guarantee that an order receives an execution at no worse than the limit price. However, if the market drops below the limit price of a sell stop order before the order can be executed, it is possible that the order will be executed. For example, if an investor enters a sell stop limit order where the stop price and the limit price are 34, then the investor's order may be executed only at 34 or better and may not be executed at all if the market moves below 34 before the order can be executed. However, if the investor is able to enter a sell order with a stop price of 34 and a limit price of 32, then the investor's order may be executed at 32 or better. Accordingly, by permitting investors to place orders where the limit price differs from the stop price, the NASD's proposal will increase the opportunities for execution of investors' orders and will allow investors to tailor their orders to reflect their objectives and strategies.

The Commission also believes that it is reasonable for the NASD to amend NASD Rule 6440(i) to clarify that members are not obligated to accept stop orders or stop limit orders. Currently, NASD Rule 6440(i)(2) states that members may accept stop limit orders in eligible securities. The NASD proposes to add language to NASD Rule 6440(i)(2) indicating that members are not obligated to accept stop limit orders.[17] Because this is a clarification of the NASD's existing policy, it does not raise new regulatory issues.

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 1 corrects a typographical error in NASD Rule 6440(I)(2). Specifically, NASD Rule 6440(i)(2) stated that when a transaction occurs at the stop price, a stop limit order to buy or sell becomes a limit order at the stop price. Amendment No. 1 revises NASD Rule 6440(i)(2) to state that when a transaction occurs at the stop price, a stop limit order to buy or sell becomes a limit order at the limit price. Because Amendment No. 1 corrects the text of the NASD's rule, the Commission finds that it is consistent with Sections 6(b) and 19(b)(2) of the Act to approve Amendment No. 1 on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR–NASD–97–20 and should be submitted by May 11, 1998.

V. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,[18] that the proposed rule change (SR–NASD–97–20) is approved, and that Amendment No. 1 is approved on an accelerated basis.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–10339 Filed 4–17–98; 8:45 am]

BILLING CODE 8010–01–M

[17] Similarly, NASD Rule 6440(i)(1), as amended, will state that a member may, but is not obligated to, accept a stop order in an eligible security.

[18] 15 U.S.C. 78s(b)(2).

[19] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39855; File No. SR–PCX–97–07]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto, by the Pacific Exchange, Inc., Relating to Position and Exercise Limits

April 13, 1998.

I. Introduction

On March 5, 1997, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') 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 modify its rules on option position and exercise limits by (a) expanding the scope of the firm facilitation exemption, (b) increasing the position and exercise limits for narrow-based index options, (c) expanding the broad-based index hedge exemption to include broker-dealers, and (d) clarifying the general rule on exercise limits. On March 27, 1997, the PCX submitted an amendment to the Commission regarding its proposal.[3]

The proposed rule change appeared in the **Federal Register** on May 20, 1997.[4] No comments were received on the proposed rule change. This order approves the PCX's proposal, as amended.

II. Description

The Exchange has proposed to modify several of its rules on position and exercise limits for equity and index options as follows:

A. Firm Facilitation Exemption

The PCX's firm facilitation exemption currently applies only to a member firm that facilitates and executes an order for its own customer.[5] The PCX proposes to amend the firm facilitation exemption in two ways. First, a member firm will qualify for the exemption if it facilitates its own customer whose account it carries, whether the firm executes the order itself or gives the order to an independent broker for execution. Second, the exemption will be expanded to include member firms who facilitate another member's customer order. Such a customer order must be for execution only against the member firm's proprietary account. Further, unlike a member firm that facilitates its own customer, the resulting position will not be carried by the facilitating member firm.[6]

Specifically, PCX Rule 6.8, Commentary .08 currently provides that for the purpose of facilitating (in accordance with the provisions of PCX Rule 6.47(b)) orders of its own customer (one that will enter, clear and have the resulting position carried with the firm) in non-multiply-listed Exchange options, the proprietary account of a

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Michael D. Pierson; Senior Attorney, Regulatory Policy, PCX, to Matthew S. Morris, Office of Market Supervision, Division of Market Regulation, Commission, dated March 26, 1997 (''Amendment No. 1'').

