

proposed rule change (File No. SR-Philadep-98-01) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 98-11213 Filed 4-27-98; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39895; File No. SR-Phlx-98-07]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Philadelphia Stock Exchange, Inc., Relating to the Listing and Trading of Options on the Exchange's Computer Box Maker Index

April 21, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on February 5, 1998, the Philadelphia Stock Exchange, Inc. ("Exchange" or "Phlx") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in items I and II below, which Items have been prepared by the Exchange. On April 3, 1998, the Exchange filed with the Commission Amendment No. 1 to the proposed rule change.<sup>2</sup> On April 20, 1998, the Exchange filed with the Commission Amendment No. 2 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is accelerating approval of the amended proposal.

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> Amendment No. 1 revised the proposal's maintenance criteria, position and exercise limits, concentration limits, and corrected technical errors and oversights.

<sup>3</sup> Amendment No. 2 clarified that the 9,000 contract position limit governing options on the proposed index is independent of the three-tiered position limits found in Exchange Rule 1001A(b)(i), and instead appears as part of Exchange Rule 1001A(c). The second amendment also modified the concentration criteria that trigger the application of alternative position and exercise limits. See Letter to Sharon Lawson, Senior Special Counsel, Division of Market Regulation, Commission, from Nandita Yagnik, Attorney, Exchange, dated April 20, 1998.

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

The Exchange proposes to list and trade European style, cash-settled options, including long term options,<sup>4</sup> on the Exchange's Computer Box Maker Index ("Index"). The Index is a price-weighted, narrow-based, A.M. settled, index comprised of nine stocks issued by companies that manufacture, market, and support desktop and notebook personal computers and fault tolerant systems.<sup>5</sup>

The text of the proposed rule change is available at the Office of the Secretary, the Exchange, 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 Exchange 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 III below. The Exchange 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 purpose of the proposed rule change is to list for trading European style, cash-settled options on the Index, a new index developed by the Exchange pursuant to Exchange Rule 1009A(a). Options on the Index will provide a potential hedging vehicle for basket traders and other market participants who trade the securities comprising this small subsector of the technology industry. The following is a detailed description of the proposed option contract and the underlying Index:

(a). *Ticker Symbol*: BMX.

(b). *Settlement Value Symbol*: BMZ.

(c). *Underlying Index*: The Index is a price-weighted index comprised of nine

stocks issued by companies that manufacture, market, and support desktop and notebook personal computers and fault tolerant systems. All of the nine component stocks trade on the New York Stock Exchange, Inc. ("NYSE"), or are National Market System ("NMS") securities that trade through the facilities of the Nasdaq Stock market ("Nasdaq"), and therefore are reported securities as defined in Rule 11Aa3-1 under the Act.<sup>6</sup> Further, all of the component stocks presently meet the Exchange's listing criteria for equity options contained in Exchange Rule 1009 and are currently the subject of listed options on U.S. national securities exchanges.

The Exchange represents that only the securities of U.S. companies are represented in the Index. However, if component securities issued by non-U.S. companies are added to the Index (stocks or American Depositary Receipts) and such component securities are not subject to comprehensive surveillance sharing agreements, those component securities will not account for more than 20% of the weight of the Index.

Statistical information provided by the Exchange indicates that as of April 2, 1998, the aggregate market capitalization of the nine component stocks in the Index exceeded \$266 billion. The individual market capitalizations ranged from a high of \$103.4 billion (IBM) to a low of \$3.43 billion (Unisys Corp.). Each of the nine component stocks in the Index had average daily trading volumes in excess of one million shares per trading day over the preceding six months. The average daily trading volumes ranged from a high of 19.9 million shares per day (Compaq Computer Corp.) to a low of 2.1 million shares per day (Gateway 2000, Inc.). The Exchange believes the Index's component stocks are some of the most widely held and highly capitalized common stocks.

(d) *Index Calculation*: The Index is a price-weighted index. The following formula will be used to compute the Index value:

$$\frac{SP_1 + SP_2 + \dots + SP_9}{3.5} \times 100$$

Where: SP=current stock price  
The initial divisor is an arbitrary number selected to achieve a certain index value. The divisor for the Index shall be 3.5 which generates an Index value of 118 as of April 2, 1998.

