because certain traders may not have considered some strategies that are effected to capture differences between the cash and futures market, such as liquidating or establishing exchanges for physicals,[5] to be index arbitrage.

Conclusion. The Exchange believes that the proposed amendments to Rule 80A will allow the collars to move with the market in a similar fashion to the triggers in Rule 80B. Thus, trading curbs would remain at an appropriate level as the market changes, *i.e.,* closer to the 1.7% move that the 50 point collar represented when implemented in 1990 as opposed to 0.56% currently.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) [6] of the Act in general and furthers the objectives of Section 6(b)(5) [7] in particular in that it is designed to promote just and equitable principles of trade, to remove impediments to, and perfect the mechanisms of a free and open market and, in general, to protect investors and the public interest.

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

The Exchange believes the proposed rule change will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

[5] In the context of program trading, the term ''exchange-for-physicals'' or ''EFP'' refers to a practice whereby an entity, such as a broker-dealer or an institution, uses an off-exchange transaction to acquire or liquidate a hedged position in a stock basket and stock index futures or options. For example, an institution wishing to liquidate a large long-stock/short-futures hedged position might negotiate with a broker-dealer to conduct an EFP outside of regular U.S. trading hours in London. In the EFP, the institution would sell the stock basket to the broker-dealer and the broker-dealer would sell the equivalent amount of stock index futures to the institution. The difference in the prices for the stock and futures trades is the negotiated price for the transaction, and is usually denominated in hundredths of a percentage point (''basis points'') of the value of the portfolio. Once the EFP is completed, the broker-dealer has acquired the long-stock/short-futures hedged position. The broker-dealer may subsequently ''unwind'' this position through trades on U.S. exchanges when profitable arbitrage spreads arise. In the example cited above, if futures are trading at a ''discount'' to underlying stocks, the broker-dealer could use program orders to sell the higher priced stocks on the NYSE while buying the lower priced futures. Such a transaction would be the functional equivalent of index arbitrage for purposes of NYSE Rule 80A(c).

[6] 15 U.S.C. 78f(b).

[7] 15 U.S.C. 78f(b)(5).

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

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

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

Within 35 days of the date of 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 Exchange 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 in 450 Fifth Street, N.W., Washington, D.C. 20549. Also, copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to File No. SR–NYSE–98–45 and should be submitted by January 13, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[8]

[8] 17 CFR 200.30–3(a)(12).

Margaret H. McFarland,
Deputy Secretary.
[FR Doc. 98–33910 Filed 12–22–98; 8:45 am]
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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40800; File No. SR–OCC–98–11]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change Regarding the Calculation of the Short Option Adjustment

December 16, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] notice is hereby given that on September 10, 1998, The Options Clearing Corp. (''OCC'') 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 primarily by OCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

Under the proposed rule change, OCC will amend the short option adjustment contained in OCC's Theoretical Intermarket Margin System (''TIMS'') to enable OCC to use a ''sliding scale'' to calculate short option adjustment amounts.

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.[2]

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Under the proposed rule change, OCC will amend Rules 601 and 602 to

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

[2] The Commission has modified the text of the summaries prepared by OCC.

provide OCC with more flexibility in calculating the amount of the short option adjustment.[3]

OCC requires its clearing members to adjust their margin deposits with OCC in the morning of every business day based on OCC's overnight calculations. OCC imposes a margin requirement on short positions in each clearing member account and gives margin credit for unsegregated long positions.[4] Under TIMS, the margin for positions in a class group is based on premium levels at the close of trading on the preceding day and is then increased or decreased by the additional margin amount for that class group.[5]

TIMS calculates additional margin amounts using options price theory. TIMS first calculates the theoretical liquidating value for the positions in each class group assuming either an increase or decrease in the market value of the underlying asset in an amount equal to the applicable margin interval. The margin interval is the maximum one day price movement that OCC wants to protect against in the price of the underlying asset.[6] Margin intervals are determined separately for each underlying interest to reflect the volatility in the price of the underlying interest.

TIMS then selects the theoretical liquidating value that represents the greatest decrease (where the actual liquidating value is positive) or increase (where the actual liquidating value is negative) in liquidating value compared with the actual liquidating value based on the premium levels at the close of trading on the preceding day. The difference between that theoretical liquidating value and the actual liquidating value is the additional margin amount for that class group unless the class group is subject to the short option adjustment.

