

underwriting syndicate before or after the date a securities depository system is available for monitoring repurchases of the distributed shares by syndicate members ("flipping tracking system").

Currently, a flipping tracking system is being developed that will include a securities depository service that (i) can be activated upon the request of the managing underwriter for a period of time that the managing underwriter specifies, (ii) in certain circumstances, will require the delivering participant to provide to the depository information sufficient to identify the seller of such shares as a precondition to the processing of book-entry delivery instructions for distributed shares, and (iii) will report to the managing underwriter the identity of any other syndicate member or selling group member whose customer(s) sold distributed shares (but will not report to the managing underwriter the identity of such customer[s]) and, in certain circumstances, will report to such syndicate member or selling group member the identity of such customer(s). Prior to the availability of a flipping tracking system, the managing underwriter may delay the date a security is deemed "depository eligible" for up to three months after trading has commenced in the security. After the availability of a flipping tracking system, a new issue will be deemed to be depository eligible upon commencement of trading on BSE.

The proposed rule change is consistent with Section 6(b)(5) of the Act⁶ in that it is designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general, to protect investors and the public interest. The proposed rule is designed to reduce the number of transactions in depository eligible securities for which settlement is effected by the physical delivery of securities. By requiring that transactions between member firms and transactions between member firms and clients that settle on a delivery-versus-payment or receipt-versus-payment basis occur only with rare exceptions in a book-entry environment, the efficiency of the U.S. settlement system will be enhanced and the systemic risk of that system will be reduced.

(B) Self-Regulatory Organization's Statement on Burden on Competition

BSE 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

BSE has neither solicited nor received comments on the proposed rule change.

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 BSE 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.

BSE has requested accelerated effectiveness of the proposed rule change in order that the rule can become effective on June 7, 1995.⁷

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submissions, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any 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 Section, 450 5th Street, N.W., Washington, D.C. 20549. Copies of such filings will also be available for inspection and copying at the principal office of BSE. All submissions should refer to file number SR-BSE-95-09 and should be submitted by June 14, 1995.

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

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-35738; File Nos. SR-Amex-95-13, SR-CBOE-95-13, SR-NYSE-95-04, SR-PSE-95-05, and SR-PHLX-95-10]

Self-Regulatory Organizations; Order Approving Proposed Rule Changes by the American Stock Exchange, Inc., the Chicago Board Options Exchange, Inc., the New York Stock Exchange, Inc., the Pacific Stock Exchange, Inc., and the Philadelphia Stock Exchange, Inc. Relating to Permanent Approval of the Hedge Exemption Pilot Programs

May 18, 1995.

On February 1, 1995, the Chicago Board Options Exchange, Inc. ("CBOE"); on February 3, 1995, the Philadelphia Stock Exchange, Inc. ("PHLX"); on February 21, 1995, the Pacific Stock Exchange, Inc. ("PSE"); on February 28, 1995, the New York Stock Exchange, Inc. ("NYSE"); and on March 14, 1995, the American Stock Exchange, Inc. ("Amex") (each individually referred to as an "Exchange" and two or more collectively referred to as "Exchanges"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission ("SEC" or "Commission") proposed rule changes seeking permanent approval of the Exchanges' hedge exemption pilot programs.

The proposed rule changes were published for comment in the **Federal Register** on March 28, 1995.³ No comments were received regarding the Exchanges' proposals.

The proposals filed by the Exchanges seek permanent approval of the Exchanges' pilot programs for exemptions from equity position limits for certain hedged positions.⁴ In addition, the proposals filed by the CBOE, the NYSE, and the PSE also seek permanent approval of the Exchanges' pilot programs for position limit exemptions for certain hedged broad-based stock index option positions.⁵

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 35523 (March 22, 1995), 60 FR 15947.

⁴ Position limits impose a ceiling on the aggregate number of options contracts on the same side of the market that can be held or written by an investor or group of investors acting in concert.