[4] *See* Securities Exchange Act Release No. 38612 (May 12, 1997) 62 FR 27643 (May 20, 1997).

[5] The PCX defines a customer order as one that is entered, cleared, and in which the resulting position is carried with the firm.

[6] The Commission notes that any solicitation of a member by another member or customer to facilitate a customer order must comply with the relevant Exchange rules concerning solicited transactions.

member organization may receive and maintain an exemption (''facilitation exemption'') from the applicable standard position limit to the extent that certain procedures and criteria are satisfied. The Exchange proposes to replace this provision with another stating that to the extent that certain procedures and criteria are satisfied, a member organization may receive and maintain for its propriety account an exemption (''facilitation exemption'') from the applicable standard position limit in non-multiply-listed Exchange options for the purpose of facilitating, pursuant to the provisions of PCX Rule 6.47(b), (a) orders for its own customer (one that will have the resulting position carried with the firm) or (b) orders received from or on behalf of a customer for execution only against the member firm's proprietary account.[7]

B. Narrow-Based Index Options

Pursuant to PCX Rule 7.6, the position and exercise limits for narrow-based (industry) index options traded on the Exchange are currently set at 6,000, 9,000, and 12,000 contracts.[8] Specifically, Exchange Rule 7.6(a) provides that position and exercise limits for narrow-based index options be set at one of three levels depending upon the weightings of the component securities in such narrow-based index. Currently, a narrow-based index option will have a 6,000 contract limit if a single component security accounts for more than 30% of the index value; a 9,000 contract limit if a single component security accounts for more than 20% (but less than 30%) of the index value or any five component securities together account for more than 50% of the index value; and a 12,000 contract limit for those narrow-based indexes that do not fall within any one of the other categories. The Exchange proposes to increase these position and exercise limits to 9,000, 12,000, and 15,000 contracts. The Exchange notes that the Commission has approved such increases to the position and exercise limits of other options exchanges.[9]

C. Broad-Based Index Hedge Exemption

PCX Rule 7.6, Commentary .02, currently provides that positions in broad-based index option issues traded on the Exchange, held in the aggregate by a customer (who is neither a member nor a broker-dealer) are exempt from this position limit rule to the extent that certain procedures and criteria are met to qualify for a hedge exemption. The Exchange proposes to modify this provision and the subject procedures in several respects.[10]

First, the Exchange proposes to extend the broad-based index hedge exemption to broker-dealers. Accordingly, the Exchange is replacing various references to ''customer'' in the text of Commentary .02 with references to ''accounts,'' which refer to the accounts in which the exempt options positions are held (*i.e.*, the ''hedge exemption account'').

Second, the Exchange proposes that it be allowed to grant approval of a broad-based index hedge exemption on the basis of verbal representations, provided that the hedge exemption account furnishes to the Exchange, within two business days (or such other time period designated by the Exchange) appropriate documentation substantiating the basis for the exemption.

Third, the Exchange proposes to add a provision (at new subsection (c)) stating that a hedge exemption account that is not carried by a PCX member organization must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group (''ISG'').

Fourth, the Exchange is eliminating current subsections (c) and (d) and replacing them with new subsection (d), which provides that the hedge exemption account must maintain a qualified portfolio, or will effect transactions necessary to obtain a qualified portfolio concurrent with or at or about the same time[11] as the execution of the exempt option positions of: (1) a net long or short position in common stocks in at least four industry groups and contains at least twenty stocks, none of which account for more than fifteen percent of the value of the portfolio or in securities readily convertible, and additionally in the case of convertible bonds, economically convertible, into common stocks which would comprise a portfolio, and/or (2) a net long or short position in index futures contracts or in options on index futures contracts, or long or short positions in index options or index warrants, for which the underlying index is included in the same margin or cross-margin product group cleared at the Options Clearing Corporation (''OCC'') as the index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards notwithstanding trading activity.