(e). *Index Maintenance*: To maintain the continuity of the Index, the divisor

<sup>6</sup> 17 CFR 240.11Aa3-1.

will be adjusted to reflect non-market changes in the price of the component securities as well as changes in the composition of the Index. Changes which may result in divisor adjustments include, but are not limited to, stock splits, dividends, spin-offs, mergers, and acquisitions. In accordance with Exchange Rule 1009A, if any change in the nature of any component in the Index (for example, due to a delisting, merger, acquisition or other event) will change the overall market character of the Index, the Exchange will take appropriate steps to remove the component stock or replace it with another stock that the Exchange believes would be compatible with the intended market character of the Index. The Exchange represents that any replacement components will be reported securities as defined in Rule 11Aa3-1 of the Act.

Initially, the Index will be comprised of nine component stocks. Absent Commission approval, the Exchange will not increase the number of components to more than twelve or reduce the number of components to fewer than eight. The Exchange represents that the component stocks, comprising the top 90% of the Index, by weight, will each maintain a minimum market capitalization of \$75 million. The remaining 10%, by weight, will each maintain a minimum market capitalization of \$50 million. The component stocks comprising the top 90% of the Index, by weight, will each maintain a trading volume of at least 500,000 shares per month. The trading volume for each of the component stocks constituting the bottom 10% of the index, by weight, will average at least 400,000 shares per month. No fewer than 90% of the component securities, by weight, or no fewer than 80% of the total number of the components, shall qualify as stocks eligible for options trading.<sup>7</sup> If the Index fails at any time to satisfy one or more of the required maintenance criteria, the Exchange will immediately notify the Commission staff of that fact and will not open for trading any additional series of options on the Index, unless the Exchange determines that such failure is insignificant and the Commission concurs in that determination, or unless the Commission approves the continued listing of options on the Index under Section 19(b)(2) of the Act.<sup>8</sup> In addition to not opening for trading any additional series, the Exchange may, in

consultation with the Commission, prohibit opening purchase transactions in series of options previously opened for trading to the extent that the Exchange deems such action necessary or appropriate.<sup>9</sup>

In addition to the above maintenance criteria, the Exchange represents that no single component security of the Index shall account for more than 35% of the Index, and that the three highest weighted component securities shall not account for more than 65% of the Index. If the Index fails to satisfy these concentration criteria, the Exchange will reduce the position and exercise limit to 5,500 contracts or to such other level approved by the Commission under Section 19(b) of the Act. All series of Index options would be scheduled for a position limit decrease to 5,500 contracts effective the Monday following the expiration of the farthest-out, then-trading, non-LEAP option series. If prior to the scheduled position limit decrease, however, the Index complied with the concentration requirements, the position limit would not be reduced. As of April 2, 1998, the highest weighted component stock (IBM) made up 24.6% of the Index and the top three components (IBM, Dell Computer Corp., and Hewlett Packard Co.) accounted for 55% of the Index.

(f). *Unit of Trading*: Each option contract on the Index will represent \$100 (the Index multiplier) times the Index value. For example, an Index value of 200 will result in an option contract value of \$20,000 (\$100 × 200).

(g). *Exercise Price*: The exercise price of an option contract on the Index will be set in accordance with Exchange Rule 1101A(a).

(h). *Settlement Value*: The Index value for purposes of settling outstanding Index option contracts upon expiration will be calculated based upon the regular way opening sale prices for each of the Index's component stocks in their primary market on the last trading day prior to expiration. In the case of National Market System securities traded through Nasdaq, the first reported sale price will be used for the final settlement value for expiring Index option contracts. In the event that a component security does not open for trading on the last day before the expiration of a series of Index option contracts, the last sale price for that security will be used in calculating the Index value. However, in the event that the Options Clearing Corporation ("OCC") determines that the current Index value is unreported or otherwise unavailable (including instances where

the primary market(s) for securities representing a substantial part of the value of the Index is not open for trading at the time when the current Index value used for exercise settlement purposes would be determined), the OCC may determine an exercise settlement amount for the Index in accordance with Article XVII, Section 4, of the OCC By-Laws.<sup>10</sup>

(i). *Last Trading Day*: The last business day prior to the third Friday of the month for options which expire on the Saturday following the third Friday of that month.

(j). *Trading Hours*: 9:30 a.m. to 4:02 p.m. e.s.t.

(k). *Position and Exercise Limits*: The Index is an industry or narrow-based index. The position and exercise limits will be 9,000 contracts.<sup>11</sup> As described earlier, if at any time any one component security accounts for more than 35% of the Index, or any three component securities account for more than 65% of the Index, the Exchange will reduce the position and exercise limits to 5,500 contracts, or to such other level approved by the Commission under Section 19(b) of the Act.

