

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 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 the file number in the caption above and should be submitted by October 4, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-36194; File No. SR-PHLX-95-16]

#### Self-Regulatory Organization; Order Approving Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Modifications of the Position and Exercise Limits for Narrow-Based Index Options

September 6, 1995.

##### I. Introduction

On March 6, 1995, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend PHLX Rule 1001A, "Position Limits," to increase the position and exercise limits<sup>3</sup> for narrow-based (or

industry) index options from the current levels of 5,500, 7,500, or 10,500 contracts to 6,000, 9,000, or 12,000 contracts.

Notice of the proposed rule change appeared in the **Federal Register** on May 16, 1995.<sup>4</sup> No comments were received on the proposal.

##### II. Background and Description

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.<sup>5</sup>

In 1983, the PHLX set position and exercise limits for narrow-based index options at 4,000 contracts.<sup>6</sup> In 1993, the Commission approved a PHLX proposal to amend PHLX Rule 1001A to increase the position limits for narrow-based index options to the current levels of 5,500, 7,500, or 10,500 contracts.<sup>7</sup> The

investors acting in concert may hold or write in each class of options on the same side of the market (i.e., aggregating long calls and short puts or long puts and short calls). Exercise limits prohibit an investor or group of investors acting in concert from exercising more than a specified number of puts or calls in a particular class within five consecutive business days. PHLX Rule 1002A, "Exercise Limits," states that for the purposes of determining compliance with PHLX Rule 1002, "Exercise Limits," exercise limits for index option contracts shall be equivalent to the position limits described in PHLX Rule 1001A.

<sup>4</sup> See Securities Exchange Act Release No. 35694 (May 9, 1995), 60 FR 26067.

<sup>5</sup> See, e.g., Securities Exchange Act Release No. 33285 (December 3, 1993), 58 FR 65201 (December 13, 1993) (order approving File No. SR-Amex-93-27) (increasing position and exercise limits for equity options and narrow-based index options).

<sup>6</sup> See Securities Exchange Act Release No. 20437 (December 2, 1983), 48 FR 55229 (December 9, 1983) (order approving File No. SR-PHLX-83-17).

<sup>7</sup> See Securities Exchange Act Release No. 33288 (December 3, 1993), 58 FR 65221 (December 13, 1993) (order approving File No. SR-PHLX-93-07) ("1993 Approval Order"). Specifically, PHLX Rule 1001A(b)(1) currently provides the following position limits for industry index options: (i) 5,500 contracts for an index where a single component stock accounted, 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; (ii) 7,500 contracts for an index where a single component

PHLX proposes to amend Exchange Rule 1001A(b)(1) to increase the position and exercise limits for industry index options from 5,500, 7,500, or 10,500 contracts to 6,000, 9,000 or 12,000 contracts.<sup>8</sup>

The Exchange believes that its proposal is consistent with the Act for several reasons. First, the Exchange notes that the current industry index option position limits have been in place since 1993 and that there have been no further increases in position limits for narrow-based index options since that time, despite substantial changes in the marketplace. Most notable among these changes, according to the PHLX, is an appreciable growth in index options trading. The PHLX states that this marked increase in index options volume has significantly increased liquidity in PHLX-traded index options.<sup>9</sup>

Second, the Exchange believes that the proposed increases are reasonable and consistent with the gradual, evolutionary approach adopted previously by the Commission and the options exchanges when increasing position and exercise limits.<sup>10</sup> Accordingly, the PHLX proposes a 9% increase in the lowest tier (from 5,000 to 6,000 contracts); a 20% increase for options currently at the 7,500 contract limit (increased to 9,000 contracts); and a 15% increase in the highest tier, currently at 10,500 contracts (increased to 12,000 contracts).

Third, the Exchange believes that the proposed increases are needed by traders and investors. According to the PHLX, Exchange members and customers have asked the Exchange to propose an increase in position limits, primarily because interested trading

stock accounted, on average, for 20% or more of the index value or any five component stocks together accounted, on average, for more than 50% of the index value but no single component stock accounted, 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; or (iii) 10,500 contracts where the conditions requiring a limit of 5,500 contracts or 7,500 contracts have not occurred.