Fifth, the Exchange proposes to clarify the method of determining the unhedged value of a ''qualified portfolio.'' Accordingly, subsection (e) of Commentary .02 will provide that the unhedged value will be determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (A) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (B) of any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows: the unhedged portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

Sixth, the proposal specifies that only the following qualified hedging transactions and positions are eligible for purposes of hedging a qualified portfolio (*i.e.*, stocks, futures, options, and warrants): (1) Long put(s) used to hedge the holding of a qualified portfolio; (2) Long call(s) used to hedge a short position in a qualified portfolio; (3) Short call(s) used to hedge the holding of a qualified portfolio; and (4) Short put(s) used to hedge a short position in a qualified portfolio. In addition, the proposal states that the following strategies may be effected only in conjunction with a qualified

[7] According to the PCX, the text of the proposed rule is substantially the same as the text of the first paragraph of Interpretation and Policy .06 to CBOE Rule 4.11 as well as the first paragraph of Commentary .10 to Amex Rule 904 and Commentary .02 to Amex Rule 904C. *See* Securities Exchange Act Release Nos. 37808 (October 10, 1996) 61 FR 54691 (October 21, 1996) (File No. CBOE–96–35), and 37945 (November 13, 1996) 61 FR 59122 (November 20, 1996) (File No. Amex–96–32).

[8] *See* Securities Exchange Act Release No. 36537 (November 30, 1995), 60 FR 62916 (December 7, 1995) (order approving increases to narrow-based index option position and exercise limits from 5,500, 7,500, and 10,500 contracts to 6,000, 9,000, and 12,000 contracts) (File No. PSE–95–30).

[9] *See, e.g.*, Securities Exchange Act Release Nos. 37863 (October 24, 1996) 61 FR 56599 (November 1, 1996) (FIle No. SR–Phlx–96–33), 38202 (January 23, 1997) 62 FR 4555 (January 30, 1997) (FIle No. SR–Amex–96–41), and 38613 (May 12, 1997) 62 FR 27638 (May 20, 1997) (File No. SR–CBOE–97–09).

[10] The Exchange notes that the Commission has approved similar changes to the rules of the CBOE. *See* Securities Exchange Act Release No. 37504 (July 31, 1996) 61 FR 40868 (August 6, 1996) (File No. CBOE–96–01).

[11] The Exchange expects that the hedge will be established concurrently with or immediately following the execution of the option transaction absent good cause. In this regard, the Exchange notes that extreme market conditions, the implementation of circuit breakers, or the lack of liquidity may affect a market participant's ability to establish a hedge within the noted time-frame.

stock portfolio: (5) For non-P.M. settled, European-style index options only—a short call position accompanied by long put(s), where the short call(s) expire with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (a ''collar'') (provided that neither side of the collar transaction can be in-the-money at the time the position is established);[12] (6) For non-P.M. settled, European-style index options only—a long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expire with the long put(s), and the strike price of the long put(s) exceed the strike price of the short put(s) (a ''debit put spread position''); and (7) For non-P.M. settled, European-style index options only—a short call position accompanied by a debit put spread position, where the short call(s) expire with the puts and the strike price of the short call(s) equals or exceeds the strike price of the long put(s) (provided that neither side of the short call, long put transaction can be in-the-money at the time the position is established).[13]

Finally, the Exchange proposes to add a new provision stating that positions included in a qualified portfolio that serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange or any other self-regulatory organization or futures contract market.

D. Exercise Limits

PCX Rule 6.9 currently provides that Exchange member organizations are prohibited from exercising certain long positions in options dealt in on the Exchange as well as options dealt in on other options exchanges.[14] The Exchange proposes to remove the phrase ''of a class of options dealt in on the Exchange'' in PCX Rule 6.9, Commentary .01, in order to make that Commentary consistent with current PCX Rule 6.9(a).

III. Findings and Conclusions

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b).[15] Specifically, the Commission finds that the proposal is designed to perfect the mechanisms of a free and open market and to protect investors and the public interest.