⁵ Under the equity option hedge exemption pilots, the applicable position and exercise limits can never exceed twice the existing position limit. Under the CBOE's and the PSE's broad-based index hedge exemption pilots, the exempted positions

Continued

⁶ 15 U.S.C. 78f(b)(5) (1988).

⁷ *Supra* note 3 and accompanying text.

⁸ 17 CFR 200.30-3(a)(12) (1994).

In 1988, the Commission approved pilot programs by the Amex, and the PHLX providing exemptions from position limits for certain fully hedged equity option positions.⁶ In addition, the Commission approved pilot programs proposed by the CBOE, the NYSE, and the PSE providing exemptions from position limits for certain fully hedged equity option positions and/or stock index option positions.⁷ Most recently, the Exchanges' pilot programs were extended through May 17, 1995.⁸

The pilot programs for equity option positions allow an exemption from equity option position and exercise limits for accounts that have established one of the four most commonly used hedged positions on a limited one-for-one basis (*i.e.*, 100 shares of stock for one option contract). The four hedged positions are: (1) Long stock and short call; (2) long stock and long put; (3) short stock and long call; and (4) short stock and short put. Under the equity option programs, the maximum position limit (including the allowed exemptions) may not exceed twice the established option position limit.

The index hedge exemption programs allow public customers to apply for

may not exceed 75,000 same-side of the market option contracts in a class of broad-based index options. Under the NYSE's broad-based index hedge exemption pilot, the exempted positions may not exceed 125,000 same-side of the market contracts. Unlike the equity option hedge exemption, each exemption to position limits under the broad-based index option hedge exemption must be specifically approved by the Exchange for each customer and each position. See CBOE Rule 24.4, "Position Limits for Broad-Based Index Options," Interpretation and Policy .01; NYSE Rule 704, "Position Limits," Supplementary Material .70; and PSE Rule 7.8, "Terms of Option Contracts," Commentary .02.

⁶ See Securities Exchange Act Release No. 25738 (May 24, 1988), 53 FR 20201 (June 2, 1988) (order approving File Nos. SR-Amex-87-13, SR-CBOE-87-27, and SR-PHLX-87-37).

⁷ See Securities Exchange Act Release Nos. 25738 (May 24, 1988), 53 FR 20204 (June 2, 1988) (order approving File No. SR-CBOE-87-25) (establishing CBOE's stock index option hedge exemption pilot program); 27786 (March 8, 1990), 55 FR 9523 (March 14, 1990) (order approving File No. SR-NYSE-89-09) (establishing NYSE's equity option and stock index option hedge exemption pilot programs); 25811 (June 20, 1988), 53 FR 23821 (June 24, 1988) (order approving File No. SR-PSE-88-09) (establishing PSE's equity option hedge exemption pilot program); 32900 (September 14, 1993), 58 FR 49077 (September 21, 1993) (order approving File No. SR-PSE-92-38) (extending PSE's stock index option hedge exemption pilot program); and 32903 (September 14, 1993), 58 FR 49068 (September 21, 1993) (order approving File No. SR-CBOE-91-44) (extending the CBOE's index option hedge exemption program).

⁸ See Securities Exchange Act Release Nos. 34986 (November 18, 1994) 59 FR 60856 (November 28, 1994) (order approving File Nos. SR-Amex-94-49, SR-CBOE-94-41, SR-PSE-94-33, and PHLX-94-53); and 85194 (January 5, 1995), 60 FR 2800 (January 11, 1995) (order approving File No. SR-NYSE-94-47).

position limit exemptions for positions in broad-based index options that are hedged with Exchange-approved qualified portfolios of stock.⁹ Under the broad-based index option hedge exemption program a public customer must receive specific Exchange approval to exceed the position limits by a specified amount before establishing a position in reliance upon the hedge exemption requirements. Under these requirements, a qualified portfolio is comprised of net long or short positions in common stocks or securities readily convertible into common stocks in at least four industry groups and contains at least twenty stocks, none of which accounts for more than 15% of the value of the portfolio. To remain qualified, a portfolio must meet these standards at all times, regardless of trading activity in the stocks.

