

book.)⁵ As a result, the purpose of the proposed rule change is to give specialists an incentive to accept professional orders for inclusion in the book.

Under proposed interpretation and policy .05 to Rule 2 of Article XXX, when a professional order "has the post," it will not be displaced by a subsequent agency order. For example, an incoming MAX order⁶ will be filled against the professional order and not subsequent agency orders that have not established time priority. However, because the professional order will only have post protection (and not primary market protection), agency orders will still get the benefit of the full panoply of protections afforded by the Best Rule without the need to fill the professional order.

In addition, under the proposed interpretation and policy, when a specialist's own dealer order "has the post," professional orders that have time priority will be displaced by subsequent agency orders if the agency order displaces the specialist's order. This will allow the agency order to displace the specialist's order, while at the same time allow the specialist's order to retain priority over the professional order in accordance with the Specialist Priority Rule.

2. Statutory Basis

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

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

⁵ See CHX Article XXX, Rule 2.

⁶ Midwest Automated Execution System ("MAX") is the Exchange's automated routing and execution system. See Article XX, Rule 37(b) of the CHX's rules for a complete description of the MAX system.

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

Within 35 days of the application of this notice in the Federal Register or within such other 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

Upon an initial review of the proposed rule change, it preliminarily appears to the Commission that the Exchange proposes to significantly modify the time priority of professional orders and public agency orders in a such manner that professional orders would not realize certain benefits associated with the Exchange's Best Rule, and would allow specialists' bids to retain priority over professional orders under certain circumstances. Therefore, the Commission specifically requests comment on whether the proposed rule change, which distinguishes broker-dealer orders from public customer orders for purposes of priority of executions, is consistent with Section 6(b)(5) of the Act. In assessing the proposed rule change commenters may wish to consider what impact, if any, the Commission's recently proposed rules on order execution obligations may have on the operation of the CHX's proposed rule change.⁷

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. 20549. Copies of such filing will also be available for inspection and copying at the principal

⁷ See Securities Exchange Act Release No. 36310 (Sept. 29, 1995).

office of the Exchange. All submissions should refer to File No. SR-CHX-95-18 and should be submitted by November 13, 1995.

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

Margaret H. McFarland,
Deputy Secretary.

[FR Doc. 95-26001 Filed 10-19-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36371; File No. SR-CBOE-95-42]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change by the Chicago Board Options Exchange, Inc., To Add Two Position and Exercise Limit Tiers for Qualifying Equity Option Classes and To Expand the Equity Option Hedge Exemption

October 13, 1995.

I. Introduction

On August 7, 1995, the Chicago Board Options Exchange, Inc. ("CBOE" 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 amend Rule 4.11 (Position Limits) and Rule 4.12 (Exercise Limits) to add two upper position and exercise limit³ tiers for those equity option classes that meet certain criteria for high liquidity in the underlying stocks. In addition, the CBOE proposed to expand its current equity option hedge exemption from twice to three times the standard or base position limit.⁴

Notice of the proposed rule change appeared in the Federal Register on

¹ 15 U.S.C. § 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ Position limits impose a ceiling on the aggregate number of option contracts on the same side of the market that an investor, or group of investors acting in concert, may hold or write. Similarly, exercise limits impose a ceiling on the aggregate long positions in option contracts that an investor, or group of investors acting in concert, can or will have exercised within five consecutive business days.

⁴ The equity hedge exemption currently exempts certain specified equity options positions from the stated (or base) position limits in Exchange Rule 4.11 where the option contracts are hedged by 100 shares of stock or securities convertible into such stock (or hedged by the same number of shares represented by an adjusted option contract), up to a maximum allowable position of twice the standard or base limit.

August 28, 1995.⁵ Two comment letters were received in response to the proposal.⁶ The Exchange subsequently filed Amendment No. 1 to the proposed rule change on October 2, 1995.⁷

II. Background and Description

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could 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. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations⁸ and for corners or squeezes of the underlying market. In addition, they serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.

In establishing position and exercise limits, the Commission has been careful to balance two competing concerns. First, the Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market for the underlying security by acquiring and exercising a number of options contracts disproportionate to the deliverable supply and average trading volume of the underlying security. At the same time, the Commission has realized that 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.⁹

In October 1980, the Commission approved proposed rule changes by the options exchanges to increase position and exercise limits from 1,000 to 2,000 contracts for all individual equity options classes.¹⁰ In conjunction with the approval, the Commission received commitments from the options exchanges to study the effects of the increased limits. The Commission indicated that the experience gained under the increased limits, if coupled with adequate monitoring and surveillance procedures, could serve as a basis for considering further position and exercise limit modifications.

