BOUNDS.

Pursuant to the rule change, OCC will margin BOUNDS as part of the stock option product group and will include BOUNDS in the same class group with put and call options on the same underlying stock. Special provisions have been added to the definition of "premium margin" to provide an appropriate definition of the term when applied to an expired but unsettled BOUND contract. The added provisions reflect that premium margin with respect to an expired long or short position in a BOUND may call for either the marking price of such underlying security due to be settled by delivery or the payment of the strike price depending upon the closing price of the underlying stock when the BOUND expires. The definition of the term "marking price" with respect to margins on options and BOUNDS has been changed to reflect that OCC will use the highest reported asked quotation in valuing an underlying security if no last sale price is available. The minimum margin required for the stock option product group includes protection against the bid/ask spread; therefore, it is not necessary to use a different

⁶ For a complete description of the characteristics of BOUNDS, refer to Securities Exchange Act Release No. 36710 (January 11, 1996), 61 FR 1791 [File Nos. SR-AMEX-94-56, SR-CBOE-95-14, and SR-PSE-95-01] (order approving proposed rule changes relating to BOUNDS).

⁷ Open interest refers to the total number of contracts that have neither been closed out nor been allowed to expire.

⁸ Generally, LEAPS are long-term equity option securities that expire up to 39 months from the date of issuance. For a complete description of LEAPS, refer to Securities Exchange Act Release No. 28890 (February 15, 1991), 56 FR 7439 [File No. SR-CBOE-90-32] (order approving proposed rule change regarding the listing of LEAPS).

⁹ It is possible that an obligation to pay or a right to receive a dividend equivalent that accrued prior to the expiration date of a BOUND will remain outstanding after the expiration date and even after expiration settlement has been completed. OCC simply will continue to carry the dividend equivalent right or obligation in a manner similar to a settlement obligation of an exercised option. It will be margined and marked to the market each day similar to other settlement obligations.

¹⁰ In the event the BOUND transaction cannot be settled through regular-way settlement (*i.e.*, on the third business day following the expiration date), the contract will be settled on a broker-to-broker basis.

quotation for puts than for calls (*i.e.*, highest reported ask quotation for call options and the lowest reported bid quotation for put options).

The term "closing price" is defined under the rule change to mean the closing price for the underlying security on the primary market on the business day prior to the expiration date of the BOUND contract. However, the exchange(s) on which any series of BOUNDS trades may provide that the closing price of a BOUND be based on an average of prices of the underlying security near the close of trading on such business day.¹¹ The rule change also sets forth the steps OCC may take in the event the closing price for an underlying security is unreported or otherwise unavailable. In addition to any other actions OCC may be entitled to take under its By-Laws and Rules, OCC may suspend settlement obligations for the affected BOUNDS until a closing price is available or until OCC determines the closing price. OCC has the authority to determine the closing price for BOUNDS by means of a panel consisting of two designated representatives of each exchange on which the affected series is open for trading and OCC's Chairman.

The rule change adds a provision to OCC's By-Laws to specify that the closing price for the underlying security of a BOUND is conclusively presumed to be accurate and shall be final for purposes of determining settlement rights and obligations with respect to a BOUND. The rule change also adds an Interpretation to OCC's By-Laws to provide that except in extraordinary circumstances OCC will not adjust an officially reported closing price for exercise settlement purposes even if the closing price is subsequently found to have been erroneous.

OCC's Securities Committee shall have the authority to make adjustments in BOUNDS contracts through the same procedures as in the case of option adjustments.¹² BOUNDS ordinarily will be adjusted according to existing adjustment rules, and adjustments are expected to ordinarily conform to adjustments made with respect to LEAPs on the same underlying stock. Whenever additional shares or other property are distributed with respect to shares of an underlying security (*i.e.*, a stock split or stock dividend) and the number of BOUND contracts outstanding is adjusted to reflect the

number of shares distributed or the unit of trading for such BOUND contract is adjusted to include the distributed property, then such adjustment will not include the obligation to pay and received a dividend equivalent. However, when the strike price of a BOUND is reduced to reflect the value of a distribution, the writer of the BOUND will be obligated to pay a dividend equivalent to the holder of the BOUND. This will occur because, unlike in the case of adjusting an option, lower the strike price of a BOUND will not give the holder the benefit of the distribution because the holder does not pay the strike price (The strike price of a BOUND caps the value that the holder will receive upon expiration of the BOUND.) Therefore, it is appropriate to give the holder the benefit of certain extraordinary distributions through a dividend equivalent at the time the distribution is made and also to reduce the strike price so that the BOUND holder cannot again receive the benefit of the distribution when the BOUND expires.

In the case of a cash-out merger of similar transaction, a BOUND will be adjusted to require the writer to pay expiration an amount equal to the lesser of the price paid for the underlying security in the merger or the strike price of the BOUND. Because there no longer will be an underlying security, the expiration date of the BOUND will be accelerated so that the cash will be paid to the BOUND holder at or about the same time that payment of the cash-out value is paid to holders of the underlying security. While the mechanics are somewhat different from the adjustment ordinarily made for the same event in the case of an option, the economic result is quite similar. Because the value of an option because fixed as the result of adjusting for a cash-out merger, in-the-money options are effectively terminated because they have no time value and because holders have every incentive to exercise them immediately to receive the cash. The expiration date of the BOUND will be accelerated because BOUNDS are European style and cannot be exercised prior to expiration.

II. Discussion

Section 17A(b)(3)(F)¹³ requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds in the custody or control of the clearing agency or for which it is responsible. The Commission believes that OCC's proposal is consistent with OCC's

obligations under Section 17A(3)(F) to assure the safeguarding of securities and funds in its custody or control because the proposal provides that OCC will process BOUNDS transactions in accordance with its existing risk-reduction methodology. For example, under the proposal, BOUNDS will be included with stock options for purposes of margin calculations, and positions in BOUNDS will be included in the formula to determine a clearing member's proportionate share of contribution to the clearing fund. Therefore, a clearing member's activity in BOUNDS will be reflected in the amount of funds collected (*e.g.*, margin and clearing fund deposits) by OCC to safeguard it against losses resulting from a clearing member's failure to settle.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of Section 71A(b)(3)(F) of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-95-20) be, and hereby is, approved.

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

Margaret H. McFarland,
Deputy Secretary.

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SOCIAL SECURITY ADMINISTRATION

Agency Information Collection Activities: Proposed Collection Request

The Social Security Administration publishes a list of information collection packages that will require submission to the Office of Management and Budget (OMB) for clearance in compliance with P.L. 104-13 effective October 1, 1995, The Paperwork Reduction Act of 1995. The information collection(s) listed below requires extension of the current OMB approval(s).

(Call the SSA Reports Clearance Officer on (410) 965-4125 for a copy of the form(s) or package(s), or write to her at the address listed below the information collections.)

1. *Application for Supplemental Security Income—0960-0229*. The information on form SSA-8000 is used by the Social Security Administration to determine a claimant's eligibility for

¹¹ The exchange(s) must specify that an average of prices will be used prior to the opening of trading in any BOUNDS series.

¹² OCC's Securities Committee consists of one designated representative of each exchange and the Chairman of OCC.

¹³ 15 U.S.C. § 78q-1(b)(3)(F) (1988).

¹⁴ 17 CFR 200.30-3(a)(12) (1996).