

levels are to be determined on a monthly basis.¹⁸

Additionally, the proposal codifies the Exchange's existing policy on when an LMM's guaranteed participation may return to 50% after having been reduced. The proposal provides that the Options Allocation Committee may in its discretion return an LMM to receiving a guaranteed 50% participation, after having had it reduced to 40% or 25%, if average daily trading volume in an issue falls below 3,000 contracts at the Exchange during any three-calendar-month period (measured on a 'rolling' three-calendar-month basis).

The Commission finds that the proposed rule changes relating to guaranteed participation are appropriate in that they reduce ambiguity and provide LMMs and the marketplace with clearer notice as to how an LMM's guaranteed participation will be determined.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act¹⁹ that the proposed rule change (SR-PCX-98-19) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 98-24373 Filed 9-10-98; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40400; File No. SR-Phlx-98-36]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to an Increase in Position and Exercise Limits for Standardized Equity Options

September 3, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 14, 1998, 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 self-regulatory organization. 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 Phlx proposes to amend Exchange Rule 1001, Position Limits, to increase position and exercise limits³ for standardized equity options to three times their current levels. Corresponding changes are also being made to the equity option hedge exemption contained in Commentary .07 to Rule 1001.

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 self-regulatory organization 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 Phlx is proposing to increase the position and exercise limits for equity options traded on the Exchange to three times their current levels. Currently, Phlx Rule 1001 subjects equity options to one of the five different position limits depending on the trading volume and outstanding shares of the underlying security. Rule 1002 establishes corresponding exercises limits.⁴ The limits are: 4,500; 7,500;

³ Position limits impose a ceiling on the number of option contracts in each class on the same side of the market relating to the same underlying security that can be held or written by an investor or group of investors acting in concert.

Exercise limits prohibit an investor or group of investors acting in concert from exercising more than a specified number of puts or calls in a particular class within five consecutive business days.

⁴ Rule 1002 states ". . . no member or member organization shall exercise, for any account in which such member or member organization has an interest or for the account of any partner, officer, director or employee thereof or for the account of any customer, a long position in any option contract of a class of options dealt in on the Exchange (or, respecting an option not dealt in on the Exchange,

10,500; 20,000; and 25,000 contracts on the same side of the market. Under the proposed changes the new limits will be: 13,500; 22,500; 31,500; 60,000; and 75,000 contracts. Corresponding changes are also being proposed to the equity option hedge exemption contained in Commentary .07 of Rule 1001 so that the example in the Commentary reflects the proposed position and exercise limits. The Exchange believes sophisticated surveillance techniques at options exchanges adequately protect the integrity of the markets for the options that will be subject to these increased position and exercise limits.

Manipulation

The Phlx believes that position and exercise limits, at their current levels, no longer serve their stated purpose. The Commission has stated that:

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market.⁵

At this time in 1998, noting the twenty-fifth anniversary of listed options trading, the Exchange believes that the existing surveillance procedures and reporting requirements at options exchanges and clearing firms that have been developed over the years are able to properly identify unusual and illegal trading activity. In addition, routine oversight inspections of Phlx's regulatory programs by the commission have not uncovered any material inconsistencies or shortcomings in the manner in which the Exchange's market surveillance reviews position limits.

another exchange if the member or member organization is not a member of that exchange) if as a result thereof such member or member organization, or partner, officer, director or employee thereof or customer, acting alone or in concert with others, directly or indirectly, has or will have exercised within any five (5) consecutive business days aggregate long positions in that class (put or call) as set forth in the position limit in Rule 1001, in the case of options on a stock, on a foreign currency or cross rate currency options, or stock index warrants; without regard to the exchange on which the options were purchased. Whether option or warrant positions should be aggregated under this rule shall be determined in the manner described in the Commentary to Exchange Rule 1001. Index option position and exercise limits are governed by Rules 1001A and 1002A."

⁵ Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998).

¹⁸ See footnote 11 *supra*.