(l). *Expiration Cycles*: Three months from the March, June, September, December cycle plus at least two additional near-term months. LEAPs also will be traded on the Index pursuant to Exchange Rule 1101A(b)(iii).

(m). *Exercise Style*: European.

(n). *Premium Quotations*: Premiums will be expressed in terms of dollars and fractions of dollars pursuant to Exchange Rule 1033A. For example, a bid or offer of 1½ will represent a premium per options contract of \$150 (\$1½ × 100).

The value of the Index will be calculated and disseminated every 15 seconds during the trading day. The Exchange has retained Bridge Data Inc. to compute and perform all necessary maintenance of the Index.<sup>12</sup> Pursuant to Exchange Rule 100A, updated Index values will be disseminated and displayed by means of primary market prints reported by the Consolidated Tape Association and over the facilities of the Options Price Reporting Authority ("OPRA"). The Index value also will be available on broker-dealer

<sup>10</sup> See OCC By-Laws, Article XVII, Section 4, and Securities Exchange Act Release No. 37315 (June 17, 1996), 61 FR 32471 (June 24, 1996).

<sup>11</sup> The 9,000 contract position limit for options on the Index is separate and independent of the position limits set forth in Exchange Rule 1001A(b)(i). See *supra* note 3.

<sup>12</sup> As a back-up to Bridge Data Inc., the Exchange will utilize its own internal index calculation system, the Index Calculation Engine ("ICE") System.

<sup>7</sup> See *infra* note 23.

<sup>8</sup> See 15 U.S.C. 78s(b)(2), and Exchange Rule 1009A.

<sup>9</sup> See Exchange Rule 1010.

interrogation devices to subscribers of options information. The Exchange represents that it has the capacity to handle the additional traffic expected to be generated by the Index.<sup>13</sup> In addition, OPRA has informed the Commission that the additional traffic from option contracts on the Index is within OPRA's capacity.<sup>14</sup>

Option contracts on the Index will be traded pursuant to current Exchange rules governing the trading of narrow-based index options, including provisions addressing sales practices, floor trading procedures, margin requirements, and trading halts and suspensions.<sup>15</sup> The Exchange represents that the surveillance procedures currently used to monitor trading in index options also will be used to monitor options based on the Index. These procedures entail complete access to trading activity in the underlying component securities which all trade on either the NYSE or Nasdaq. In addition, the Intermarket Surveillance Group ("ISG") Agreement dated July 14, 1983, as amended on January 29, 1990, will be applicable to the trading of option contracts on the Index.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6 of the Act,<sup>16</sup> in general, and with Section 6(b)(5),<sup>17</sup> in particular, in that it is designed to promote just and equitable principles of trade; prevent fraudulent and manipulative acts and practices; foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; remove impediments to and perfect the mechanism of a free and open market and a national market system; and protect investors and the public interest.

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

The Exchange does not believe 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*

The Exchange did not solicit or receive written comments with respect to the proposed rule change.

## II. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing proposed rule change and Amendment Nos. 1 and 2 thereto, including whether the proposed rule change, as amended, is consistent with the Act. 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 submissions, 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 persons, 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, N.W., Washington, D.C. 20549. 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-98-07 and should be submitted by May 19, 1998.

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

The Exchange has requested that the Commission grant accelerated approval of the Index pursuant to Section 19(b)(2) of the Act.<sup>18</sup> The request for accelerated approval is predicated on the Index's substantial compliance with the generic listing standards<sup>19</sup> and the Exchange's desire to remain competitive in the area of new product development.<sup>20</sup>

## V. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Commission has carefully reviewed the Exchange's proposed rule change and believes, for the reasons set forth below, the proposal is consistent with the requirements of the Act and the

rules thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5).<sup>21</sup> Specifically, the Commission finds that the trading of options on the Index will serve to promote the public interest and help to remove impediments to a free and open securities market by providing investors with a means of hedging exposure to market risks associated with the securities issued by companies that manufacture and support computers.

The Commission finds that the trading of options on the Index will permit investors to participate in the price movements of the nine securities on which the Index is based. Further trading of options on the Index will allow investors holding positions in some or all of the securities underlying the Index to hedge the risks associated with these securities. Accordingly, the Commission believes that options on the Index will provide investors with an additional trading and hedging mechanism.<sup>22</sup>

Nevertheless, the trading of options on the Index raises several issues related to design of the Index, customer protections, and surveillance. The Commission believes, however, for the reasons described below, that the Exchange adequately has addressed these issues.