A. Firm Facilitation Exemption

The Commission believes that by allowing member firms an exemption from position limits to facilitate large customer orders, whether they are firms who accept customer orders for execution only against the member firm's proprietary account, or they are firms who carry their own customers' accounts and positions, the depth and liquidity of the market will be enhanced in a manner consistent with the protection of investors and the public interest. Further, permitting a member firm who facilitates its own customer order to qualify for the exemption whether it executes the order itself or gives it to an independent broker for execution should provide firms with flexibility in handling such orders while still requiring compliance with the rule's requirements.

Specifically, the Commission believes that the PCX's proposal to amend its firm facilitation exemption will accommodate the needs of investors as well as market participants without substantially increasing concerns regarding the potential for manipulation and other trading abuses. The Commission also believes that the proposed rule change will further enhance the potential depth and liquidity of the options market as well as the underlying markets by providing Exchange members greater flexibility in executing large customer orders. Moreover, the Commission is relying on the absence of discernible manipulation problems under the PCX's current firm facilitation exemption as an indicator that the proposal is appropriate. In addition, the PCX's existing safeguards that apply to the current facilitation exemption will continue to serve to minimize any potential disruption or manipulation concerns.

In summary, the Commission continues to believe that the safeguards built into the facilitation exemptive process will serve to minimize the potential for disruption and manipulation concerns, while at the same time benefiting market participants by allowing member firms greater flexibility to facilitate large customer orders. The Commission also notes that the facilitation exemption will be monitored in the same manner, whether the facilitation is done by the member firm for its own customer and executed by the firm itself or given to an independent broker for execution, or whether the facilitation is done by another member firm willing to facilitate the order of another member firm's customer. Further, as noted above, any firm solicitation to facilitate a customer order must comply with the PCX's solicitation rules as well as with the PCX's facilitation and crossing rules. Lastly, the Commission believes that the PCX has adequate surveillance procedures to surveil for compliance with the rule's requirements. Based on these reasons, the Commission believes that it is appropriate for the PCX to amend its firm facilitation exemption.

B. Narrow-Based Index Options

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of option contracts that a member or customer can hold or exercise. These rules are intended to prevent the establishment of large options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. At the same time, the Commission has recognized that option position and exercise 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.

In this regard, the PCX has stated that the current position limits discourage market participation by certain large investors and the institutions that compete to facilitate their trading. In addition, the PCX notes that index option trading volume has increased significantly since 1995, when the current industry index option position limits were established. In light of the increased volume of narrow-based index option trading and the needs of investors and market makers, the Commission believes that the PCX's proposal is a reasonable effort to accommodate the needs of market participatants.

In addition, the Commission notes that the proposal, while increasing the positions limits for narrow-based index options, continues to reflect the unique characteristics of each index option and to maintain the structure of the current three-tiered system. Specifically, the lowest proposed limit, 9,000 contracts,

[12] For purposes of determining compliance with PCX Rules 6.8 and 7.6, a collar position will be treated as one contract.

[13] For purposes of determining compliance with PCX Rules 6.8 and 7.6, the short call and long put positions will be treated as one contract.

[14] *See* Securities Exchange Act Release No. 36350 (October 6, 1995) 60 FR 53654 (October 16, 1995) (approval order relating to members' compliance with position and exercise limits for non-PCX listed options) (File No. PSE–95–17).

[15] 15 U.S.C. 78f(b).

will apply to narrow-based index options in which a single underlying stock accounts, on average, for 30% or more of the index value during the 30-day period immediately preceding the Exchange's semi-annual review of industry index option positions limits. A position limit of 12,000 contracts will apply if any single underlying stock accounts, on average, for 20% or more of the index value or any five underlying stocks account, on average, for more than 50% of the index value, but no single stock in the group accounts, on average, for 30% or more of the index value during the 30-day period immediately preceding the Exchange's semi-annual review of industry index option position limits. The 15,000 contract limit will apply only if the Exchange determines that the conditions requiring either the 9,000 contract limit or the 12,000 contract limit have not occurred.

