

1997.⁸ The report indicated that the Exchange had received no formal complaints on the operation of the pilot since the previous report. Moreover, the Exchange found no significant impact from the pilot on bid/ask spreads, depth, and continuity in the Exchange's options markets.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b)⁹ of the Act, in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁰ in particular, because it is designed to perfect the mechanism of a free and open market, to promote just and equitable principles of trade, to facilitate transactions in securities, and in general, to protect investors and the public interest.

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

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

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

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. 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 also will be available for inspection and copying at the principal office of PCX. All submissions should refer to File No.

SR-PCX-98-50 and should be submitted by November 12, 1998.

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

The Commission finds that PCX's proposal to make the LMM Book Pilot Program permanent is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5)¹¹ of the Act.

Section 6(b)(5) requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to protect investors and the public interest and not be designed to permit unfair discrimination between customers, issuers, brokers or dealers. The Commission believes that the proposal is consistent with these provisions of the Act because it is designed to give LMMs greater control over their operations on the Exchange floor while maintaining sufficient safeguards to permit proper Exchange oversight of the LMMs managing the Book function.¹²

The Commission notes that the LLM Book Pilot Program has been in operation two years without significant problems and may have resulted in cost savings to customers in Book execution charges while improving the Exchange's competitiveness.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication. The Commission notes when the LMM Book Pilot Program was initially proposed, notice was published in the **Federal Register** for the full 21-day comment period without any comments being received by the Commission.¹³ Moreover, amendments to the LMM Book Pilot Program did not generate public comment.¹⁴ Finally, the Commission believes it is important to ensure that the proposal runs without interruption. As a result, it is approved permanently.

It is therefore ordered, pursuant to Section 19(b)(2)¹⁵ of the Act that the proposed rule change (SR-PCX-98-50) is hereby approved on an accelerated basis.

¹¹ 15 U.S.C. 78f(b)(5).

¹² See n. 3 above (order approving pilot and noting that, among other safeguards, the Exchange's Options Allocation Committee will evaluate LMMs at least semiannually.)

¹³ See, n. 3 above.

¹⁴ *Id.*

¹⁵ 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40557; File No. SR-Phlx-97-55]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 to Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Establishing an Enhanced Parity Split Pilot Program for Specialists in Foreign Currency Options Effective Until October 1, 1999

October 15, 1998.

I. Introduction

On December 1, 1997, the Philadelphia Stock Exchange, Inc. ("Exchange" or "Phlx") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to establish an enhanced parity split pilot program for Exchange specialists trading foreign currency options. The proposed rule change was published for comment in the **Federal Register** on January 23, 1998.³ The Commission did not receive any comment letters with respect to the proposal. The Exchange submitted Amendment No. 1 to the proposal on June 17, 1998,⁴ and Amendment No. 2 on October 2, 1998.⁵ This order

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 39552 (Jan. 15, 1998), 63 FR 3611 (Jan. 23, 1998).

⁴ Amendment No. 1 modifies the application of the enhanced parity split in situations where a customer order for 100 or more FCO contracts is on parity. The revision requires that for customer bids/offers of 100 FCO contracts or more, no such customer order on parity shall receive a smaller participation than any other crowd participant, including the specialist. Amendment No. 1 also revises the text of the proposed rule to clarify that customer orders for less than 100 FCO contracts have time priority. See Letter to Michael Loftus, Attorney, Division of Market Regulation, Commission, from Nandita Yagnik, Counsel, Exchange, dated June 16, 1998.

⁵ Amendment No. 2 extends the expiration date of the pilot program to October 1, 1999. See Letter to Michael Loftus, Attorney, Division of Market Regulation, Commission, from Nandita Yagnik, Counsel, Exchange, dated September 30, 1998.

⁸ See n. 3 above.

⁹ 15 U.S.C. 78f.