### *A. Index Design and Structure*

The Commission believes it is appropriate for the Exchange to apply its rules governing the trading of narrow-based index options to options based on the Index. The Commission notes that the Index contains nine stocks representing one industry group, and thus reflects a very narrow segment of the U.S. equities market.

The Commission notes that the nine securities comprising the Index are actively-traded. For the six month period ending April 2, 1998, the average daily trading volume among the component securities ranged from a high of 19.9 million shares per day (Compaq Computer Corp.) to a low of 2.1 million shares per day (Gateway 2000, Inc.). In addition, the market capitalizations of the securities in the Index are extremely large, ranging from

<sup>13</sup> See Letter to Michael Walinskas, Senior Special Counsel, Office of Market Supervision, Commission, from Thomas A. Wittman, First Vice President, Trading Systems, Exchange, dated February 6, 1998.

<sup>14</sup> See Letter to Michael Walinskas, Senior Special Counsel, Office of Market Supervision, Commission, from Joseph P. Corrigan, Executive Director, OPRA, dated February 11, 1998.

<sup>15</sup> See Exchange Rule 722, Exchange Rules 1000A through 1102A, and generally Exchange Rules 1000 through 1072.

<sup>16</sup> 15 U.S.C. 78f.

<sup>17</sup> 15 U.S.C. 78f(b)(5).

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> See *infra* note 27.

<sup>20</sup> See Letter to Michael Loftus, Attorney, Division of Market Regulation, Commission, from Nandita Yagnik, Attorney, Exchange, dated April 3, 1998.

<sup>21</sup> 15 U.S.C. 78f(b)(5).

<sup>22</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new option proposal upon a finding that the introduction of such new derivative instrument is in the public interest. Such finding would be difficult for a derivative instrument that served no hedging or other economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

a high of \$103.4 billion (IBM) to a low of \$3.43 billion (Unisys Corp.) as of April 2, 1998. Finally, no one component stock accounted for more than 24.6% of the Index's total value, and the percentage weighting of the three largest issues in the Index accounted for 55% of the Index's value.

With respect to the maintenance of the Index, the Commission believes the Exchange has implemented several safeguards in connection with the listing and trading of options on the Index that will serve to ensure that the Index remains comprised of highly-capitalized, actively-traded securities, thereby ensuring that the Index will remain substantially the same over time. In this regard, the Exchange will maintain the Index so that: (1) the component securities comprising the top 90% of the Index, by weight, each will have market capitalizations of at least \$75 million, and the remaining 10% each will have market capitalizations no less than \$50 million; (2) the component securities comprising the top 90% of the Index, by weight, each will have monthly trading volumes of at least 500,000 shares, and the remaining 10% each will have monthly trading volumes no less than 400,000 shares; (3) at least 90% of the components in the Index, by weight, and 80% of the number of components in the Index will be eligible<sup>23</sup> for standardized options trading; (4) the component securities will be "reported" securities pursuant to Rule 11Aa3-1 of the Act;<sup>24</sup> (5) absent approval from the Commission pursuant to Section 19(b)(2) of the Act, the Exchange will not increase the number of components to more than twelve or reduce the number of components to fewer than eight; and (6) if any component security requires replacement because of a delisting, merger, acquisition, or other event affecting the market character of such component security, the Exchange will replace it with another security that the Exchange believes would be compatible with the intended market character of the Index.

The Commission further believes the maintenance standards governing the

Index will help protect against material changes in the composition and design of the Index that might adversely affect the Exchange's obligations to protect investors and to maintain fair and orderly markets in options based on the Index. The Exchange is required to immediately notify the Commission staff if the Index fails at any time to satisfy one or more of the specified maintenance criteria. Further, in such an event, the Exchange will not open for trading any additional series of options on the Index, unless the Exchange determines that such failure is insignificant and the Commission concurs in that determination, or unless the Commission approves the continued listing of options on the Index under Section 19(b)(2) of the Act.<sup>25</sup>

#### *B. Customer Protection*

The Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as options based on the Index, can commence on a national securities exchange. The Commission notes that the trading of standardized exchange-listed options occurs in an environment that is designed to ensure that: (1) the special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. Accordingly, because the Index options will be subject to the same regulatory regime as the other standardized options currently traded on the Exchange, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Index options.