In July 1983, the Commission approved a further increase in position and exercise limits for individual stock options based on a tiering approach.¹¹ Limits for options on stocks with the greatest trading volume and public float were increased to 4,000 contracts and limits on all other options classes were increased to 2,500 contracts.¹² In approving the increased limits under a two-tiered framework, the Commission noted that tiering was consistent with the gradual, evolutionary approach that the Commission and the exchanges have adopted in increasing position and exercise limits.

In 1985, the Commission approved a further increase in position and exercise limits for individual equity options. This approval extended the tiering approach commenced by the options exchanges in 1983.¹³ The Commission

noted in the 1985 Release that liberalizing position and exercise limits would further increase the potential depth and liquidity of the individual stock options markets without significantly increasing concerns regarding intermarket manipulations or disruptions of the market for the options or underlying securities.

Lastly, in December 1993, the Commission approved the CBOE's existing position and exercise limit framework for individual equity options.¹⁴ Depending on certain criteria related to the trading volume of the underlying stock or a combination of both the trading volume and the number of shares outstanding of the underlying stock, the Exchange's current position and exercise limits were established at levels of 10,500 contracts, 7,500 contracts, and 4,500 contracts.¹⁵

The Exchange proposes to add two position and exercise limit tiers at 25,000 and 20,000 contract levels. The criterion to qualify for the proposed 25,000 contract limit will require that the underlying security must have at least 300 million shares outstanding with 75 million shares traded in the past six months, or have 100 million shares traded in the past six months. To qualify for the proposed 20,000 contract limit, the underlying security must have at least 240 million shares outstanding with 60 million shares traded in the past six months, or have 80 million shares traded in the past six months.

According to the Exchange, the number of equity option classes currently listed on the CBOE that would qualify for either of these new higher position and exercise limit tiers is small. The Exchange represents that based on

shares currently outstanding. To be eligible for the 5,500 contract limit an underlying security was required to have had either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 40 million shares currently outstanding. All other options not meeting these requirements were subject to the 3,000 contract limits.

¹⁴ See Securities Exchange Act Release No. 33283 (December 3, 1993), 58 FR 65204 (December 13, 1993) ("1993 Release").

¹⁵ To be eligible for the 10,500 contract limit an underlying security must have either (i) trading volume of at least 40 million shares during the most recent six month trading period; or (ii) trading volume of at least 30 million shares during the most recent six month trading period and at least 120 million shares currently outstanding. To be eligible for the 7,500 contract limit an underlying security must have either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 40 million shares currently outstanding. All other options not meeting these requirements are subject to the 4,500 contract limits.

⁵ See Securities Exchange Act Release No. 36124 (August 18, 1995), 60 FR 44524 (August 28, 1995).

⁶ See Letter from CS First Boston, Goldman, Sachs & Co., J.P. Morgan Securities, Lehman Brothers, Merrill Lynch & Co., Morgan Stanley & Co., PaineWebber Incorporated, and Salomon Brothers Inc., to Jonathan G. Katz, Secretary, Commission, dated September 18, 1995 ("Working Group Letter"); and letter from Peter A. Ianello, President, and Patricia Levy, Executive Director, Swiss Bank Corporation Capital Markets, Inc., to Jonathan G. Katz, Secretary, Commission, dated September 28, 1995 (supporting views expressed in Working Group Letter).

⁷ In Amendment No. 1, the CBOE stated its intention to restrict the use of the new position and exercise limit tiers and the expanded hedge exemption to option classes which solely trade on the Exchange and are not multiply traded. Implementation of the proposed rule change for multiply traded option classes will be delayed until the Commission approves similar proposals by the other options exchanges or the Commission otherwise determines that implementation is appropriate. See letter from Mary L. Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Holly Smith, Associate Director, Division of Market Regulation ("Division"), Office of Market Supervision ("OMS"), Commission, dated October 2, 1995 ("Amendment No. 1").

⁸ Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established derivatives position.