¹⁰ 15 U.S.C. 78f(b)(5).

approves the Exchange's proposed rule change and accelerates approval of Amendment Nos. 1 and 2.

II. Description of the Proposal

The proposed rule change would revise Exchange Rule 1014(h) to establish an enhanced parity split pilot program ("Pilot Program") for the Exchange's foreign currency option ("FCO") specialists. The Exchange seeks to implement an enhanced parity split procedure similar to the one currently applied to transactions in equity and index options at the Exchange.⁶ Under the Pilot Program, however, the application of the proposed FCO enhanced parity split would be more widespread, and the enhanced parity split would be available to all FCO specialists assigned to FCO products.⁷ The Pilot Program would remain in effect until October 1, 1999.

The proposed enhanced parity split would apply to the first 500 contracts in a FCO transaction when the specialist is on parity with one or more trading crowd participants. When the enhanced parity split is applied, the FCO specialist will be counted as two crowd participants when determining the allocation of the FCO contracts among the trading crowd participants on parity, except in the following circumstances: (i) When there is one other trading crowd participant on parity, the FCO

specialist will receive 60% of the FCO contracts making up the order; or (ii) when there are two other trading crowd participants on parity, the FCO specialist will receive 40% of the FCO contracts making up the order.

Because a customer bid/offer for less than 100 FCO contracts currently is deemed to have time priority over all other bids/offers, such a customer order will not be subject to the enhanced parity split.⁸ This provision will help ensure that small customer orders are not disadvantaged by the application of the enhanced parity split. In addition, any customer order that is on parity, and is for 100 or more FCO contracts, will not receive a smaller participation than any other crowd participant, including the specialist. This measure ensures that larger customer orders (*i.e.*, 100 or more FCO contracts) will not be negatively impacted by the proposed enhanced parity split. Finally, if a FCO transaction involves more than 500 contracts, these contracts exceeding the 500 contract threshold will be allocated on a pro rata basis among the crowd participants on parity.

The Commission notes that the application of the enhanced parity split for FCO specialists will be mandatory. Therefore, with respect to any FCO transaction that implicates the enhanced parity split, the FCO specialist will be required to accept the preferential allocation and may not decline the enhancement.⁹

III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange. In particular, the Commission believes the proposed rule change is consistent with the Section 6(b)(5)¹⁰ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and protect investors and the public interest.¹¹ The

Commission also finds that the proposal may serve to remove impediments to and perfect the mechanism of a free and open market by encouraging the Exchange's FCO specialists to maintain tight markets in order to attract order flow to the Exchange.

The Exchange previously provided an enhanced parity split to the specialist dealing in dollar denominated delivery German Mark ("3D German Mark") options.¹² The enhanced parity split gave the specialist 50% of the first 500 contracts of any parity trade in 3D German Mark options, except for customer orders involving less than 100 contracts. The Exchange eliminated the enhanced parity split in September, 1997, because the specialist in 3D German Mark options found the enhancement to be of little benefit.¹³ At the time the enhanced parity split was eliminated, the Exchange informed the Commission that it would continue to study the potential use of an enhanced parity split for all FCO specialists on a broader basis. This proposed rule change represents the Exchange's plan for the expanded use of the enhanced parity split in FCOs.

The purpose of the enhanced parity split is to encourage FCO specialist to make deep and liquid markets in order to attract order flow to the Exchange. The Commission has previously noted that specialists have responsibilities that other crowd participants do not share, such as the staff costs associated with continually updating and disseminating quotes.¹⁴ As a result, the Commission believes it is reasonable for the Exchange to grant certain advantages to specialists, such as the enhanced parity split, to attract and retain well capitalized specialists at the Exchange. As long as these advantages do not unreasonably restrain competition and do not harm investors, the Commission believes that the granting of such benefits to specialists, in general, is within the business judgment of the Exchange. Therefore, even though the

