

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38637; File No. SR-CBOE-97-16]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to the Trading of Index FLEX Options

May 14, 1997.

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 March 13, 1997, the Chicago Board Options Exchange, Inc. ("CBOE" 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 self-regulatory organization. On May 14, 1997, CBOE submitted Amendment No. 1 ("Amendment No. 1") to the filing to clarify issues related to priority procedures applicable to FLEX options.<sup>1</sup> 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 CBOE proposes to make certain changes to its rules governing the trading of Index FLEX options. Specifically, those changes involve a reduction in the percentage of a trade to which a Submitting Member indicating an intent to cross is entitled and the establishment of bid-offer spreads for certain Index FLEX trades.

The text of the proposed rule change is available at the Office of the Secretary, CBOE 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 CBOE 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 CBOE 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 proposed rule change is to make certain changes to the Exchange's rules governing the trading of Index FLEX options. Specifically, those changes involve a reduction in the percentage of a trade to which a Submitting Member indicating an intent to cross is entitled and the establishment of bid-offer spreads for certain Index FLEX trades. Since their inception,<sup>2</sup> Index FLEX options have relied on Appointed Market-Makers ("AMMs") supplemented by Qualified Market-Makers ("QMMs) to provide liquidity for FLEX requests for quotes ("RFQs). AMMs are required, pursuant to Rule 24A.9(b), to enter a FLEX Quote in response to any RFQ on any FLEX Option of the class to which the AMM is appointed. A QMM may, but is not required to, enter a FLEX Quote in response to an RFQ.

As an inducement to attract volume that would otherwise be transacted in the over-the-counter market, the Exchange established percentage entitlements for the Exchange member that initiates FLEX bidding and offering by submitting an RFQ ("Submitting Member") where the Submitting Member has indicated an intention to cross or act as principal on the trade and has matched or improved the best bid or offer ("BBO"). Generally, with some qualifications, the Submitting Member is entitled to 50% (1/2) of the trade in the case where the Submitting Member matches the BBO and 66.67% (2/3) of the trade where the Submitting Member improves the BBO.

To the extent Submitting Members accept their entire entitlement on a trade, half of the trade or less would remain for the other market-makers to share. Through experience the Exchange has learned these entitlements have discouraged participation by market-makers in the Index FLEX product. The Exchange has, therefore, decided in order to encourage more active

participation by Exchange market-makers and to provide as liquid a market as possible for Index FLEX options, that the entitlement for Submitting Members should be reduced to the greater of 25% or a proportional share of the trade.<sup>3</sup> This means, for example, that if there are four market-makers participating on the trade in addition to the Submitting member then the Submitting member would be entitled to 25% of the trade even though this is greater than a proportional share (1/5) of the trade. However, if there were two market-makers participating on a trade along with a Submitting Member, the Submitting Member would be entitled to a proportional share of the trade, or 1/3 of the trade. This is different from the current entitlement for Submitting Members in Equity FLEX Options who are entitled only to 25% of the trade regardless of the number of participants to the trade. Consequently, the rule will be revised to separate the treatment of Index FLEX and Equity FLEX into different paragraphs.

The proposed rule change also amends the language of subparagraphs (e)(iii) (A) and (B) of Rule 24A.5 to state that a submitting member "will have priority to execute" the specified share of a trade that is the subject of a RFQ, instead of the term "be permitted to execute." The Exchange initially adopted this rule language in Securities Exchange Act Release No. 37337 in order to clarify that a member may cross more than the designated share as to which he has priority if no one else is willing to trade at the same or a better price.<sup>4</sup> The current filing, however, inadvertently utilized the old rule language. Amendment No. 1 to the filing clarifies that the rule language will remain unchanged.

The Exchange is also proposing to make a second change to its rules governing Index FLEX Options. This change would impose maximum bid-offer spreads on certain Index FLEX Options. Currently, under Rule 24A.9(d), market-makers are not required to quote a minimum bid-offer spread in FLEX Options because of the unique nature of the product in which new series are established periodically by the submission of an RFQ. Through experience with the trading of the

<sup>3</sup> The rule currently provides that the Submitting Member is entitled to the largest of the percentage of the trade (1/2 or 2/3), \$1 million Underlying Equivalent Value, or the remaining Underlying Equivalent Value on a closing transaction valued at less than \$1 million. These qualifications of \$1 million Underlying Equivalent Value or the remaining Underlying Equivalent Value remain in the proposed rule.