Subject to the maximum number of exempt option contracts allowed under the Exchanges' broad-based index option hedge exemption programs,¹⁰ the broad-based index option hedge exemption applies to positions in broad-based index options to the extent that the underlying value of the option positions does not exceed the unhedged value of the qualified portfolio. The unhedged value is determined as follows: (1) The value of the net long or short positions for each of the stocks or their equivalents are totaled; and (2) the value of (a) any opposite side of the market calls and puts in broad-based index options, (b) any opposite side of the market positions in stock index futures, and (c) any economically equivalent opposite side of the market positions in other stock index options and in options on stock index futures, is subtracted from the total.

Under the broad-based index option hedge exemption programs, hedge exemption customers agree to, among other things, establish and liquidate options and stock positions or their equivalents in an orderly fashion; not establish or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; not establish or liquidate a stock position or its equivalent contemporaneously with the establishment or liquidation of an equivalent broad index stock group option position with a view toward taking advantage of any differential between the prices of the stocks or their equivalents and the options; and

⁹ The CBOE's broad-based index hedge exemption program does not apply to A.M.-settled, European-style Standard & Poor's ("S&P") 500 Index options and Quarterly Index Expiration options on the S&P 500.

¹⁰ See note 5, *supra*.

liquidate an offsetting portion of the options position prior to or contemporaneously with any decrease in the available hedge value of the qualified portfolio.

Each of the pilot programs allow the underlying hedged positions to include securities that are readily convertible into common stock.¹¹ Under all of the pilot programs, exercise limits continue to correspond to position limits, so that investors are allowed to exercise, during five consecutive business days, the number of option contracts set forth as the position limit, as well as those contracts purchased pursuant to the pilot program.¹²

The Exchanges believe that the proposed rule changes are consistent with Section 6(b) of the Act, in general, and further the objectives of Section 6(b)(5), in particular, in that they are designed to protect investors and the public interest and to remove impediments to and perfect the mechanism of a free and open market.

The Commission finds that the proposed rule changes seeking permanent approval of the Exchanges' hedge exemption pilot programs are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) thereunder.¹³ The Commission concludes, as it did when originally approving each of the pilot programs, that providing for increased position and exercise limits for equity options and broad-based stock index options in circumstances where those excess positions are fully hedged with offsetting stock positions will provide greater depth and liquidity to the market and will allow investors to hedge their stock portfolios more effectively.

¹¹ The Commission expects the Exchanges to determine on a case-by-case basis whether an instrument that is being used as the basis for an underlying hedged position is readily and immediately convertible into the security underlying the corresponding option position. In this regard, the Commission finds that an instrument which will become convertible into a security at a future date, but which is not presently convertible, is not a "convertible" security for purposes of the equity option position limit hedge exemption until the date it becomes convertible. In addition, if the convertible security used to hedge an options position is called for redemption by the issuer, the security would have to be converted into the underlying security immediately or the corresponding options position reduced accordingly. See, *e.g.*, Securities Exchange Act Release No. 32903, *supra* note 7.

¹² Exercise limits prohibit the exercise by an investor or group of investors acting in concert of more than the number of options contracts specified in the position limit rule within five consecutive business days.

¹³ 15 U.S.C. § 78f(b)(5) (1988 & Supp. V 1993).

without significantly increasing concerns regarding intermarket manipulations or disruptions of either the options market or the underlying stock market.