⁶ The enhanced parity split for equity and index option specialists works as follows: when an equity or index option specialist is on parity with one controlled account (any account controlled by or under common control with a member broker-dealer) and the order is for more than 5 contracts, the specialist will receive 60% of the contracts and the controlled account will receive 40%. When the specialist is on parity with two controlled accounts and the order is for more than 5 contracts, the specialist will receive 40% of the contracts and each controlled account will receive 30%. When the specialist is on parity with three or more controlled accounts and the order is for more than 5 contracts, the specialist will be counted as 2 crowd participants when allocating the contracts. In any of these situations, if a customer is on parity, he will not be disadvantaged by receiving a lesser allotment than any other crowd participant, including the specialist.

In December, 1997, the Exchange amended its enhanced parity split pilot program for equity and index option specialists to expand its application. As a result of the revisions, all index options and all newly listed equity options receive the enhanced parity split. However, only 50% of those equity options not considered "newly listed" are eligible to receive the enhanced parity split. In addition, specialists are now permitted to revise the list of eligible equity options on a quarterly basis, rather than an annual basis. See Securities Exchange Act Release No. 39401 (Dec. 4, 1997), 62 FR 65300 (Dec. 11, 1997).

⁷ It should be noted that because FCOs on the Italian Lira and the Spanish Peseta are traded as customized options, there are not specialists assigned to those products. For simplicity and clarity, all further references to FCOs shall not include these two products.

⁸ Exchange Rule 1014(h), "Options on Foreign Currencies," Subsection (i), states that "all bids/offers of customer accounts for under 100 contracts have time priority over all other bids/offers" on the FCO floor. In that instance, the FCO specialist cannot be on parity with such customer so the enhanced parity split will not apply.

⁹ Telephone conversation between Michele R. Weisbaum, Vice President and Associate General Counsel, Exchange, and Michael L. Loftus, Attorney, Division of Market Regulation, Commission (December 15, 1997).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² The enhanced parity split for the specialist in 3D German Mark options was first approved on December 29, 1994. See Securities Exchange Act Release No. 35177 (Dec. 29, 1994), 60 FR 2419 (Jan. 9, 1995). 3D German Mark options are cash-settled, European-style, cash/spot foreign currency option contracts on the German mark.

¹³ The enhanced parity split was eliminated as of September 8, 1997. See Securities Exchange Act Release No. 39030 (Sept. 8, 1997), 62 FR 48332 (Sept. 15, 1997). The sole specialist firm trading 3D German Mark options indicated that the enhanced parity split was not particularly useful. Furthermore, the Exchange represented that the 3D German Mark enhanced parity split did not serve as an effective means of attracting order flow to the Exchange.

¹⁴ See *e.g.*, Securities Exchange Act Release No. 35177 (Dec. 29, 1994), 60 FR 2419 (Jan. 9, 1995).

proposed rule change could arguably have some negative impact on crowd participants, other than customers, the Commission believes the proposal is consistent with the Act.

The Commission believes that customers, as they are defined in Exchange Rule 1014(h),¹⁵ will not be disadvantaged by the proposal and that current benefits available to customers will not be affected. Specifically, customer bids/offers for less than 100 FCO contracts will continue to have time priority over all other bids/offers. In that instance, an FCO specialist cannot be on parity with such customer, and as a result the enhanced parity split will not apply. The time priority ensures that customers' smaller FCO orders will be filled first and that FCO specialists will not benefit to the detriment of FCO customers.