The Commission believes that the proposed increases for the three tiers of 25%, 33%, and 50%, for highest to lowest, respectively, appear to be appropriate and consistent with the Commission's evolutionary approach to position and exercise limits. As noted above, the Commission also has approved previously these increased position and exercise limits for several other exchanges.[16] To date, there have been no discernible manipulation problems that have arisen at the higher three-tier position and exercise limits for narrow-based index options on these exchanges. The Commission notes that the Exchange has had considerable experience monitoring the current three-tiered framework in narrow-based index options. The Commission has not found that differing position and exercise limit requirements based on the particular options product to have created programming or monitoring problems for securities firms, or to have led to significant customer confusion. Based on the current experience in handling position and exercise limits, the commission believes that the proposed increase in position and exercise limits for narrow-based index options will not cause significant problems.

Finally, the Commission believes that the Exchange's surveillance programs are adequate to detect and deter violations of position and exercise limits as well as to detect and deter attempted manipulative activity and other trading abuses through the use of such illegal positions by market participants. Accordingly, the Commission concludes that the increase in the position and exercise limits for narrow-based index options proposed by the Exchange are warranted and should be approved.[17]

C. Broad-Based Index Hedge Exemption

1. Expansion of Definition of Qualified Portfolio and Extension of Broad-Based Index Hedge Exemption to Broker-Dealers

Currently, the PCX's broad-based index hedge exemption may be granted for positions in broad-based index options that are hedged with Exchange-approved qualified portfolios. The PCX proposes to expand the current definition of a qualified portfolio to take into account the broader range of hedging strategies currently used by market participants. Specifically, the PCX has proposed to include within the definition of a qualified portfolio products that overlay various broad-based indexes, including index futures, options on index futures, index options, and index warrants, where the indexes are represented in margin or cross-margin product groups at the OCC. Under the new index hedge exemption's requirements, a qualified portfolio may consist of: (i) net long or short positions in common stocks, or securities readily convertible into common stocks, in at least four industry groups, where the portfolio contains at least twenty stocks, none of which accounts for more than fifteen percent of the value of the portfolio; and/or (ii) net long or short positions in index futures contracts or in options on index futures contracts, or long or short positions in index options or index warrants, for which the underlying index is included in the same margin or cross-margin product group cleared at the OCC as the index option class to which the hedge exemption applies. To remain qualified, a portfolio must at all times meet these standards, notwithstanding trading activity. In addition, the index hedge exemption applies to positions in broad-based index options and is applicable to the unhedged value of the qualified portfolio.[18] The Exchange also proposes to grant approval of a broad-based index hedge exemption on the basis of verbal representations, provided that the hedge exemption account furnishes to the Exchange, within two business days, or such other time period designated by the Exchange, appropriate documentation substantiating the basis for the exemption. The Exchange further proposes to extend the broad-based index hedge exemption to broker-dealers.

The Commission believes, as it did when originally approving the PCX's index hedge exemption, that providing for increased position and exercise limits for broad-based index options in circumstances where those excess positions are effectively hedged with offsetting positions will provide greater depth and liquidity to the market and will allow investors to hedge their portfolios more effectively, without significantly increasing concerns regarding intermarket manipulations or disruptions of either the options market or the underlying stock market. The Commission believes that through the expanded definition of a qualified portfolio, an increased number of public customers with long or short portfolios will be able to utilize the broad-based index hedge exemption, thereby making an alternative hedging technique more available.

Although the Exchange may, under the terms of the proposal, grant approval on the basis of verbal representations, the Commission believes that trading abuses are unlikely because the hedge exemption account is required to furnish to the Exchange, within two business days or such other time period designated by the Exchange, appropriate documentation substantiating the basis for the exemption. The Exchange recently adopted surveillance procedures appropriate to the new broad-based index hedge exemption authority. The Commission also notes that the authority to grant approval for index hedge exemptions on the basis of verbal representations has been previously approved by the Commission for another exchange.[19]

In addition, the Commission believes that it is reasonable for the PCX to allow

[16] *See supra* note 9.