<sup>8</sup> The PHLX currently trades options on the following narrow-based indexes: (1) the Gold/Silver Index ("XAU") 5,500 contracts; (2) the Utility Index ("UTY") (10,500 contracts); (3) the PHLX/KBW Bank Index ("KBX") (10,500 contracts); (4) the Phone Index ("PNX") (5,500 contracts); (5) the Semiconductor Index ("SOX") (7,500 contracts); and (6) the Airline Sector Index ("PLN") (10,500 contracts).

<sup>9</sup> The PHLX states that index options volume increased 450% (from 354,614 contracts to 1,957,171 contracts in 1994 as compared to 1993).

<sup>10</sup> According to the PHLX, the most recent position limit changes in 1993 represented changes of 38% (from 4,000 to 5,500 contracts); 25% (from 6,000 to 7,500 contracts); and 31% (from 8,000 to 10,500 contracts).

<sup>11</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> 15 U.S.C. § 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> Position limits impose a ceiling on the number of option contracts which an investor or group of

participants have not been able to meet their investment needs at current position limit levels. Specifically, the PHLX notes that certain institutional traders handling industry funds deal in securities valued many times higher than the maximum permissible position under PHLX rules. Based on such member and customer requests, the Exchange believes that the current position limit levels discourage market participation by large investors and the institutions that compete to facilitate the trading interests of large investors. Accordingly, the PHLX proposes to raise position and exercise limits for narrow-based index options to accommodate the liquidity and hedging needs of large investors and the facilitators of those investors.

Fourth, the Exchange believes that the proposal should increase the depth and liquidity of the markets for index options. The PHLX also believes that higher position limits would further accommodate the hedging needs of Exchange market makers and specialists, who are also restricted by current levels.

The PHLX notes that it continues to monitor the markets for evidence of manipulation or disruption caused by investors with positions at or near current position or exercise limits and that the new limits will not diminish the surveillance function in this regard. Additionally, the PHLX states that its surveillance procedures have become increasingly sophisticated and automated.

For these reasons, the Exchange believes that the proposal to increase narrow-based index option position limits is consistent with Section 6 of the Act, in general, and, in particular, with Section 6(b)(5), in that it is designed to promote just and equitable principles of trade and to prevent fraudulent and manipulative acts and practices, as well as to protect investors and the public interest. The Exchange believes that the proposal should remove impediments to and perfect the mechanism of a free and open market by providing market opportunity to investors constricted by current position limit levels. The PHLX also believes that by stimulating market participation and thereby increasing option market depth and liquidity, the proposed rule change should promote just and equitable principles of trade.

### III. Discussion

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, the

requirements of Section 6(b)(5).<sup>11</sup> Specifically, the Commission finds that the proposed position and exercise limits for narrow-based index options should accommodate the needs of investors and market participants and should increase the potential depth and liquidity of the options market as well as the underlying cash market without significantly increasing concerns regarding intermarket manipulations or disruptions of the market for the options or the underlying securities.

As noted above, the Commission believes that although the position and exercise limits for options must be sufficient to protect the options and related markets from disruptions by manipulation, the 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 market makers from adequately meeting their obligations to maintain a fair and orderly market. In this regard, the PHLX 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 PHLX notes that index option trading volume has increased significantly since 1993, 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 PHLX's proposal is a reasonable effort to accommodate the needs of market participants.

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, 6,000 contracts, will apply to narrow-based index options in which a single underlying stock accounts 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 9,000 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 12,000-contract limit will apply only if the Exchange determines that the conditions requiring either the 6,000-contract limit or the 9,000-contract limit have not occurred. Accordingly, the proposal allows the Exchange to avoid placing unnecessary restraints on those narrow-based index options where the manipulative potential is the least and the need for increased positions, both by traders and institutional investors, may be the greatest.