The Commission notes that Exchange Rule 1014(h) does not confer time priority on customer orders for 100 or more FCO contracts. Under the proposal, therefore, an FCO specialist on parity with a customer orders for 100 or more FCO contracts will receive the enhanced parity split. However, the proposal specifies that the application of the enhanced parity split cannot cause the customer to receive a smaller participation than any other crowd participant, including the specialist. The Commission believes this provision adequately protects customer orders for 100 or more FCO contracts from any negative impact that might flow from application of the enhanced parity split. As a result, the customer is ensured a participation that, at a minimum, is equal to that given any other crowd participant on parity. Finally, the Commission notes that this provision is consistent with the enhanced parity split that applies to specialists trading equity and index options.¹⁶

The Commission finds good cause for approving Amendment Nos. 1 and 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission believes the Exchange's FCO specialists should begin receiving the benefits of the enhanced parity without delay. The Commission notes that Amendment No. 1 provides protection to customer orders for 100 or more FCO contracts by requiring that any such customer order on parity may not receive a smaller

participation than any other crowd participant, including the specialist. The Commission believes this change strengthens the proposal by providing protection to customer order for 100 or more FCO contracts that might otherwise be impacted negatively by full application of the enhanced parity split. Finally, Amendment No. 2 extends the expiration date of the Pilot Program to October 1, 1999, to allow the Exchange to implement the Pilot Program for one full year. The Commission believes, the Exchange will benefit by operating the Pilot Program for one year rather than a shorter period of time. A one year Pilot Program should provide the Exchange with sufficient experience to determine in what form the Pilot Program should be extended or made permanent, or whether the Pilot Program should be discontinued. Accordingly, the Commission believes it is consistent with Section 6(b)(5) of the Act¹⁷ to approve Amendment Nos. 1 and 2 to the Exchange's proposed rule change on an accelerated basis.

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2 to the proposal, including whether the proposed rule change as modified by Amendment Nos. 1 and 2 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. 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, NW, Washington, DC 20549. Copies of such filing will be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Phlx-97-55 and should be submitted by November 12, 1998.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-Phlx-97-55), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

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OFFICE OF THE UNITED STATES TRADE REPRESENTATIVE

Notice of Meeting of the Industry Sector Advisory Committee on Aerospace Equipment (ISAC-1)

AGENCY: Office of the United States Trade Representative.

ACTION: Notice of meeting.

SUMMARY: The Industry Sector Advisory Committee (ISAC-1) will hold a meeting on October 21, 1998 from 9:00 a.m. to 2:30 p.m. The meeting will be open to the public from 9:00 a.m. to 9:30 a.m. and closed to the public from 9:30 a.m. to 2:30 p.m.

DATES: The meeting is scheduled for October 21, 1998, unless otherwise notified.

ADDRESSES: The meeting will be held at the Department of Commerce Room 6808, located at 14th Street and Constitution Avenue, N.W., Washington, D.C., unless otherwise notified.

FOR FURTHER INFORMATION CONTACT: Fred Elliot, Department of Commerce, 14th St. Constitution Ave., N.W., Washington, D.C. 20230, (202) 482-1233 or Bill Daley, Office of the United States Trade Representative, 600 17th St. N.W., Washington, D.C. 20508, (202) 395-6120.

SUPPLEMENTARY INFORMATION: The ISAC-1 will hold a meeting on October 21, 1998 from 9:00 a.m. to 2:30 p.m. The meeting will include a review and discussion of current issues which influence U.S. trade policy. Pursuant to Section 2155(f)(2) of Title 19 of the United States Code and Executive Order 11846 of March 27, 1975, the Office of the U.S. Trade Representative has determined that part of this meeting will be concerned with matters the disclosure of which would seriously compromise the development by the United States Government of trade policy, priorities, negotiating objectives or bargaining positions with respect to the operation of any trade agreement and other matters arising in connection with the development, implementation and administration of the trade policy of the United States. During the discussion of such matters, the meeting will be closed to the public from 9:30 a.m. to 2:30 p.m. The meeting will be open to

¹⁵ Exchange Rule 1014(h) defines customer accounts as "all accounts other than ROT [Registered Options Trader], member or specialist accounts."

¹⁶ See Description of the enhanced parity split available to Exchange specialists trading equity and index options *supra* note 6.

¹⁷ 15 U.S.C. 78f(b)(5).

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).