For net short positions[7] in deep out of the money options, little or no change in value would be predicted given a change in value of the underlying interest equal to the applicable margin interval. As a result, TIMS would calculate additional margin amounts of zero or close to zero for deep out of the money options. However, volatile markets could cause such positions to become near to or in the money and thereby could create increased risk to OCC. OCC protects against such risk by incorporating into the additional margin calculation a margin cushion known as the short option adjustment.[8]

Currently, the short option adjustment requires a minimum additional margin amount equal to twenty-five percent of the applicable margin interval for all unpaired[9] net short positions in options series for which the ordinary calculation of the additional margin requirement would be less than twenty-five percent of the applicable margin interval. OCC believes that this methodology requires clearing members to deposit margin in excess of the risk presented by some unpaired net short positions in out of the money options.

OCC believes that this excess margin requirement can be attributed essentially to two causes. First, some short positions are so far out of the money that even an extreme market move would not cause them to prevent risk to OCC commensurate with a short option adjustment equivalent to twenty-five percent of the applicable margin interval. To illustrate, on October 27, 1997, the S&P 500 Index fell 6.9% to 876.98 from its closing value of 941.64 on October 24, 1997.[10] There was a series of SPX 11/97 put options with an exercise price of 700 open on that date. At the close of October 24, 1997, that series was 25.7% out of the money and had a closing premium of $25.00. At the close on October 27, 1997, that series was 20.2% out of the money and had a closing premium of $56.25. The increase in the closing premium from October 24 to October 27 was $31.25. In the absence of the short option adjustment, TIMS would have required additional margin of $23.25. With the short option adjustment, TIMS required additional margin of $875.00 (equal to the margin interval, which was 35 points, times the index multiplier of 100, times 25%). Even in this extreme market move the short option adjustment required far more collateral than OCC needed to hedge the risk presented to it by unpaired short positions in this series.

Second, out of the money short call positions present less risk to OCC than short put positions that are equally out of the money. This is essentially because a market that moves sharply down (presenting risk to OCC from short put positions) is generally associated with an increase in option implied volatility whereas a market that moves sharply up (presenting risk to OCC from short call positions) is generally associated with a decrease in option implied volatility. Other things being equal, an upward move in the market of a given size creates less risk for OCC from short call positions than a downward move in the market of the same size from short put positions. Therefore, because TIMS employs a twenty-five percent short option adjustment for both puts and calls, it tends to require excessive additional margin particularly with respect to short call positions.

To address these situations, the proposed rule change will establish a sliding scale short option adjustment methodology. Using the sliding scale, the short option adjustment percentage will be applied to a particular series according to the extent to which the series is out of the money. In addition, OCC will use different sliding scales for put options and for call options.

OCC believes that the margin required by these sliding scales should be sufficient to protect it against the risks

[3] OCC Rule 601 describes TIMS as it applies to equity options (''equity TIMS'') and OCC Rule 602 describes TIMS as it applies to non-equity options (''non-equity TIMS'').

[4] A long position is unsegregated for OCC's purposes if OCC has a lien on the position (*i.e.*, has recourse to the value of the position in the event that the clearing member does not perform an obligation to OCC). Long positions in firm accounts and market-maker accounts are unsegregated. Long positions in the clearing member's customers' account are unsegregated only if the clearing member submits instructions to that effect in accordance with Rule 611.

[5] For purposes of equity TIMS, a class group consists of all put and call options, all BOUNDS, and all stock loan and borrow positions relating to the same underlying security. For purposes of non-equity TIMS, a class group consists of all put and call options, certain market baskets, and commodity options and futures (that are subject to margin at OCC because of a cross-margining program with a commodity clearing organization) that relate to the same underlying asset. A NEO TIMS class group may also contain stock loan baskets and stock borrow baskets.

[6] Some combinations of positions can present a greater net theoretical liquidating value at an intermediate value than at either of the endpoint values. As a result, TIMS also calculates the theoretical liquidating value for the positions in each class group assuming intermediate market values of the underlying asset.

[7] A net position in an option series in an account is the position resulting from offsetting the gross unsegregated long position in that series against the gross short position in that series. After netting, an account will reflect a net short position or a net long position for each series of options held in the account.