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

These procedures entail a daily monitoring of market movements automated to identify unusual activity in both the options and underlying stock. Further, the significant increases in unhedged options capital charges resulting from the September 1997 adoption of risk-based haircuts and the Exchange margin requirements applicable to these products under Exchange rules serves as a more effective protection than position limits.⁶

Further, large stock holdings must be disclosed to the Commission by way of Schedules 13D or 13G.⁷ Options positions are part of any reportable positions and cannot be legally hidden. In addition, Exchange Rule 1003—which requires members to file reports with the Exchange for any customer who held aggregate long or short positions of 200 or more option contracts of a put class and call class on the same side of the market covering the same underlying security—will remind unchanged and an important part of the Exchanges's surveillance efforts.

Position and Exercise Limits Restrict Legitimate Options Use

Equity option position limits prevent large customers such as mutual funds and pension funds from using options to gain meaningful exposure to individual stocks, resulting in lost liquidity in both the options market and the stock market. Equity option position limits also act as a barrier to the use of options by corporations wishing to implement options strategies with their own stock. For example, existing equity option position limits could restrict the number of put options that could be sold under a corporate buyback program.⁸

Financial Requirements

The Exchange believes that financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer could try to maintain an inordinately large unhedged position in an equity option. Current margin, and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. It should also be noted that the Exchange has the

authority under Rule 722(d)(1), (d)(4) and (i)(8) to impose a higher margin requirement upon a member or member organization when the Exchange determines a higher requirement is warranted. In addition, the Commission's net capital rule, Rule 15c3-1, imposes a capital charge on members to the extent of any margin deficiency resulting from the higher margin requirement.

Past Increases Have Had No Adverse Consequences

Equity option position limits have been gradually expanded from 1,000 contracts in 1973 to the current level of 25,000 contracts for the largest and most active stocks. In 1998, the Commission approved the elimination of position and exercise limits in FLEX equity options under a two-year pilot program.⁹ To date, the Exchange does not believe that there have been adverse effects on the market as a result of the past increases in the limits for equity options or the elimination of position and exercise limits for FLEX equity options.

Changes Will Allow Options Exchanges To Compete More Fairly With OTC Markets

The Commission has stated that "limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market."¹⁰ However, in today's market, equity option position limits place listed options at a competitive disadvantage to over-the-counter ("OTC") derivatives. OTC dealers can execute options trades through overseas subsidiaries not subject to National Association of Securities Dealers ("NASD") regulation, and therefore not subject to position limits. As a result, the largest trades can go unobserved and unmonitored for regulatory and oversight purposes. Member firms continue to express concern to options Exchanges that position limits are an impediment to their business and that they have no choice but to move their business to off-shore markets where position limits are not an issue.

In addition, the Commission has recently approved the NASD's proposed rule change to raise position limits for

conventional equity options (*i.e.*, those options not issued, or subject to issuance by The Options Clearing Corporation) to three times their current levels and three times the levels established by current Exchange rules for standardized options.¹¹ Because conventional options often have nearly the identical terms as standardized, exchange-traded options, the Exchange believes the position limits for standardized options should be at least as high as those for conventional options. This is critical for listed options to compete with a growing OTC market, thus promoting fair competition. The proposed rule change should help to attract business back to the Exchange where the trades will be subject to reporting requirements and surveillance. In releases respecting FLEX equity option's, which have no position limits, the Commission noted that the elimination of position limits will allow the listed options markets to better compete with the OTC market.¹²

It should also be noted that individual stocks are not subject to position limits. Investors can theoretically hold 100% of a company's shares outstanding as long as they file the appropriate Schedule 13D or 13G. The Exchange believes the increase in the position and exercise limits will better enable the Exchange to compete against the OTC markets and is an appropriate and responsible increase given the nature of the Exchange's surveillance.

2. Statutory Basis

The Exchange represents that the proposed rule change is consistent with Section 6(b)¹³ of the Act, in general, and Section 6(b)(5) of the Act,¹⁴ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, to protect investors and the public interest and is not designed to permit unfair discrimination between customer, issuers, brokers, or dealers.

¹¹ The NASD's position limit filing established position and exercise limits for conventional equity options identical to those being proposed by Phlx in this filing. See Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23).

¹² See, e.g., Exchange Act Release No. 39549 (January 14, 1998), 63 FR 3601 (January 23, 1998) (SR-Phlx-96-38).

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

⁶ See Exchange Act Release No. 38248 (February 6, 1997), 62 FR 6474 (February 12, 1997) (adopting Risk-Based Haircuts) and Phlx rule 722.

⁷ Exchange Act Rule 13d-1.