The Commission believes that the proposed increases for the three tiers of 9%, 20%, and 15%, for lowest to highest, respectively, appear to be appropriate and consistent with the Commission's evolutionary approach to position and exercise limits. In this regard, the absence of discernible manipulative problems under the current three-tiered position and exercise limit system for narrow-based index options leads the Commission to conclude that the modest increases proposed by the Exchange are warranted. The Commission recognizes that there are no ideal limits in the sense that options positions of any given size can be stated conclusively to be free of any manipulative concerns. However, based upon the absence of discernible manipulation or disruption problems under current limits, the Commission believes that the proposed limits can be safely considered. Accordingly, the Commission believes that the liberalization of existing position and exercise limits for narrow-based index options is now appropriate.<sup>12</sup>

The Commission notes that the Exchange has had considerable experience monitoring the current three-tiered framework in narrow-based stock 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

<sup>12</sup> 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.

<sup>11</sup> 15 U.S.C. 78f(b) (1988 & Supp. V 1993).

options will not cause significant problems.

Finally, the PHLX has indicated that its surveillance procedures have become increasingly sophisticated and automated. 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.<sup>13</sup>

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the proposal to increase the position and exercise limits for narrow-based index options to 6,000, 9,000, or 12,000 contracts, depending on the percentage stock concentrations within the index, 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,<sup>14</sup> that the proposed rule change (SR-PHLX-95-16) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-36198; File No. SR-Phlx-95-64]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Amendment of the Exchange's Schedule of Fees and Charges

September 7, 1995.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 23, 1995 the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The

<sup>13</sup> The Commission emphasizes that the PHLX must closely monitor compliance with position and exercise limits and to impose appropriate sanctions for failures to comply with the Exchange's position and exercise limit rules.

<sup>14</sup> 15 U.S.C. § 78f(b)(2) (1988).

<sup>15</sup> 17 CFR 200.30-3(a)(12) (1994).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

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 submits a proposed rule change to amend the Phlx's Schedule of Fees and Charges respecting charges for nonexchange sponsored securities execution equipment operated by Phlx members and member organizations on the Phlx equity options trading floor. The proposed amendment would modify the existing \$250.00 monthly fee assessed upon each stock execution machine on the Phlx equity options floor. A new securities execution equipment registration fee of \$300.00 per terminal would be imposed for the period September 1, 1995 through December 31, 1996, on each member operating equipment that has execution capability and/or order routing access to the common message switch of the primary registered national securities exchanges.

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

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

###### 1. Purpose

Since 1990, the Exchange has imposed a monthly proprietary stock execution machine charge of \$250.00.<sup>2</sup> Effective at the opening of business, Friday, September 1, 1995, the Exchange will impose a \$300.00 securities execution equipment registration fee for the period September 1, 1995 through December 31, 1996, on nonexchange sponsored terminals or computers configured for execution

<sup>2</sup> See Securities Exchange Act Release No. 28212 (July 17, 1990), 55 FR 30065 (implementing a monthly charge on proprietary stock execution machines); Securities Exchange Act Release No. 33954 (April 21, 1994), 59 FR 22191 (allowing members to earn a monthly credit of 50% of the fees charged for stock execution machines).

and/or routing capabilities to the common message switch of the primary registered national securities exchanges maintained on or accessible to the Phlx equity options trading floor. This registration fee will be assessed to each Phlx member or member organization maintaining and operating such nonexchange sponsored securities execution equipment on the Phlx options trading floors. The Phlx will continue to retain the monthly \$250.00 fee charged to members and member organizations maintaining and operating such equipment on the Phlx equity trading floor.

###### 2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act<sup>3</sup> in general and furthers the objectives of Section 6(b)(4)<sup>4</sup> in particular in that it provides for the equitable allocation of reasonable dues, fees, and other charges among the Exchange's members and other persons using its facilities.

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

The Exchange believes the proposed rule change does not impose any burden on competition.

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

The Phlx Finance Committee and the Phlx Floor Procedure Committee provided specific recommendations to the Phlx's Board of Governors.

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

The foregoing rule change constitutes or changes a due, fee, or other charge imposed by the Exchange and, therefore, has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>5</sup> and subparagraph (e) of Rule 19b-4 thereunder.<sup>6</sup>

At any time within sixty days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and

<sup>3</sup> 15 U.S.C. 78f(B).

<sup>4</sup> 15 U.S.C. 78f(b)(4).

<sup>5</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>6</sup> 17 CFR 240.19b-4.