⁹ See H.R. Rept. No. IFC-3, 96th Cong., 1st Sess. at 189-91 (Comm. Print 1978) ("Options Study").

¹⁰ See Securities Exchange Act Release No. 17237 (October 22, 1980), 45 FR 71454 (October 28, 1980) ("1980 Release").

¹¹ See Securities Exchange Act Release No. 19975 (July 15, 1983), 48 FR 33389 (July 21, 1983) ("1983 Release").

¹² To be eligible for the 4,000 contract limit an underlying security was required to have had either (i) trading volume of at least 20 million shares during the most recent six month trading period; or (ii) trading volume of at least 15 million shares during the most recent six month trading period and at least 60 million shares currently outstanding. All other options not meeting these requirements were subject to the 2,500 contract limits.

¹³ See Securities Exchange Act Release No. 21907 (March 29, 1985), 50 FR 13440 (April 4, 1985) ("1985 Release"). The 1985 Release created a three-tiered system of position and exercise limits of 8,000, 5,500, and 3,000 contracts. To be eligible for the 8,000 contract limit an underlying security was required to have had either (i) trading volume of at least 40 million shares during the most recent six month trading period; or (ii) trading volume of at least 30 million shares during the most recent six month trading period and at least 120 million

available statistics, as of June 30, 1995, approximately 73 classes would qualify for the 25,000 contract tier. Similarly, approximately 22 classes would satisfy the requirements for the 20,000 contract tier, out of approximately 580 equity option classes currently listed on the CBOE.

In addition to the proposed 25,000 and 20,000 contract tiers, the CBOE is also proposing to expand the equity hedge exemption in Rule 4.11, Interpretation and Policy .04. Under this proposal, the maximum allowable position, after exempting from the base limit specified positions where the option contract is hedged by 100 shares of stock or securities convertible into stock, will be three times instead of twice the standard or base limit currently provided.¹⁶

As set forth in greater detail in a recent report prepared by the Exchange ("Study"),¹⁷ the CBOE has represented that position and exercise limit tiers can be added and that the equity hedge exemption can be expanded to the benefit of investors without increasing the potential for market disruption.¹⁸

III. Summary of Comments

The Commission received two comment letters on the proposed rule change.¹⁹ The commenters, in general, expressed support for the proposed changes noting that there is a demonstrated need for the higher tiers and that the higher tiers and expanded hedge exemption will not increase market disruptions. Although believing that the proposals are a "good first step" in reducing the undue constraints imposed by position limits, the commenters state that further expansion of position limits is required. Specifically, the commenters note that the depth and liquidity of the markets for many of the most highly capitalized and actively traded stocks support the allowance of large options positions and that increased levels will not raise concerns about manipulation or disruption of the market for the underlying stock. Moreover, the commenters state that due to the

sophisticated surveillance systems currently in place in the markets, any efforts to manipulate the market with large positions in options would be readily detectable. In this light, the commenters believe that further increases in tier size are warranted.

In addition, the commenters stated that any limitation on the ability of market participants to use options to hedge their positions exposes participants to unnecessary risk on the unhedged portion of their portfolios. In this regard, the commenters believe that the adoption of an uncapped hedge exemption (*i.e.*, the ability to accumulate an unlimited number of options contracts provided that such contracts are properly hedged) is appropriate.²⁰

IV. Discussion

The Commission finds that the proposed rule changes are 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)(5).²¹ Specifically, the Commission believes that the proposed addition of position and exercise limit tiers of 25,000 contracts and 20,000 contracts for qualifying equity options, and the proposed expansion of the equity hedge exemption to three times the standards or base limit will accommodate the needs of investors and market participants. The Commission also believes that the proposed rule changes will increase the potential depth and liquidity of the equity 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 underlying securities. Accordingly, as discussed below, the rule proposal is consistent with the requirements of Section 6(b)(5) that Exchange rules facilitate transactions in securities while continuing to further investor protection and the public interest.

In approving the increased limits, the Commission recognizes that securities with active and deep trading markets, as

well as with broad public ownership, are more difficult to manipulate or disrupt than securities having less active and deep markets and having smaller public floats.²² The proposed additional position and exercise limit tiers recognize this by seeking to minimize the restraints on those options classes that can accommodate larger limits without significantly increasing manipulation concerns.²³ In particular, the proposed limit of 25,000 contracts and 20,000 contracts for options on the most actively traded, widely held securities, permits the Commission to avoid placing unnecessary restraints on those options where the manipulative potential is the least and the need for increased positions likely is the greatest. Accordingly, the Commission believes that the additional position and exercise limit tiers and the expanded equity hedge exemption is warranted.