<sup>4</sup> See Securities Exchange Act Release No. 37337 (June 19, 1996), 61 FR 33561 (June 27, 1996).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> See Letter from Timothy H. Thompson, Senior Attorney, CBOE, to Steve Youhn, SEC, dated May 13, 1997.

<sup>2</sup> The Exchange was approved for trading FLEX options on February 24, 1993. See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993).

product over the last four years, however, the Exchange has determined it is appropriate to now establish maximum bid-offer spreads for Index FLEX AMMs and QMMs when quoting European exercise FLEX options overlying the S&P 100 Index or the S&P 500 Index with a time to expiration of more than two weeks and less than two years. The Exchange expects that the establishment of these spreads will increase customer confidence in the CBOE markets for these products. The establishment of these maximum bid-offer spreads will ensure tight markets for the majority of the Index FLEX RFQs submitted to the CBOE floor; the proposed spreads would have applied to 77% of the RFQs submitted in 1996. The Exchange also believes that if, as expected, the reduction in the entitlement of a trade to a Submitting Member encourages more active participation by market-makers in the quoting process, then bid-offer spreads, through competition, should decrease in any event.

The bid-offer spreads which are being established for European exercise options overlying the S&P 100 Index or the S&P 500 Index are as follows.

Options with a time to expiration greater than two weeks and less than or equal to one year shall have the following maximum bid/ask spreads:

Where the bid is	The maximum bid/ask spread is
Less than \$5 .....	¾ of \$1
At least \$5 but not more than \$10.	\$1
At least \$10 but not more than \$1.50.	
At least \$20 .....	\$2

Options with a time to expiration greater than one year and less than two years shall have the following maximum bid/ask spreads:

Where the bid is	The maximum bid/ask spread is
Less than \$10 .....	\$1.50
At least \$10 but not more than \$20.	\$2
At least \$20 but not more than \$40.	\$3
At least \$40 .....	\$4

Because the proposed rules should encourage more active participation of market-makers in the establishment of bid-ask spreads and will require the quoting of spreads on Index FLEX options within a certain range, CBOE believes the proposed rules are consistent with and further the

objectives of Section 6(b)(5) of the Act in that they are designed to improve communications to and from the Exchange's trading floor in a manner that promotes just and equitable principles of trade, prevents fraudulent and manipulative acts and practices, and maintains fair and orderly markets:

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

The Exchange believes the proposed rule change will impose no burden on competition.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

#### **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 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 CBOE. All submissions should refer to File No. SR-CBOE-97-

16 and should be submitted by June 12, 1997.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-38646; File No. SR-DCC-96-13]

#### **Self-Regulatory Organizations; Delta Clearing Corp.; Order Granting Approval of a Proposed Rule Change Relating to the Definitions of Trading Limits and Maximum Potential System Exposure**

May 15, 1997.

On November 26, 1996, Delta Clearing Corp. ("DCC") filed a proposed rule change (File No. SR-DCC-96-13) with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> On January 10, 1997, DCC filed an amendment to the proposed rule change. Notice of the proposal was published in the **Federal Register** on January 30, 1997, to solicit comments from interested persons.<sup>2</sup> No comments were received. As discussed below, this order approves the proposed rule change.

#### **Description**

The proposed rule change amends DCC's procedures and provides for the issuance of Policy Statement 96-02 in order to revise DCC's current method of limiting its exposure to participants.<sup>3</sup> The term "trading limit" in DCC's procedures is replaced with the "exposure limit." Section 204 and 2204 and the definitions of "exposure limit" in Section 101 and 2101 are amended to clarify that each participant has one exposure limit applicable to both repurchase agreement ("repo") and option transactions.

The consequences of a participant exceeding its exposure limit are clarified so that a participant may continue to effect trades for clearance and settlement in the repo clearing

<sup>5</sup> 17 CFR 200.30-3(a)(12) (1994).

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

<sup>2</sup> Securities Exchange Act Release No. 38197 (January 23, 1997), 62 FR 4557.

<sup>3</sup> Policy Statement 96-02 described such items as the processes for rejecting trades and notification of the affected participants.