

trading of ELNs are consistent with the Act.

As with previously approved ELNs, ELDS, and SEEDS, the ELNs, the PSE is proposing to trade are not leveraged instruments. Their price, however, will be derived and based upon the underlying linked security. Accordingly, the level of risk involved in the purchase and sale of an ELN is similar to the risk involved in the purchase or sale of traditional common stock. Nonetheless, in considering other SROs' respective proposals to list and trade ELNs, ELDS, and SEEDS, the Commission had several specific concerns with this type of product because the final rate of return of an ELN is derivatively priced (*i.e.*, based on the performance of the underlying security). The concerns included: (1) Investor protection concerns, (2) dependence on the credit of the issuer of the instrument, (3) systemic concerns regarding position exposure of issuers with partially hedged positions or dynamically hedged positions, and (4) the impact on the market for the underlying linked security.¹⁵ The Commission concluded, however, that the SROs' proposals adequately addressed each of these issues such that the Commission's regulatory concerns were minimized adequately.¹⁶ Similarly, in this proposal, the PSE has proposed safeguards, as described above, that the Commission finds to be equivalent to those approved for the trading of equity-linked debt securities in other markets. In particular, by imposing the listing standards, suitability, disclosure, and compliance requirements noted above, the PSE has adequately addressed the potential public customer concerns that could arise from the hybrid nature of ELNs. Further, the Commission believes that the listing standards and issuance restrictions should help to reduce the likelihood of any adverse market impact on the securities underlying the ELNs.

The Commission finds good cause for approving the amended proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the Federal Register in order to allow the PSE to begin listing ELNs without delay. As discussed above, the proposal merely provides the PSE with the ability to list equity-linked debt securities on the same basis as other SROs. Moreover, the Commission notes that the prior proposals by other SROs to list and trade equity-linked debt securities were

published by the Commission for the full statutory comment period without any comments being received by the Commission. In light of the Commission's approval of the listing and trading equity-linked debt securities by other SROs, accelerating approval of this proposal does not raise any new regulatory issues and will allow the PSE to compete on an equal basis with other markets with regard to these equity-linked products.¹⁷ Therefore, the Commission there is good cause to grant accelerated approval to the proposed rule change, as amended, consistent with Section 6(b)(5) and Section 19(b)(2) of the Act.¹⁸

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-PSE-96-23), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-37635; File No. SR-Phlx-96-19]

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 Philadelphia Stock Exchange, Inc., To Establish a Firm Facilitation Exemption

September 4, 1996.

I. Introduction

On June 3, 1996, 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")¹ and Rule 19b-4 thereunder,² a proposed rule change to establish a firm facilitation exemption³ for all non-multiply-listed Exchange options by adding new Commentary .08

¹⁷ See Equity-Linked Note Approval Orders, *supra* note 14.

¹⁸ 15 U.S.C. 78f(b)(5) and 78s(b)(2).

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 C.F.R. 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4.

³ The Commission notes that a facilitation trade is defined as a transaction that involves crossing an order of a member firm's public customer with an order for the member firm's proprietary account.

to Exchange Rule 1001 and new Commentary .02 to Exchange Rule 1001A. The exemption would be available to equity and index options, including customized options.⁴

The proposed rule change appeared in the Federal Register on July 10, 1996.⁵ No comments were received on the proposed rule change. The Phlx subsequently filed Amendment No. 1 to the proposed rule change on July 26, 1996.⁶ This order approves the Phlx's proposal.

II. Background and Description

The Phlx is proposing to establish a firm facilitation exemption for all non-multiply-listed Exchange options. Under the proposal, the procedures in Exchange Rule 1064(b) for crossing a customer order with a firm facilitation order must be followed. Moreover, only after all market participants in the trading crowd have been given a reasonable opportunity to accept the terms, may the representing Floor Broker cross all or any remaining part of such order in accordance with the rule. According to the Phlx, the purpose of this procedure is to ensure that the trading crowd cannot first facilitate the order before resorting to a position limit exemption for the facilitating firm. Thus, only after it is determined that the trading crowd will not fill the order may the firm's customer order be crossed with the firm's facilitation order pursuant to the exemption.

The Phlx notes that the firm facilitation provision will be in addition to and separate from the standard limit, as well as other exemptions available under Exchange position limit rules. For example, if a member organization decides to facilitate customer orders in

⁴ See Securities Exchange Act Release No. 37048 (March 29, 1996), 61 FR 15549 (April 8, 1996) (File No. SR-Phlx-96-08).

⁵ See Securities Exchange Act Release No. 37398 (July 2, 1996), 61 FR 36410 (July 10, 1996).