The Commission believes that the proposed additions to the CBOE's position and exercise limit tiers and increased hedge exemption appear to be both appropriate and consistent with the Commission's gradual, evolutionary approach. 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. The Commission, however, is relying on the absence of discernible manipulation problems under the current framework as an indicator that the proposed additional limit tiers and expanded hedge exemption is justified.

The Commission does not believe that the addition of the two new higher limit tiers and the expanded hedge exemption will have any adverse effects on the options markets. In approving the two-tiered system in 1983, the Commission stated that it did not believe that requiring traders to keep track of two

¹⁶ The Commission notes that the proposed increase in the maximum hedge exemption will apply to all position limit tiers, not just to the proposed 25,000 and 20,000 contract tiers.

¹⁷ See Letter from Mary Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Holly Smith, Associate Director, OMS, Division, Commission, dated April 28, 1995 (market analysis of increased limits and expanded hedge exemption).

¹⁸ See Securities Exchange Act Release No. 36124 (August 18, 1995), 60 FR 44524 (August 28, 1995) (notice of File No. SR-CBOE-95-42) (summarizing findings of Study).

¹⁹ See *supra* note 6.

²⁰ The Commission notes that prior to the CBOE submitting its proposed rule change, the Exchange received six letters from member firms supporting an increase in the current position limit levels. Further, the CBOE received comments from member firm representatives and customers who stated that they did not have adequate hedging capabilities under the current position limit tiers. Lastly, the CBOE received comment from money managers who believed that the current equity option position limits were too restrictive with respect to the size of assets managed.

²¹ 15 U.S.C. 78f(b)(5) (1988).

²² The Commission notes that the quantitative options listing and maintenance standards require: (1) A minimum of 7 and 6.3 million shares outstanding, respectively, which are owned by persons other than "insiders," as defined in Section 16 of the Act; (2) a minimum of 2,000 and 1,600 shareholders, respectively; (3) trading volume of at least 2.4 and 1.8 million shares, respectively, during the past twelve months; (4) for an original listing, the market price per share of the underlying security must have closed at or above \$7.50 during the majority of business days over the preceding three months; and (5) to maintain its listing, the market price per share of the underlying security must have closed at or above \$5 during the majority of business days over the preceding six months. See CBOE Rule 5.4, Interpretation and Policy .01.

²³ The Commission continues to believe that proposals to increase position and exercise limits must be justified and evaluated separately. After reviewing the proposed exercise limits, along with the eligibility criteria for the two new tiers, the Commission has concluded that the proposed exercise limit additions do not raise manipulation problems or increase concerns over market disruption in the underlying securities.

limits rather than one was burdensome or confusing or would lead to accidental violations.²⁴ The Commission does not believe that a change from the current three tiers to five tiers should change this conclusion. Similarly, as the Commission views the expansion of the equity hedge exemption as consistent with its steady progression in this area, the enactment of the proposed rule change should not prove difficult to implement or cumbersome to monitor.

The Commission believes that although position and exercise limits for options must be sufficient to protect the options and related markets from disruptions by manipulations, 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 CBOE has noted that customers and member firms view the current position and exercise limits for certain options classes as too low. The Commission believes that the CBOE's proposal is a reasonable and appropriately tailored effort to accommodate the identified needs of options market participants.²⁵ In this regard it is important to note that the proposal only adds higher position and exercise limit tiers for classes of options overlying the most liquid stocks. As a result, the proposal currently affects only 95 of the existing 580 classes of equity options that are traded on the CBOE.

In 1988, the Commission approved a pilot program proposed by the CBOE which provided exemptions from position limits for certain fully hedged equity option positions.²⁶ The pilot program created an exemption from equity option position and exercise limits for accounts that had established one of the four most commonly used hedged positions.²⁷ Under this exemption, the maximum position limit (including the allowable exemptions)

could not exceed twice the established option position limit.²⁸

The Exchange currently proposes to increase the hedge exemption to three times the applicable position limits. According to the CBOE, as institutional accounts are unable to fully hedge their stock holdings due to the restrictive limits, investors are unnecessarily forced to keep a portion of their portfolio at risk.

