

15, the PHLX believes that the proposal is consistent with Section 6(b) 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, remove impediments to and perfect the mechanism of a free and open market and protect investors and the public interest by incorporating the new, broader equity hedge exemption in to the Exchange's Minor Rule Plan.

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

The PHLX does not believe that the proposed rule change will impose an 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.

III. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The Exchange has requested that the proposed rule change be given accelerated effectiveness pursuant to Section 19(b)(2) of the Act in order to promptly correct Advice F-15 to reflect the expanded equity option hedge exemption approved in the Hedge Exemption Order and to clarify the application of the Minor Rule Plan to the exemption.

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) in that it is designed to protect investors and the public interest and to facilitate transactions in securities.<sup>9</sup> Exchange Rule 1001, Commentary .07 and Advice F-15(b) set forth an exemption from equity option position and exercise limits for equity options hedge by 100 shares of stock or securities convertible into the stock. In the Hedge Exemption Order, the Commission approved a proposal to amend PHLX Rule 1001, Commentary .07, to expand the maximum allowable hedged position for equity options to three times the standard position and exercise limit of the option. However, a corresponding amendment to Advice F-15(b) was inadvertently omitted from the PHLX's proposal to amend PHLX Rule 1001, Commentary .07.

The Commission believes that the proposal protects investors and the

public interest by making Advice F-15(b) consistent with PHLX Rule 1001, Commentary .07, as amended by the Hedge Exemption Order, thereby clarifying the Exchange's rules and eliminating potential confusion. Specifically, the proposal amends Advice F-15(b) to indicate that the maximum allowable position for each option contract hedge by 100 shares of stock or securities convertible into the stock, will be three times, instead of twice, the standard position and exercise limit of the option.

As the Commission found in the Hedge Exemption Order, the Commission believes that the proposal to expand the hedge exemption is an appropriate method to accommodate the needs of options market participants. By increasing the hedge exemption, the Commission continues to believe that 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. Based on the PHLX's experience, the Commission believes, as it concluded in the Hedge Exemption Order, that the increased equity option hedge exemption should result in little or no additional risk to the marketplace.<sup>10</sup>

In addition, the Commission believes that it is appropriate to continue to administer Advice F-15, as amended, pursuant to the PHLX's Minor Rule Plan. Under the proposal, violations of the hedge exemption continue to be objective in nature and easily verifiable; therefore, the enforcement of the expanded hedge exemption should not entail the complicated factual and interpretive inquiries associated with more sophisticated disciplinary actions. Accordingly, the Commission believes that violations of the equity option hedge exemption continue to lend themselves to the use of the PHLX's Minor Rule Plan and the fines provided for in Advice F-15.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. The Commission believes that the proposal clarifies the PHLX's rules by making Advice F-15(b) consistent with PHLX Rule 1001, Commentary .07. In addition,

<sup>10</sup>The Commission notes that to the extent the potential for manipulation increases because of the expanded hedge exemption, the Commission believes that the PHLX'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 PHLX's surveillance programs to ensure that problems do not arise.

the proposal does not raise any new regulatory issues since the Commission previously approved an identical amendment to PHLX Rule 1001, Commentary .07. Accordingly, the Commission believes that granting accelerated approval of the proposed rule change is appropriate and consistent with Sections 6(b)(5) and 19(b)(2) of the Act.

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 February 16, 1996.

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-PHLX-95-87) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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<sup>11</sup> 15 U.S.C. § 78s(b)(2) (1982).

<sup>12</sup> 17 CFR 200.30-3(a)(12) (1995).

<sup>9</sup> 15 U.S.C. § 78f(b)(5) (1988 & Supp. V 1993).

[Release No. 34-36745; File No. SR-Phlx-95-38]

**Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to an Increase in Position and Exercise Limits on the Phlx National Over-the-Counter Index**

January 19, 1996.

**I. Introduction**

On September 25, 1995, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") submitted to the Securities and Exchange Commission ("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 increase the position<sup>3</sup> and exercise limits<sup>4</sup> for options ("XOC") on the Phlx's National Over-the-Counter Index ("Index")<sup>5</sup> from 17,000 to 25,000 contracts.

The proposed rule change appeared in the Federal Register on November 14, 1995.<sup>6</sup> No comments were received on the proposed rule change. This order approves the Phlx's proposal.

**II. Background and Description**

On May 17, 1985, the Commission approved the Exchange's proposal to list and trade options on the Index.<sup>7</sup> According to the Phlx, trading volume on the Index has increased sharply since 1991, and consistently since 1993.<sup>8</sup>

The Exchange recently conducted a "two-for-one split" of the Index, which effectively reduced the value of the Index to one-half of its previous value.<sup>9</sup> In accounting for the split, the Phlx doubled the position and exercise limits

applicable to the XOC from 17,000 contracts<sup>10</sup> to 34,000 contracts until the last expiration then trading, which is the June 1996 expiration.