⁶ In Amendment No.1, the Phlx amended its proposed rule filing to: (1) require that a member organization submit to the Exchange's Market Surveillance Department appropriate forms substantiating the basis for the exemption within two business days or the time specified by the Exchange when approval is granted on the basis of verbal representations; (2) clarify that the proposal does not apply to multiply-listed options; (3) add language prohibiting the use of the exemption with respect to "all or none" or "fill or kill" orders; and (4) state that violations of the exemptive requirements, absent reasonable justification or excuse, shall result, in addition to any disciplinary action, in the withdrawal of the exemption, and may form the basis for subsequent denial of an application for an exemption under this rule. See letter from Gerald D. O'Connell, Senior Vice President, Market Regulation and Trading Operations, Phlx, to Matthew Morris, Office of Market Supervision, Division of Market Regulation, Commission, dated July 26, 1996 ("Amendment No. 1").

¹⁵ See Equity-Linked Note Approval Orders, *supra* note 14.

¹⁶ See Equity-Linked Note Approval Orders, *supra* note 14.

ABC options, which is assumed not to be multiply-listed and also assumed to have a 10,500 contract standard position limit, the member organization may qualify for a firm facilitation exemption of up to twice that limit (21,000 contracts), as well as an equity hedge exemption of up to twice the standard limit (21,000 contracts), in addition to the 10,500 contract standard limit. If both exemptions are allowed, the facilitation firm may hold or control a combined position of up to 52,500 ABC contracts on the same-side of the market.⁷

The Phlx notes, however, that the firm facilitation exemption would not presently extend to all options listed on the Exchange. Rather, until coordinated intermarket procedures are developed, the firm facilitation exemption will be extended only to non-multiply-listed options.

Under the proposal, the facilitation exemption requires prior approval from two Floor Officials and submission of a Firm Facilitation Form.⁸ Although approval may be granted on the basis of verbal representation, the facilitation firm is required to furnish to the Market Surveillance Department, within two business days or such other time period designated by the Exchange, appropriate forms substantiating the basis for the exemption.⁹

Within five business days after the execution of a facilitation exemption order, a facilitation firm must hedge all exempt option positions that have not previously been liquidated, and furnish to the Market Surveillance Department documentation reflecting the resulting hedged positions. In meeting this requirement, and to ensure fair and orderly markets, the facilitation firm must establish and liquidate its own as well as its customer's option and

stock positions (or their equivalent) in an orderly fashion, and not in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes.

In addition, a facilitation firm is not permitted to use the facilitation exemption with a view toward taking advantage of any differential in the price between a group of securities and an overlying stock index option. According to the Phlx, this prohibition against index arbitrage should prevent undue market impact on the options or any underlying stock positions by preventing the increased positions from being used in a leveraged manner. Moreover, to facilitate surveillance and to ensure an accurate audit trail, the facilitation firm is required to promptly provide to the Exchange any information or documents requested concerning the exempted and hedged positions, to furnish copies of the relevant order tickets to the Market Surveillance Department on the day of execution, and to notify the Exchange of any material change in the exempted options position or the hedge.

The Exchange is also proposing several minor changes to its rules. First, the introductory paragraph to Exchange Rule 1001 is to be amended to list the 20,000 and 25,000 contract position limit tiers, which were inadvertently omitted when Commentary .05(a) was amended to adopt these limits.¹⁰ Second, Exchange Rule 1064(b) is to be amended to eliminate the incorrect limitation to "equity" options, as this provision applies to index options as well. Third, the equity option hedge exemption contained in Commentary .07 to Exchange Rule 1001 is to be amended to state that the exemption is available up to "two times above" existing limits, as opposed to "three times" the limits, as currently stated. The maximum size of the exemption is not being changed, just rephrased in terms of the excess number of contracts above the applicable position limit. In this manner, the provision will be consistent with the index option hedge exemption of the Phlx as well as other exchanges.¹¹ Fourth, the equity option hedge exemption is to be amended to state that it is separate from any other exemption available under Exchange rules.

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).¹² Specifically, the Commission believes that the Phlx's proposal is reasonably designed to accommodate the needs of investors and other market participants without substantially increasing concerns regarding the potential for manipulation and other trading abuses. The Commission also believes that the proposed rule change has the potential to enhance the depth and liquidity of the options market by providing Exchange members greater flexibility in executing large customer orders. Accordingly, as discussed below, the Commission believes that 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.

The Phlx proposal contains several safeguards that will serve to minimize any potential disruption or manipulation concerns. First, the facilitation firm must receive approval from the Exchange prior to executing facilitation trades. Although Exchange approval maybe granted on the basis of verbal representations, the Commission believes that trading abuses are unlikely because the facilitation firm is required to furnish to the Exchange's Market Surveillance Department, within two business days or such other time period designated by the Exchange, forms and documentation substantiating the basis for the exemption.

Second, a facilitation firm must, within five business days after the execution of a facilitation exemption order, hedge all exempt options positions that have not previously been liquidated, and furnish to the Exchange's Market Surveillance Department documentation reflecting the resulting hedging positions. In meeting this requirement, the facilitation firm must liquidate and establish its customer's and its own options and stock positions (or their equivalent) in an orderly fashion, and not in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes. In addition, a facilitation firm is not permitted to use the facilitation exemption for the purpose of engaging in index arbitrage.