[17] The Commission continues to believe that proposals to increase position limits and exercise limits must be justified and evaluated separately. After reviewing the proposed exercise limits, along with the eligibility criteria for each tier, the Commission has concluded that the proposed exercise limit increases for the three-tiered framework do not raise manipulation problems or increase concerns over market disruption in the underlying securities.

[18] *See* new Commentary .02(c) to Rule 7.6. Under this provision, the unhedged value is determined as follows: (1) the values of the net long or short positions of all qualifying products in the portfolio are totaled; (2) for positions in excess of the standard limit, the underlying market value (A) of any economically equivalent opposite side of the market calls and puts in broad-based index options, and (B) of any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows: the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

[19] *See* Interpretation .01(a) to CBOE's Rule 24.4.

broker-dealers as well as public customers to utilize the broad-based index hedge exemption. The Commission believes that extending the exemption to broker-dealers may help to increase the depth and liquidity of the market for broad-based index options and may help to ensure that public customers receive the full benefit of the exemption. Moreover, the Commission is relying on the absence of discernible manipulation problems under the corresponding equity hedge exemption, which is available to both public customers and broker-dealers, as an indicator that the proposed extension of the broad-based index hedge exemption is appropriate. The Commission notes that the broad-based index hedge exemption will continue to include safeguards designed to lessen the possibility that the exempted positions could be used to disrupt or manipulate the market.

2. Prospective Broad-Based Index Hedge Exemption for Broker-Dealers

The PCX proposes to amend the broad-based index hedge exemption so that the Exchange may grant prospective broad-based index hedge exemptions to broker-dealers who may not yet have established qualified portfolios under Commentary .02(d) to Exchange Rule 7.6.

The Commission does not believe that trading abuses are likely to result from the prospective hedge exemption for the following reasons. First, the exemption is limited to registered broker-dealers, and second these broker-dealers must effect the transaction(s) necessary to obtain a qualified portfolio ''concurrent with or at or about the same time as the execution of the exempt options positions.'' [20] The Commission expects that the hedge will be established immediately following the execution of the options transaction. Moreover, broker-dealers must provide to the Exchange appropriate documentation related to the portfolio within two business days. The Commission believes that the PCX's surveillance procedures are sufficient to detect and deter trading abuses arising from the prospective hedge exemption and, in the event a broker-dealer is found to have violated the exemption, the PCX is authorized to take all necessary and appropriate disciplinary actions. Accordingly, the Commission believes that it is appropriate for the Exchange to adopt a limited prospective broad-based index hedge exemption for broker-dealers.

[20] *See also* 11, *supra*, on when the hedge is expected to be established.

3. Treatment of Collar and Debit Put Spread Transaction as One Contract for Hedging and Position Limit Purposes and Neither Side of Collar Transaction Can Be In-the-Money When Established for Broad-Based Index Hedge Exemption Purposes

The PCX proposes to treat a collar position as one contract rather than as two contracts in Commentary .02(g)(5) to Exchange Rule 7.6. Under the PCX's rules, a collar is defined as a short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). Within a limited range, the collar has less opportunity to benefit from upward and downward price changes than either of the collar's components. If the market climbs, the collar is equivalent to a covered write position. If the market declines, the collar is equivalent to a long put position. Because the strategy requires both the purchase of puts and the sale of calls, the PCX believes that the position is more appropriately treated as one contract for hedging purposes rather than two separate put and call components. In adopting this interpretation of a collar, the PCX is also proposing that new language in Commentary .02(g)(5) and .02(g)(7) to Exchange Rule 7.6 will be added to require that neither side of the collar transaction (or the short call, long put transaction) can be in-the-money at the time the position is established. Similarly, because a strategy involving a covered write accompanied by a debit put spread requires a collar component, the PCX also believes that the short call and long put should be treated as one contract in Commentary .02(g)(7) to Exchange Rule 7.6.[21]

The Commission believes that the increased number of options positions available by virtue of the Exchange's proposal will not result in disruptions to either the options or underlying stock market due to the conditions and limitations that must be met to be eligible for the exemption.[22] For example, the broad-based index hedge exemption collar strategy can only be effected in conjunction with a qualified stock portfolio; the exemption is available only for non-p.m. settled, European-style index options; the short call(s) must expire with the long put(s); the strike price of the short call(s) must equal or exceed the strike price of the long put(s); and neither side of the collar transaction can be in-the-money at the time the position is established.