In the absence of the proposed rule change, following the expiration of the June 1996 option series, the XOC's position limit would revert to the 17,000 contract level. At this limit, with the Index at a post-split value of 424,<sup>11</sup> the aggregate dollar value of the maximum permissible XOC position would be approximately \$721 million.<sup>12</sup> In comparison, with the limit raised to 25,000 contracts, the aggregate dollar value of the maximum permissible XOC position would be approximately \$1 billion.<sup>13</sup> The Exchange believes that even with the increased position limit, the Index's value compares with the values of other exchanges' broad-based index options,<sup>14</sup> as well as its own.<sup>15</sup> Moreover, as most broad-based index options have position limits of at least 25,000 contracts,<sup>16</sup> with certain products trading with higher limits,<sup>17</sup> the proposed rule change is intended to keep the Phlx in line with the position limits of index options traded on other exchanges.

**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, with the requirements of Section 6(b)(5),<sup>18</sup> in that

it should help to remove impediments to and perfect the mechanism of a free and open market, promote just and equitable principles of trade, and protect investors and the public interest.

In analyzing and reviewing specific position and exercise limits proposed by the options exchanges, the Commission has attempted to balance two competing concerns. First, limits must be sufficiently low to prevent investors from disrupting the underlying cash market. Second, limits must not be established at levels that are so low as to unnecessarily discourage participation in the options market by institutions and other investors who have substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain fair and orderly markets.

The Commission believes that the proposed increase in position and exercise limits to 25,000 contracts<sup>19</sup> should increase the depth and liquidity of the XOC market without significantly increasing concerns regarding intermarket manipulations or disruptions of the markets for the options or the underlying securities. The Commission has previously stated that markets with active and deep trading, as well as broad public ownership, are more difficult to manipulate or disrupt than less active markets with smaller public floats.<sup>20</sup> In this regard, the Commission notes that the Index is a broad-based index consisting of the 100 largest capitalized stocks trading over-the-counter ("OTC"). Moreover, the Phlx's maintenance requirements ensure that the Index will not contain a large number of thinly-capitalized, low-priced securities with small public floats and low trading volumes.<sup>21</sup> Accordingly, given the size and breadth of the Index, the Commission does not believe that increasing the position and exercise limits for the Index will substantially increase the Index's susceptibility to manipulation or increase the potential for disruption in the markets for the underlying securities.

In addition, the Exchange's surveillance program will continue to be applicable to the trading of XOC options and should detect and deter any trading

<sup>19</sup> The Commission again notes that the Exchange's proposal will not be implemented until after the June 1996 expiration.

<sup>20</sup> See, e.g., Securities Exchange Act Release No. 31330 (October 16, 1992), 57 FR 48408 (October 23, 1992).

<sup>21</sup> See Securities Exchange Act Release No. 22026 (May 8, 1985), 50 FR 20310 (May 15, 1985).

<sup>10</sup> See Securities Exchange Act Release No. 33634 (February 17, 1994), 59 FR 9263 (February 25, 1994) (order approving increase in position and exercise limits on Index from 10,000 to 17,000 contracts) (File No. SR-Phlx-93-07).

<sup>11</sup> This value of the Index was recorded on December 19, 1995.

<sup>12</sup> The aggregate dollar value of the maximum permissible XOC position is calculated by multiplying the Index value by the multiplier by the position limit as follows:

$$424 \times 100 \times 17,000 = \$720,800,000$$

$$13 \quad 424 \times 100 \times 25,000 = \$1,060,000,000$$

<sup>14</sup> These values were recorded on June 27, 1995:

$$\text{CBOE: OEX } 520 \times 100 \times 25,000 = \$1,300,000,000$$

$$\text{CBOE: SPX } 545 \times 100 \times 45,000 = \$2,452,500,000$$

$$\text{CBOE: RUT } 281 \times 100 \times 50,000 = \$1,405,000,000$$

$$\text{CBOE: NDX } 534 \times 100 \times 25,000 = \$1,335,000,000$$

$$\text{Amex: XMI } 477 \times 100 \times 34,000 = \$1,621,800,000$$

$$\text{PSE: WSX } 363 \times 100 \times 37,500 = \$1,361,250,000$$

$$\text{NYSE: NYA } 292 \times 100 \times 45,000 = \$1,314,000,000$$

$$15 \quad \text{VLE } 518 \times 100 \times 25,000 = \$1,295,000,000$$

$$\text{TPX } 482 \times 100 \times 25,000 = \$1,205,000,000$$

<sup>16</sup> See, e.g., American Stock Exchange, Inc.'s ("Amex") EUR—25,000 contracts, HKO—25,000 contracts, JPN—25,000 contracts; and Chicago Board Options Exchange, Inc.'s ("CBOE") NDX—25,000 contracts.

<sup>17</sup> See, e.g., CBOE's SPX—45,000 contracts, RUT—50,000 contracts; Amex's XII—45,000 contracts, XMI—34,000 contracts; and New York Stock Exchange, Inc.'s ("NYSE") NYA and NNA—45,000 contracts each.