⁷ In addition, exercise limits will continue to correspond to position limits, such that investors may exercise the number of contracts set forth as the position limit as well as those contracts exempted by this proposal, during five consecutive business days. See Exchange Rules 1002 and 1002A.

⁸ According to the Phlx, the purpose of the Firm Facilitation Form is to detail the terms of the customer order and the resulting facilitation, as well as to ensure compliance with the exemption. In addition, pursuant to the existing requirements of Exchange Rule 1064(b), facilitation orders must be marked with an "F" prior to executing facilitating trades. Lastly, Firm Facilitation Forms will be made available at the Exchange's Surveillance Post.

⁹ The Exchange also notes that the facilitation firm need not have the customer order in hand when requesting the exemption, as long as the exemption is properly used to facilitate a customer order pursuant to the rule. Because the provision states the position "will facilitate" a customer order, a firm approaching the limit may request an exemption prior to receiving an order, in response to customer interest.

¹⁰ See Securities Exchange Act Release No. 36409 (October 23, 1995), 60 FR 55399 (October 31, 1995) (File No. SR-Phlx-95-71).

¹¹ See Phlx Rule 1001A, Commentary .01. See also CBOE Rule 4.11, Interpretations and Policies .04(b).

¹² 15 U.S.C. 78f(b)(5) (1988).

The Commission believes that these requirements will help to ensure that the facilitation exemption will not have an undue market impact on the options or any underlying stock positions.

Third, the facilitation firm is required to promptly provide to the Exchange any information or documents requested concerning the exempted options positions and the positions hedging them, as well as to promptly notify the Exchange of any material change in the exempted options positions or the hedge.

Fourth, neither the member's nor the customer's order may be contingent on "all or none" or "fill or kill" instructions, and the orders may not be executed until the procedures in Exchange Rule 1064(b) have been satisfied and crowd members have been given a reasonable time to participate in the trade.

Fifth, in no event may the aggregate exempted position exceed two times the applicable standard limit, in addition to the standard position limit.¹³

Sixth, the facilitation firm may not increase the exempted options position once it is liquidated, unless approval from the Exchange is again received pursuant to a reapplication.

In summary, the Commission believes that the safeguards built into the facilitation exemption process discussed above should serve to minimize the potential for disruption and manipulation, while at the same time benefiting market participants by allowing member firms greater flexibility to facilitate large customer orders. This structure substantially mirrors the firm facilitation exemption processes that were recently approved for other option exchanges.¹⁴ Accordingly, the Commission believes it is appropriate to extend the benefits of a firm facilitation exemption to non-multiply-listed Phlx options.

In addition, because the other minor rule changes that the Exchange is proposing will make the Phlx's rules clearer and are non-substantive in nature, the Commission believes that they are consistent with Section 6(b)(5) of the Act.

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, Amendment No. 1 conforms the Exchange's firm facilitation exemption to the relief recently approved for the other options exchanges. Accelerated approval of the proposed rule change will thereby provide for the desired uniformity of the exchanges' position limit exemptions. Any other course of action could lead to unnecessary investor confusion. In addition, the Chicago Board Options Exchange's proposal was noticed for the entire twenty-one day comment period and generated no responses.¹⁵ Accordingly, the Commission believes that it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 1 to the proposed rule change 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 Phlx. All submissions should refer to File No. SR-Phlx-96-19 and should be submitted by October 3, 1996.

IV. Conclusion

For the foregoing reasons, the Commission finds that the Phlx's proposal to establish a firm facilitation exemption, as well as the other non-substantive changes to the Phlx's rules, are consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2)¹⁶ of the Act, that the proposed rule change (File No. SR-Phlx-96-19), as amended, is hereby 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. 34-37643; File No. SR-Phlx-96-23]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Options Specialist Evaluations

September 5, 1996.

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 July 1, 1996, 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 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, pursuant to Rule 19b-4 of the Act,¹ proposes to update its Options Specialist Evaluation program by adopting a new questionnaire and revising Exchange Rules 509, 511 and 515 regarding the evaluation procedure.

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.

¹³ The Commission notes, however, that the firm facilitation exemption is in addition to any other exemption available under the Exchange's rules.

¹⁴ See Securities Exchange Act Release Nos. 36964 (March 13, 1996), 61 FR 11453 (March 20, 1996) (File No. SR-CBOE-95-68); 37178 (May 8, 1996), 61 FR 24523 (May 15, 1996) (File No. SR-PSE-96-10); 37179 (May 8, 1996), 61 FR 24520 (May 15, 1996) (File No. SR-Amex-96-11).

¹⁵ *Id.*

¹⁶ 15 U.S.C. 78s(b)(2) (1988).

¹⁷ 17 CFR 200.30-3(a)(12).

¹ 17 CFR 240.19b-4.