#### *C. Surveillance*

In evaluating new derivative instruments, the Commission, consistent with the protection of investors, considers the degree to which the derivative exchange has the ability to obtain information necessary to detect and deter market manipulation and other trading abuses. Therefore, the Commission believes that a surveillance sharing agreement between an exchange proposing to list a security index derivative product and the exchange(s) trading the securities underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. Such agreements facilitate and

ensure the availability of information needed to fully investigate manipulation if it were to occur.<sup>26</sup> In this regard, the Commission notes that the primary markets for the stocks underlying the Index—the NYSE and the NASD (the self-regulatory organization which oversees Nasdaq)—as well as the Exchange, are members of the ISG, which provides for the sharing of all necessary surveillance information. The Commission believes this arrangement will ensure the availability of information necessary to detect potential manipulations and other trading abuses.

The Commission finds good cause for approving the proposal, including Amendment Nos. 1 and 2 thereto, prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that proposed rule changes regarding the listing and trading of options on narrow-based indexes may become effective immediately upon filing provided they satisfy certain generic listing standards.<sup>27</sup> The generic listing standards establish minimum guidelines concerning the design and operation of narrow-based indexes. The Commission recognizes that the Index, as amended, satisfies all of the generic listing standards save two, the minimum number of component securities<sup>28</sup> and the concentration limits.<sup>29</sup> In addition, to the extent that the Index deviates from the generic listing standards in these categories, the Commission notes that the Exchange has amended its proposal to adequately address the concerns identified by the Commission staff. This includes for example, providing for a reduction in position and exercise limits if the concentration limits are exceeded, and maintaining the Index at a minimum of eight component securities.<sup>30</sup> Therefore, the

<sup>26</sup> See Securities Exchange Act Release No. 31243 (Sept. 28, 1992), 57 FR 45849 (Oct. 5, 1992).

<sup>27</sup> See Securities Exchange Act Release No. 34157 (June 3, 1994), 59 FR 30062 (June 10, 1994). Although, a proposed rule change filed in accordance with the generic listing standards becomes effective immediately upon filing, trading in the approved options may not commence until 30 days after the date of effectiveness.

<sup>28</sup> The generic listing standards require that a narrow-based index initially consist of no fewer than ten component securities. Thereafter, it may not consist of fewer than nine component securities. *Id.*

<sup>29</sup> Under the generic listing standards, an individual component security may not represent more than 25% of the weight of the index. Furthermore, in an index of less than 25 components, the five highest weighted component securities may not constitute more than 60% of the weight of the index. *Id.*

<sup>30</sup> As previously noted, the Index currently contains nine securities and may consist of as few as eight component securities. On other occasions,

<sup>23</sup> The Exchange's options listing standards, which are uniform among the options exchanges, provide that a security underlying an option must, among other things, meet the following requirements: (1) the public float must be at least 7,000,000 shares; (2) there must be a minimum of 2,000 securityholders; (3) trading volume in the U.S. must have been at least 2.4 million shares over the preceding twelve months; and (4) the market price per share must have been at least \$7.50 for a majority of the business days during the preceding three calendar months. See Exchange Rule 1009, "Criteria for Underlying Securities," Commentary .01.

<sup>24</sup> 17 CFR 240.11Aa3-1.

<sup>25</sup> See 15 U.S.C. 78s(b)(2), and Exchange Rule 1009A.

Commission believes there is no compelling reason to delay the listing and trading of options based on the Index. Accordingly, because the Index substantially complies with the generic listing standards, and the investor protection concerns have been addressed, the Commission finds good cause exists for granting accelerated approval to the proposed rule change and Amendment Nos. 1 and 2 thereto.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> that the proposed rule change, SR-Phlx-98-07, and Amendment Nos. 1 and 2 thereto, are hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>32</sup>

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

[FR Doc. 98-11164 Filed 4-27-98; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39889; File No. SR-Phlx-97-51]

### Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to the Allocation of Options Trades

April 20, 1998.

#### I. Introduction

On October 22, 1997, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), 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> a proposed rule change to amend two Floor Procedure Advices ("Advices"): F-2, Allocation, Time Stamping, Matching and Access to Matched Trades; and F-12,

the Commission has approved narrow-based indexes with similar minimum component standards. See e.g., Securities Exchange Act Release Nos. 38143 (Jan. 8, 1997), 62 FR 2411 (Jan. 16, 1997) (permitted American Stock Exchange's "Tobacco Index" to initially consist of nine securities and thereafter consist of no fewer than nine securities); 37198 (May 10, 1996), 61 FR 25251 (May 20, 1996) (permitted Chicago Board Options Exchange's "PC Index" to initially consist of eight securities and thereafter consist of no fewer than eight securities); and 34345 (July 11, 1994), 59 FR 36245 (July 15, 1994) (permitted Exchange's "Phone Index" to initially consist of eight securities and thereafter consist of no fewer than eight securities).