<sup>18</sup> 15 U.S.C. § 78f(b) (1988).

<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 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. See Phlx Rule 1001A(a)(ii).

<sup>4</sup> 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. See Phlx Rule 1002A.

<sup>5</sup> The Index is a capitalization-weighted market index composed of the 100 largest capitalized stocks trading over-the-counter.

<sup>6</sup> See Securities Exchange Act Release No. 36461 (November 6, 1995), 60 FR 57257 (November 14, 1995).

<sup>7</sup> See Securities Exchange Act No. 22044 (May 17, 1985), 50 FR 21532 (May 24, 1985) (File Nos. SR-Phlx-84-28 and SR-Phlx-85-11).

<sup>8</sup> According to the Exchange, XOC volume for the period January-June 1995 was 167,894 contracts, compared to 158,228 contracts for the period January-June 1993.

<sup>9</sup> See Securities Exchange Act Release No. 36577 (December 12, 1995) (order approving File No. SR-Phlx-95-61).

abuses arising from the Index's increased position and exercise limits.

Lastly, the Exchange submitted data comparing the Index to several other broad-based indexes, including the CBOE's Nasdaq 100 Index, which is comprised of OTC stocks similar to those companies in the XOC.<sup>22</sup> The Commission believes that the comparative data confirms that the proposed increase in the Index's position and exercise limits to 25,000 contracts are comparable to those of similar indexes which trade on other options exchanges.

#### IV. Conclusion

For the foregoing reasons, the Commission finds that the Phlx's proposal to increase the position and exercise limits of the Index from 17,000 to 25,000 contracts is consistent with the requirements of the Act and the rules and regulations thereunder. In addition, the Commission notes that the change in position and exercise limits on the XOC does not become effective until after the expiration of the June 1996 option series.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>23</sup> that the proposed rule change (SR-Phlx-95-38) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-36744; File No. SR-Phlx-95-92]

#### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to the Listing and Trading of Options on the PHLX OTC Industrial Average Index

January 19, 1996.

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> notice is hereby given that on December 21, 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 Exchange. On December 29, 1995, the Exchange filed with the Commission Amendment No. 1 to the proposed rule change.<sup>3</sup> 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 list and trade options on the Phlx OTC Industrial Average Index ("OTC Industrial Index" or "Index"), a price weighted index developed by the Phlx composed of ten of the largest stocks, by capitalization, traded through the National Association of Securities Dealers Automated Quotations system and are reported national market system securities ("NASDAQ/NMS"). The text of the proposed rule change is available at the Office of the Secretary, the Exchange, 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 Exchange 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 Phlx proposes to list for trading an European-style option<sup>4</sup> on the Phlx OTC Industrial Average Index which is composed of ten of the largest capitalized common stock issues traded through NASDAQ/NMS representing diversified industries including Telecommunications, Pharmaceuticals, Semiconductors, and Data Processing.<sup>5</sup>

The Phlx believes there are numerous benefits to listing the OTC Industrial Index options. First, the Exchange believes that the OTC Industrial Index will appeal to individual investors as well as program and basket traders because the Index reflects the direction and pricing of some of the nation's most important and heavily traded companies. These stocks are frequently found in investor and trader portfolios alike. Second, because the OTC Industrial Index is based on a relatively small number of actively traded stocks, replication of the Index for hedging purposes with underlying stocks can be readily accomplished with complete accuracy. Third, the Exchange does not believe that the OTC Industrial Index will be susceptible to manipulation because the stocks comprising the OTC Industrial Index are some of the largest and most widely held common stocks. Furthermore, all of the component stocks in the Index are options eligible and have overlying options currently trading.

The formula for calculating the OTC Industrial Index is as follows:

$$\text{Index Value} = \frac{SP_1 + SP_2 + SP_3 + \dots + SP_{13}}{\text{divisor}} \times 100$$

SP = the stock price of each component.

<sup>22</sup> See also *supra* notes 14-15.

<sup>23</sup> 15 U.S.C. § 78s(b)(2) (1988).

<sup>24</sup> 17 CFR 200.30-3(a)(12) (1994).

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

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

<sup>3</sup> The Exchange amended the proposed rule change to indicate that the Index will be treated as

a narrow based index. See Letter from Nandita Yagnik, New Product Development, Phlx, to John Ayanian, Attorney, Office of Market Supervision ("OMS"), Division of Market Regulation ("Market Regulation"), Commission, dated December 27, 1995 ("Amendment No. 1").

<sup>4</sup> European-style options can be exercised only during a specific time period prior to expiration of the options.

<sup>5</sup> The components of the Index are: Amgen, Inc.; Applied Materials; Bay Networks, Inc.; CISCO Systems; Intel Corp.; Microsoft Corp.; MCI Communications; Oracle Corp.; Sun Microsystems; and Tele Communications, Inc.