

[Release No. 34-38113; International Series Release No. 1042; File No. SR-PHLX-96-45]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Incorporated; Approval of Proposed Rule Change Relating to Minimum Transaction Size for Customized Foreign Currency Options

January 3, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on November 1, 1996, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to revise the minimum opening and closing transaction size and responsive quotation size for customized foreign currency options from 100 to 50 contracts. The proposal was published for comment in the Federal Register on November 20, 1996.² No comments were received on the proposed rule change. This order approves the Exchange's proposal.

On November 1, 1994, the Commission approved the Exchange's proposal to trade customized foreign currency options.³ Users now have the ability to customize the strike price and quotation method and choose any underlying and base currency combination out of all Exchange listed currencies, including the U.S. dollar. The product was introduced to attract institutional customers who like the flexibility and variety offered in the over-the-counter market but would prefer the benefits attributed to an exchange auction market to hedge their exchange rate risks.

The Exchange originally instituted a 300 contract minimum opening transaction size pursuant to Rule 1069(a)(6). A number of mid-sized corporations and institutions then told the Exchange that the contract value was too large for their purposes. They believed that customized currency options would fill a market need for them, but that the opening transaction size was prohibitive. The Exchange, thus, determined to reduce the transaction size in stages. In March of 1995, the Exchange reduced the size of an opening transaction to 200 contracts⁴ and then reduced it further to 100

contracts in August of that year.⁵ According to the Exchange, that size, however, still remains too large for a significant segment of medium sized corporations, especially those that are located in Canada and the Pacific basin. Those companies would like the opportunity to hedge their currency risk using an exchange traded customized option contract in a cost-effective manner. Therefore, the Exchange now proposes to reduce the minimum opening transaction size to 50 contracts, which would be equivalent in dollar terms to an average minimum transaction value for customized foreign currency options of between \$2 and \$3 million.⁶

The minimum size of the closing transaction and the minimum responsive quote size obligation would also be reduced from 100 contracts to the lesser of 50 contracts or the remaining contracts.

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),⁷ in that the proposal is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and to protect investors and the public interest. Specifically, the Commission believes that the proposed rule change is designed to make the customized foreign currency option market accessible to more medium sized corporate foreign currency option users while maintaining the focus of this market towards institutional investors. As a result, the Commission believes that the proposal may serve to add liquidity to this market, which would benefit all users of customized foreign currency options.

Even with lowering the minimum opening transaction size to 50 contracts, the minimum value of an opening customized foreign currency option transaction involving any approved currency will be between \$2 and \$3 million. The Commission believes that because the customized foreign currency option market is used almost exclusively by institutional investors, and because the dollar value of opening transactions in customized foreign currencies is still very substantial, lowering the minimum transaction size

to 50 contracts should not result in the entrance of unsophisticated investors into this market. Furthermore, the Exchange, in publicizing the reduction of the minimum contract size for customized foreign currency options to its members in a regulatory circular, will emphasize the necessity for compliance with the Phlx suitability rule, Rule 1026, applicable to options transactions.⁸ Rule 1026(b), among other things prohibits a member from recommending to a customer an opening transaction in any option contract, unless the person making the recommendation has a reasonable basis for believing, at the time of making the recommendation, that the customer is capable of evaluating the risks of the recommended transaction, and is financially able to bear the risks of the recommended position in the option contract. Based on the foregoing, the Commission believes that this proposal does not raise any regulatory concerns that were not adequately addressed by the Exchange when the Commission approved the trading of customized foreign currency options.⁹ Moreover, the institutional nature of customized foreign currencies should remain unchanged, even with the reduction in minimum opening transaction size being approved herein.¹⁰

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-Phlx-95-43) is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

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DEPARTMENT OF TRANSPORTATION

Office of the Secretary

Reports, Forms and Recordkeeping Requirements; Agency Information Collection Activity Under OMB Review

AGENCY: Department of Transportation (DOT).

⁸ Telephone conversation between Michelle R. Weissbaum, Vice President and Associate General Counsel, Phlx, and Janet W. Russell-Hunter, Special Counsel, Office of Market Supervision, Division of Market Regulation, Commission, on November 13, 1996.

⁹ See Securities Exchange Act Release No. 34925, *supra* note 3.

¹⁰ The Commission notes that it would have serious concerns about any further reductions in the minimum opening contract size, which could change the institutional nature and intent of the product.

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1)

² Securities Exchange Act Release No. 37944 (November 13, 1996), 61 FR 59125.

³ Securities Exchange Act Release No. 34925 (November 1, 1994), 59 FR 55720.

⁴ Securities Exchange Act Release No. 35464 (March 9, 1995), 60 FR 14043.

⁵ Securities Exchange Act Release No. 6176 (August 31, 1995), 60 FR 46879.

⁶ See Securities Exchange Act Release No. 37944, *supra* note 2.

⁷ 15 § 78f(b)(5).