[21] The PCX defines a debit put spread position as a long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s).

[22] The Commission notes that it has previously approved identical changes to the rules of CBOE. *See supra* note 10.

4. Miscellaneous Changes

The PCX is also proposing several other changes to its rules, including a requirement in Commentary .02(c) to Exchange Rule 7.6 that a hedge exemption account can be carried by a member of a SRO participating in the ISG. The Commission believes that through the Exchange's ISG information sharing arrangements, the hedge exemption account will continue to be adequately monitored. Other changes to the Exchange's rules include: (1) clarifying language to reflect the change in the Exchange corporate name; (2) removing superfluous language from Commentary .02 to Rule 7.6; (3) changing a cross-reference from ''Rule 6.74(b)'' to ''Rule 6.47(b)'' in Commentary .08 to Rule 6.8; and (4) changing the first character of the words ''member,'' ''firm,'' and ''organization'' to upper case. Because these changes are non-substantive or technical in nature or raise no additional regulatory issues, the Commission believes that they are consistent with Section 6(b)(5) of the Act.[23]

D. Exercise Limits

The Exchange proposes to remove the phrase ''of a class of options dealt in on the Exchange'' in PCX Rule 6.9, Commentary .01, in order to make that Commentary consistent with current PCX Rule 6.9(a). The Commission believes that the Exchange's rule change clarifies and strengthens the PCX's proposal, as originally intended, and raises no new regulatory issues.[24]

IV. Conclusion

For the foregoing reasons, the Commission finds that the PCX's proposal relating to position and exercise limits is consistent with the requirements of the Act and the rules and regulations thereunder.

It is Therefore Ordered, pursuant to section 19(b)(2) of the Act,[26] that the proposed rule change (SR–PCX–97–07), as amended, is approved.

[23] 15 U.S.C. 78f(b)(5).

[24] *See* discussion in order approving changes to PCX Rule 6.8 and 6.9 in Securities Exchange Act Release No. 36350 (October 6, 1995) 60 FR 53654 (October 16, 1995).

[26] 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[27]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–10273 Filed 4–17–98; 8:45 am]

BILLING CODE 8010–01–M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–39856; File No. SR–Phlx–97–63]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. to Amend its Method of Calculating Initial and Maintenance Margin Requirements for Foreign Currency Options

April 13, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on December 22, 1997, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Phlx. On February 20, 1998, the Phlx filed a Letter Amendment to the proposed rule change.[3] The Phlx filed Amendment No. 1 to the proposed rule change on April 6, 1998.[4] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Phlx proposes to amend Phlx Rule 722 to codify its method of calculating initial and maintenance customer margin requirements for foreign currency options. Under proposed new Commentary .16 to Rule 722, the Exchange would calculate the margin requirements for each foreign currency separately, rather than determining one margin level for all foreign currencies based upon the historical pricing information for all foreign currencies together.

The complete text of the proposed rule change is available at the Office of the Secretary, Phlx and at the Commission.

II. Self-Regulatory Organization's Statements Regarding the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Phlx 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 Phlx 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

Currently, the Exchange calculates the margin requirement for customers that assume short foreign currency option positions by adding 4% of the current market value of the underlying foreign currency contract to the option premium price less an adjustment for the out-of-the-money amount of the option contract.[5] The 4% add-on percentage was adopted in 1986 and provided for initial margin which would cover the aggregate underlying foreign currencies' historical volatility over a seven day period with a 95% confidence level over the latest nine month period.[6] This add-on percentage is now reviewed by the Exchange every quarter to assure that it provides for a 97.5% confidence level over a five day period. Recently, the Exchange has listed new foreign currency options such as the Spanish peseta and the Italian lira[7] and has received approval to trade options on the Mexican peso.[8] In determining the appropriate margin levels for these new currencies, the Commission has indicated that it believes that the Exchange should set margin levels for each foreign currency option independently and that it should state its specific procedure for setting these levels in its rules. The purpose of this proposal is to address this issue by adopting new foreign currency options margin procedures as proposed in Commentary .16 to Rule 722.