The Commission believes that the CBOE's proposal to expand the hedge exemption is an appropriate method to accommodate the identified needs of options market participants.²⁹ By increasing the hedge exemption, the Commission believes, large hedge funds and institutional accounts will be provided with the means necessary to adequately hedge their stock holdings without adding risk to the options market.

Lastly, the Commission notes that despite an appreciable growth in equity options trading and the sophisticated and automated surveillance procedures employed by the Exchange, the last change in position limits occurred in 1993. Based on the CBOE's experience, the Commission believes that the proposed increased hedge exemption and additional limit tiers should result in little or no additional risk to the marketplace.³⁰

As noted above, Amendment No. 1 states that the CBOE will only initially implement the changes being approved in this order for those classes of options solely traded on the CBOE and that the revised limits for multiply traded classes will only be effected uniformly on all the options exchanges at an agreed upon date after Commission approval of all necessary rule filing. The Commission believes this approach is reasonable and balances the market need to expand position and exercise limits and the hedge exemption, while continuing to ensure that uniform position and exercise limits will exist among the options exchanges for multiply traded classes.³¹

The Commission finds good cause to approve Amendment No. 1 to the

proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Specifically, by limiting the implementation of the increase in position and exercise limits and the expanded hedge exemption to only qualifying non-multiply traded options, pending approval of similar proposals by the other options markets, Amendment No. 1 will ensure that uniform position and exercise limits among the options exchanges will exist for all multiply traded classes. Accordingly, the Commission believes that it is consistent with Section 6(b)(5) of the Act to approve Amendment No. 1 to the proposal on an accelerated basis.

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1 to the rule proposal. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street NW., Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-95-42 and should be submitted by November 13, 1995.

V. Conclusion

For the foregoing reasons, the Commission finds that the CBOE's proposal to add two position and position and exercise limit tiers for qualifying equity option classes and to expand the equity option hedge exemption, as well as to delay the implementation of the proposal for multiply traded options classes, 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,³² that the proposed rule change (SR-CBOE-95-

²⁴ In this regard, the Commission notes that the CBOE routinely, and on a continuous basis, reviews the trading characteristics of the underlying stocks to determine the appropriate position and exercise limit tiers for the option classes.

²⁵ See Study, *supra* note 17, at 3, and Comment Letters, *supra* note 6.

²⁶ See Securities Exchange Act Release No. 25738 (May 24, 1988), 53 FR 20201 (June 2, 1988) ("Pilot Approval Order").

²⁷ 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.

²⁸ In May 1995, after several extensions, the Commission granted permanent approval to the CBOE's hedge exemption pilot program. See Securities Exchange Release No. 35738 (May 18, 1995), 60 FR 27573 (May 24, 1995).

²⁹ See Study, *supra* note 17, at 4 and 6.

³⁰ The Commission notes that to the extent the potential for manipulation increases because of the additional tiers and expanded hedge exemption, the Commission believes the Exchange's surveillance programs will be adequate to detect as well as to deter attempted manipulative activity. The Commission will, of course, continue to monitor the Exchange's surveillance programs to ensure that problems do not arise.

³¹ See *supra* note 7.

³² 15 U.S.C. 78s(b)(2) (1988).

42), including Amendment No. 1, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³³

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95-26003 Filed 10-19-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36372; File No. SR-DTC-94-10]

Self-Regulatory Organizations; the Depository Trust Company; Notice of Withdrawal of a Proposed Rule Change Regarding the Establishment of a Fee Schedule for Certain Inter-Depository Deliveries

October 16, 1995.

On July 7, 1994, the Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ a proposed rule change to establish a fee schedule for certain inter-depository deliveries. Notice of the proposed rule change was published in the Federal Register on August 9, 1994.² DTC subsequently requested and the Commission granted two extensions of the period for public comment on the proposed rule change.³

On October 11, 1995, DTC withdrew the proposed rule change.⁴

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95-26002 Filed 10-19-95; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36370; File No. SR-PSE-95-11]

Self-Regulatory Organizations; Pacific Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to the Number of Trading Posts That May Be Included as Part of Each Market Maker's Primary Appointment Zone

October 13, 1995.