⁸ The Commission notes that issuers would, of course, need to comply with all applicable provisions of the federal securities laws in conducting their share repurchase programs.

⁹ See Exchange Act Release No. 39549 (January 14, 1998) (SR-Phlx-96-38).

¹⁰ See H.R. Rep. No. IFC-3 96th Cong., 1st Sess. At 189-91 (Comm. Print 1978).

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organizations Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were either solicited or received.

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, 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, 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 Room. 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-98-36 and should be submitted by October 2, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98-24371 Filed 9-10-98; 8:45 am]

BILLING CODE 8010-01-M

DEPARTMENT OF STATE

[Public Notice 2884]

Privacy Act of 1974; Altered System of Records

Notice is hereby given that the Department of State proposes to alter an existing system of records, STATE-36, pursuant to the provisions of the Privacy Act of 1974, as amended (5 U.S.C. (r)), and the Office of Management and Budget Circular No. A-130, Appendix I. The Department's report was filed with the Office of Management and Budget on August 24, 1998.

It is proposed that the current system will retain the name "Security Records." It is also proposed that due to the expanded scope of the current system, the system description will include revisions and/or additions to each section. These changes to the existing system description are proposed in order to reflect more accurately the Bureau of Diplomatic Security's record-keeping system, and a reorganization of activities and operations. Also, certain relevant records will be removed from "Security Access Control Records, STATE-55" and will become part of STATE-36. STATE-55 will be deleted in the near future.

Any persons interested in commenting on the altered system of records may do so by submitting comments in writing to Kenneth F. Rossman; Acting Chief; Programs and Policies Division; Office of IRM Programs and Services; Room 1239; Department of State; 2201 C Street, NW; Washington, DC 20520-1512. This system of records will be effective 40 days from the date of publication, unless we receive comments that will result in a contrary determination.

The altered system description, "Security Records, STATE-36" will read as set forth below.

Dated: August 24, 1998.

Patrick F. Kennedy,

Assistant Secretary for the Bureau of Administration.

STATE-36

SYSTEM NAME:

Security Records.

SECURITY CLASSIFICATION:

Unclassified and classified.

SYSTEM LOCATION:

Department of State, Bureau of Diplomatic Security, State Annex 1, 2401 E Street NW, Washington, DC 20037; State Annex 7, 7943-50 Cluney Court, Springfield, VA 22153; State Annex 10, 2121 Virginia Avenue NW, Washington, DC 20522; State Annex-11, 2216 Gallows Road, Dunn Loring, VA 22027; and overseas at some U.S. embassies, U.S. consulates general and U.S. consulates.

CATEGORIES OF INDIVIDUALS COVERED BY THE SYSTEM:

Present and former employees of the Department of State including Diplomatic Security Special Agents; applicants for Department employment who have been or are presently being investigated for security clearance; contractors working for the Department; interns and detailees to the Department; individuals requiring access to the official Department of State premises who have undergone or are undergoing security clearance; some passport and visa applicants concerning matters of adjudication; individuals involved in matters of passport and visa fraud; individuals involved in unauthorized access to classified information; prospective alien spouses of American personnel of the Department of State; individuals or groups whose activities have a potential bearing on the security of Departmental or Foreign Service operations, including those involved in criminal or terrorist activity. Others files include individuals issued security violations or infractions; litigants in civil suits and criminal prosecutions of interest to the Bureau of Diplomatic Security; individuals who have Department building passes; unformed security officers; individuals named in congressional inquiries to the Bureau of Diplomatic Security; individuals subject to investigations conducted abroad on behalf of other Federal agencies; individuals whose activities other agencies believe may have a bearing on U.S. foreign policy interests.

AUTHORITY FOR MAINTENANCE OF THE SYSTEM:

- (a) 5 U.S.C. 301, (Management of Executive Agencies);
- (b) 5 U.S.C. 7311 (Suitability, Security, and Conduct);
- (c) 5 U.S.C. 7531-33 (Adverse Actions, Suspension and Removal, and Effect on Other Statutes);
- (d) 8 U.S.C. 1104 (Aliens and Nationality—passport and visa fraud investigations);
- (e) 18 U.S.C. 111 (Crimes and Criminal Procedures) (Assaulting, resisting, or impeding certain officers or employees);

¹⁵ 15 CFR 200.30-(a)(12).