[8] The short option adjustment is described in Rule 601(c)(1)(C)(1) for equity options and Rule 602 (c)(1)(ii)(C)(1) for non-equity options. OCC recently amended Interpretation .06 to Rule 602 so that net short non-equity option positions can be paired off against net long non-equity positions whose underlying interests exhibit price correlation of at least seventy percent. Securities Exchange Act Release No. 40515 (September 30, 1988), 63 FR 53970.

[9] The term unpaired is defined in Interpretation .04 to Rule 601 for equity options and Interpretation .06 to Rule 602 for non-equity options.

[10] This market decline of 64.66 points was the 14th largest one day percentage decline in the period from January 1930 through June 1998, and it constituted a more extreme daily move than 99.9% of the daily moves during this period. The decline on October 27, 1997, actually represents a more rigorous test of the short option adjustment methodology than the market move on October 19, 1987. There are several reasons for this, such as the option implied volatility was so high on October 19, 1987, and the theoretical additional margin levels calculated by TIMS generally exceeded the alternative short option adjustment calculations.

presented by out of the money short positions even in extreme market conditions. For example, in the illustration described above, the sliding scale short option adjustment would still have required additional margin of $350.00 (equal to the margin interval of 35 points, times the index multiplier of 100, times 10%, the applicable percentage for a short put 25.7% out of the market) which is well in excess of the risk presented to OCC by the short puts in the SPX 11/97 700 series.

Under the proposed rule change, OCC will modify Rules 601 and 602 to provide that the short option adjustment to be applied to any unpaired short position will be determined using a percentage that OCC deems to be appropriate. A specific short option adjustment percentage will not be included in the rules.[11]

OCC believes that this information provides appropriate flexibility to make adjustments to the sliding scales from time to time as OCC determines is warranted. OCC further believes that the proposed rule change is consistent with the approach taken in Rule 60(c)(1)(C)(1) and Rule 602(c)(1)(ii)(C)(1) which both permit OCC to use such formulas, assumptions, and data as it deems appropriate for purposes of calculating additional margin.

OCC believes that the proposed rule change is consistent with Section 17A of the Act[12] and the rules and regulations thereunder because it furthers the public interest by reducing the overcollateralization of certain short positions in deep out of the money options. In addition, OCC believes that the proposed rule change should remove an impediment to market liquidity while still providing OCC with appropriate protection to the risks presented by short out of the money option positions.

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

OCC does not believe that the proposed rule change would impose any burden on competition.

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

Written comments were not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

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

Within thirty-five days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to ninety 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 OCC consents, the Commission will:

(A) by order approve such 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 Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and coping at the principal office of OCC. All submissions should refer to File No. SR–OCC–98–11 and should be submitted by January 12, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40798; File No. SR–Phlx-98–45]

Self-Regulatory Organizations: Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Philadelphia Stock Exchange, Inc. Proposing To Adopt New Rule 949 Respecting Purchase, Sale, Transfer, and Posting of Membership Transactions

December 16, 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 November 5, 1998, 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 Exchange. On December 15, 1998, the Exchange submitted an amendment to the proposed rule change.[3] 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 Exchange proposes to adopt new Rule 949 respecting the purchase, sale, transfer and posting of membership transactions. The proposed rule change codifies procedures for conducting the market for Exchange memberships and provides that private transactions may only be undertaken under certain specified circumstances. Below is the text of the proposed rule change. Additions are italicized.

Rule 949 Purchase, Sale, Transfer and Posting of Membership Transactions

A. Public Sales and Membership Market Procedures. A membership may be purchased by an approved applicant, an existing member organization or an approved lessor through the Office of the Secretary of the Exchange in accordance with Exchange procedures. A bid stating the price to be paid shall be submitted in writing to the Office of the Secretary by an approved applicant, member organization or approved

[11] A schedule of the sliding scales that OCC intends to use initially is attached as Exhibit A to its filing, which is available for inspection at the Commission's Public Reference Room and through OCC. OCC will always specify a minimum short option adjustment percentage. OCC will inform its members of the initial schedule of the sliding scales through an Important Notice and will notify its members of any changes to the schedule.

[12] 15 U.S.C. 78q–1.

[13] 17 CFR 200–30(a) (12).

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

[2] 17 CFR 240.19b-4.

[3] Letter from Murray L. Ross, Vice President and Secretary, Exchange, to Michael Walinskas, Deputy Associate Director, Division of Market Regulation, SEC, dated December 14, 1998 (''Amendment No. 1). Amendment No. 1 corrected grammatical errors in the proposed rule language.