The Exchange is proposing to determine the applicable add-on percentage by reviewing, on a quarterly calendar basis,[9] five-day price changes over the preceding three-year period for each underlying currency and set the add-on percentage at a level which would have covered those price changes at least 97.5% of the time (''confidence level''). If the results of subsequent reviews show that the current margin level provides a confidence level below 97%, the Exchange will increase the margin requirement for that individual currency up to a 98% confidence level. If the confidence level is between 97% and 97.5%, the margin level will remain the same but will be subject to monthly follow-up reviews until the confidence level exceeds 97.5% for two consecutive months.[10] If during the course of the monthly follow-up reviews, the confidence level drops below 97%, the margin level will be increased to a 98% level and if it exceeds 97.5% for two consecutive months, the currency will be taken off monthly reviews and will

[27] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter from Michele R. Weisbaum, Vice President and Associate General Counsel, Phlx, to Sharon Lawson, Senior Special Counsel, Division of Market Regulation (''Division''), Commission, dated February 19, 1998 (''Letter Amendment''). In the Letter Amendment, the Phlx proposes to amend its proposed rule change to: (1) conduct margin reviews quarterly rather than semi-annually; (2) monitor currencies monthly when the confidence level falls to between 97% and 97.5% until the confidence level exceeds 97.5% for two consecutive months, rather than just one month; and (3) revise Rule 722 to exclude the actual margin level for each currency and to note that instead, the Phlx will distribute membership circulars announcing the margin levels that are derived pursuant to Commentary .16 of Rule 722.

[4] *See* Letter from Nandita Yagnik, Counsel, Phlx, to Sharon Lawson, Senior Special Counsel, Division, Commission, dated April 3, 1998 (''Amendment No. 1''). Amendment No. 1 incorporates the original proposed rule change and Letter Amendment into a Rule 19b–4 notice.

[5] This 4% ''add-on'' percentage is applicable to the following foreign currencies: Australian dollar, British pound, Canadian dollar, German mark, European Currency Unit, French franc, Japanese yen and Swiss franc. The Spanish peseta and the Italian lira currently have a 7% add-on percentage and the Mexican peso has an add-on percentage of 17%.

[6] *See* Securities Exchange Act Release No. 22469 (September 26, 1985) 50 FR 40663 (October 4, 1985) (order approving File Nos. SR–Amex–84–29, SR–CBOE–84–27, SR–NASD–85–15, SR–PSE–84–20, SR–Phlx–84–32 and SR–Phlx–85–18 and establishing a uniform margin system for options products).

[7] *See* Securities Exchange Act Release No. 36255 (September 20, 1995) 60 FR 50229 (September 28, 1995) (order approving File Nos. SR–Phlx–95–20 and SR–Phlx–95–21).

[8] *See* Securities Exchange Act Release No. 39460 (December 17, 1997) 62 FR 67425 (December 24, 1997) (order approving File No. SR–Phlx–97–22).

[9] Although the Phlx initially proposed semi-annual margin reviews, in Amendment No. 1, the Phlx proposes to amend Commentary .16(b) of Rule 722 to require margin reviews to be conducted quarterly, on the 15th of January, April, July and October of each year. *See* Amendment No. 1, *supra* note 4.

[10] As initially proposed, it was unclear whether monthly margin reviews would be required once the confidence level equaled 97.5%. Amendment No. 1 makes clear that the confidence level must exceed 97.5% for two consecutive months before the currency will no longer be reviewed monthly. *See* Amendment No. 1, *supra* note 4.