In this regard, the Commission notes that the Exchanges' hedge exemption programs have operated on a pilot basis since 1988 and that the Exchanges have not experienced any significant difficulties with the pilots since their inception or observed any market disruptions resulting from the increased positions. In addition, the Exchanges have submitted reports to the Commission describing, among other things, the frequency with which the exemptions have been utilized, the types of investors using the exemptions, the size of the positions assumed pursuant to the programs, and the market impact of the programs. The reports indicate that the Exchanges have not observed any negative impact on their markets as a result of the hedge exemption programs. Finally, the Exchanges have established surveillance procedures designed to monitor compliance with the position limit hedge exemption programs. The Commission expects the Exchanges to continue to monitor utilization of the hedge exemptions to ensure compliance with the programs' requirements.

With regard to the equity option hedge exemption, the Commission believes, as it has concluded in the past,¹⁴ that the exemption will not disrupt the options or equity markets or substantially increase the possibility of manipulation in the underlying stocks or options. In this regard, the Commission notes that the position and exercise limit exemption is limited to accounts that have established one of four hedged positions. Moreover, market disruption concerns are lessened because any option positions in excess of current position limits must be hedged fully with an offsetting stock position on a one-for-one basis; thus, the holder of the options position would not be required to enter the market to buy or sell the stock if the options were exercised or assigned. The Commission also believes that a maximum position of double the existing position and exercise limits will help to ensure that any potential market disruptions are minimal.

With regard to the broad-based index option hedge exemption programs, the Commission believes, as it has concluded previously,¹⁵ that the

programs will allow more effective hedging of stock portfolios and may increase the depth and liquidity of the stock index options market. In this regard, public customers with long or short stock portfolios (or instruments convertible into such securities) will be able to utilize the broad-based index hedge exemption, thereby making an alternative hedging technique more available to such customers and facilitating their use of index options to hedge their portfolios, rather than financially equivalent index futures products.

As noted above, the broad-based index option hedge exemption applies only to public customers and each request for the exemption must be specifically approved by the appropriate Exchange. This should ensure that the hedges are appropriate for the position being taken and in compliance with Exchange rules.

In addition, the Commission notes that the broad-based index option hedge exemptions have additional safeguards that will make it difficult to use the exempted positions to disrupt or manipulate the market. In this regard, the qualified stock portfolio must be broad-based, and correspond in value to the value of the options hedge so that the increased positions could not be used in a leveraged manner. Both the options and stock positions must be initiated and liquidated in an orderly manner. The requirement that a reduction in the options position must occur at or before the corresponding reduction in the stock portfolio position should ensure that the stock transactions are not used to impact the market so as to benefit the options position. Moreover, because the exemption may not be used for arbitrage in stock baskets and overlying stock index options, the broad-based index option hedge exemption should not exacerbate stock market volatility. Finally, the Commission notes that the index option hedge exemption applies only to options on broad-based indexes, where the potential for manipulation is minimal and thus regulatory concerns are decreased.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule changes (SR-Amex-95-13, SR-CBOE-95-13, SR-NYSE-95-04, SR-PSE-95-09, and SR-PHLX-95-10) are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-35725; File No. SR-CBOE-95-15]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Telephones at the S&P 100 Index Option Trading Post on the Floor of the Exchange

May 17, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on May 12, 1995, the Chicago Board Options Exchange, Inc. ("CBOE" 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 Exchange. 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 CBOE proposes to treat as a rule of the Exchange the conditions governing the use of member-owned and Exchange-owned telephones located at the S&P 100 Index option ("OEX") trading post on the floor of the Exchange. The text of the proposed rule change is available at the Office of the Secretary, the CBOE, and at the Commission.

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

In its filing with the Commission, the CBOE included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Section (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

The purpose of the proposed rule change is to apply the policy currently governing the use of telephones at

¹⁴ See Securities Exchange Act Release No. 25738, *supra* note 6.

¹⁵ See Securities Exchange Act Release Nos. 32903 and 32900, *supra* note 7.

¹⁶ 15 U.S.C. 78s(b)(2)(1982).

¹⁷ 17 CFR 200.30-3(a)(12) (1994).