<sup>31</sup> 15 U.S.C. 78s(b)(2).

<sup>32</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.

Responsibility for Assigning Participation. The proposed rule change was published for comment in the **Federal Register** on December 10, 1997.<sup>3</sup> No comments were received on the proposal. This order approves the proposal.

#### II. Description of the Proposal

The Phlx proposes to amend the two Advices to provide that the seller or largest participant to an option transaction is responsible for allocating an executed trade.

##### A. Advice F-2

Currently, Advice F-2 states that it is the duty of the largest participant in an options transaction to both match and time stamp the order tickets involved. There is currently no specific provision for who allocates options trades among trade participants. The Phlx represents that the practice in most options crowds is that specialists announce trade splits by saying to the trading crowd, for example, "You did 10, you did 5," etc. This practice may differ, especially where a specialist unit is not involved in a trade, or where a great deal of trading and quote activity renders specialists allocating trades impractical. In these situations, Floor Brokers have assisted in allocating trades, along with performing their duty to match and submit the trade and ensure the best execution of orders.<sup>4</sup> The purpose of the proposed rule change to paragraph (a) of Advice F-2 is to assign the responsibility of properly allocating option trades to the largest participant (or seller)<sup>5</sup> involved in the trade, which normally will be the Floor Broker who represents the original order in the trading crowd. The Exchange asserts that the amendment will promote the original intent of Advice F-2 (i.e., the facilitation of prompt and accurate trade reporting).<sup>6</sup> Paragraphs (b) concerning ticket preservation and (c) concerning member access to matched trades, of Advice F-2, remain unchanged.

##### B. Advice F-12

The purpose of the proposed rule change to Advice F-12 is to extend its requirements regarding how trades are allocated to the equity/index options floor. Currently, Advice F-12 only

<sup>3</sup> Securities Exchange Act Release No. 39393 (December 3, 1997), 62 FR 65117 (December 10, 1997).

<sup>4</sup> See Phlx Rule 1063.

<sup>5</sup> The seller has the responsibility only when there are two parties to a trade. When there are multiple participants, the largest participant is responsible for allocating the trade.

<sup>6</sup> See e.g., Securities Exchange Act Release No. 33512 (January 24, 1994) 59 FR 4759 (February 1, 1994).

applies to foreign currency options trading. Specifically, Advice F-12 currently requires that foreign currency option trade participants: (a) must confirm and immediately inform the largest participant of their contra-side participation; (b) should not leave the crowd absent such confirmation; (c) should not submit tickets absent participation; and (d) must handle disputes properly. The Exchange additionally proposes that Advice F-12 is proposed to be amended to only detain in the crowd actual trade participants and simplify ticket submission requirements.

The Phlx believes that the proposed amendments to Advice F-12 will bolster its effectiveness in controlling the trade allocation process. Under the proposed amendments, no one who has participated in the trade would be allowed to leave the crowd until the level of his/her participation in the trades has been confirmed by the largest participant. Previously, this obligation also applied to those who *believed they may have* participated in a trade. This change is intended to require only those who actually participated in a trade to remain in the trading crowd to confirm their participation in the trade. The Phlx states that the language concerning belief was difficult to administer and did not capture violations necessary to improve the post-trade process.

Further, Advice F-12 currently provides that no person in the crowd shall submit a ticket for matching on a trade when that person has or should have grounds to believe that he is not due participation in the trade. Thus, a violation of Advice F-12 currently may result from submitting a ticket where no participation is due, even though the participant believed he/she participated. The Phlx asserts that by deleting the reference to "belief," the proposal is designed to simplify trade ticket submission, and as a result, establish the practice that a person who did not participate in a trade should not submit a ticket.

##### C. Minor Rule Plan

Violation of the new responsibility under Advice F-2 will be subject to the existing fine schedule accompanying Advice F-2. Advice F-12 currently contains a fine schedule, which is proposed to apply to the entire options floor. The proposal thus amends the Exchange's minor rule violation enforcement and reporting plan ("minor rule plan"),<sup>7</sup> by amending the text of

<sup>7</sup> The Phlx's minor rule plan, codified in Phlx Rule 970, contains Advices, such as Advice F-2,