I. Introduction

On April 7, 1995, the Pacific Stock Exchange, Inc. ("PSE" 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 proposal to increase the number of trading posts that may be included as part of each market maker's primary appointment zone. The proposed rule change was published for comment in the Federal Register on June 16, 1995.³ No comments were received on the proposed rule change.

II. Description of the Proposal

PSE Rule 6.35 currently requires each options market maker to select and maintain a primary appointment zone consisting of one or two trading posts.⁴ Pursuant to Rule 6.35, Commentary .03, at least 75% of the trading activity of each market maker (measured in terms of contract volume per quarter) must be in classes of option contracts to which such market maker's primary appointment zone extends. In addition, under the short sale rule applicable to stocks traded in the Nasdaq market, the options market maker exemption to that rule is limited to stocks underlying options in which a market maker holds an appointment.⁵

The Exchange proposal seeks to amend Rule 6.35 in two respects. First,

the maximum number of trading posts that could be included as part of each primary appointment zone would be increased from two to six. Second, the Options Appointment Committee could allow a market maker to exceed the six trading post maximum if special circumstances were to exist.⁶

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) of the Act⁷ that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public.

The Commission believes that increasing from two to six the maximum number of contiguous trading posts that may comprise an options market maker's primary appointment zone is a reasonable measure designed by the Exchange to help ensure adequate market maker participation in each class of options traded on the Exchange. The Exchange has stated that the effect of increasing the trading post maximum will be to increase the maximum number of issues a market maker could have within his or her primary appointment zone. Accordingly, out of a total of 366 options issues at PSE, the change potentially could result in increases from 58 to 98 in appointed issues, representing an increase from 16% to 27% of the total number of issues traded on the Exchange.⁸

The Commission believes that the PSE's proposal will benefit the market and investors by increasing the potential number of options classes to which the obligations of a market maker will apply.⁹ Although the Commission

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 35836 (June 9, 1995), 60 FR 31751.

⁴ PSE Rule 6.35 requires multiple posts to be contiguous, except under special circumstances.

⁵ The NASD short sale rule prohibits broker-dealers from effecting short sales for themselves or their customers at or below the "bid" when the current "inside" or best price is below the previous inside bid. See NASD Rules of Fair Practice, Art. III, § 48. The PSE's market maker exemption to the short sale rule allows options market makers to hedge options positions in their primary appointment zone by buying or selling (including selling short) shares of underlying stocks or underlying component stocks contained in stock indexes. Such an "exempt hedge transaction" is defined by the Exchange as a short sale effected to hedge, and which in fact serves to hedge, an existing offsetting options position or an offsetting options position that was created in one or more transactions contemporaneous with the short sale. See PSE Rule 4.19.

⁶ See Discussion below

⁷ 15 U.S.C. 78f(b)(5) (1988).

⁸ See Facsimile from Michael D. Pierson, Senior Attorney, Market Regulation, PSE, to Francois Mazur, Attorney, Office of Market Supervision, Division of Market Regulation, Commission, dated September 12, 1995. In comparison, out of a total of 644 classes of options at the CBOE, there are a maximum of 241 classes of options in which a CBOE market maker may hold an appointment, representing 37% of the total number of options classes traded at the CBOE. Securities Exchange Act Release No. 35629 (April 19, 1995), 60 FR 20542.

⁹ For example, PSE Rule 6.37 requires generally that a market maker's transactions constitute a course of dealing reasonably calculated to contribute to the maintenance of a fair and orderly market. Specific requirements include engaging in dealings for the market maker's own account when there exists, or it is reasonably anticipated that there will exist, a lack of price continuity, a

Continued

³³ 17 CFR 200.30-3(a)(12) (1994).

¹ 15 U.S.C. § 78s(b)(1) (1988).

² Securities Exchange Act Release No. 34480 (August 2, 1994), 59 FR 40630.

³ Securities Exchange Act Release Nos. 34594 (August 25, 1994), 59 FR 45317 [File No. SR-DTC-94-10] (order extending comment period until September 30, 1994); and 34828 (October 12, 1994), 59 FR 52849 [File No. SR-DTC-94-10] (order extending comment period until November 15, 1994).

⁴ Letter from Richard B. Nesson, Executive Vice President and General Counsel, DTC, to Jerry Carpenter, Assistant Director, Division of Market Regulation, Commission, (October 11, 1995).

⁵ 17 CFR 200.30-3(a)(12) (1994).