

[Release No. 34-38295; International Series Release No. 1052; File No. SR-PHLX-96-44]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Modifying the Formula Which Calculates the Settlement Value for Dollar Denominated Deliver Options

February 14, 1997.

I. Introduction

On October 30, 1996, as subsequently amended on November 19, 1996, December 2, 1996, December 3, 1996,¹ and February 11, 1997,² the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")³ and Rule 19b-4 thereunder,⁴ a proposed rule change to modify the formula which calculates the settlement value for Dollar Denominated Deliver foreign currency options ("3D Options").

Notice of the proposed rule change, including Amendment Nos. 1, 2 and 3, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No. 38017 (December 3, 1996), 61 FR 65244 (December 12, 1996). No comments were received on the proposal. This order approves the proposed rule change, as amended, including Amendment No. 4 on an accelerated basis.

¹ See Letters to Heather Seidel, Attorney, Market Regulation, SEC, from Nandita Yagnik, Attorney, PHLX, dated November 18, 1996 ("Amendment No. 1"), November 25, 1996 ("Amendment No. 2"), and December 3, 1996 ("Amendment No. 3") respectively. The substance of these amendments was incorporated into the notice release and is discussed below. See Securities Exchange Act Release No. 38017 (December 4, 1996), 61 FR 65244 (December 12, 1996).

² Amendment No. 4 was filed with the Commission on February 11, 1997. The amendment changed the rule language to require that the appropriate number of interbank foreign exchange participants be selected at random from a pool of *at least* twenty-five (25) active interbank foreign exchange participants (addition underlined), and further explained the procedure for calculating a settlement value for the 3D Options. See letter from Nandita Yagnik, Attorney, New Product Development, PHLX to Heather Seidel, Attorney, Market Regulation, Commission, dated February 7, 1997.

³ 15 U.S.C. 78s(b)(1).

⁴ 17 CFR 240.19b-4.

II. Description

The Exchange proposes to amend PHLX Rule 1057, in order to modify the formula which calculates the settlement value for 3D Options. The Commission approved trading for 3D Foreign Currency Options on the Deutsche Mark ("3D Mark") on March 8, 1994.⁵ In November 1995, the Commission approved trading for 3D Foreign Currency Options on the Japanese Yen ("3D Yen").⁶ 3D Yen options, however, have not begun trading on the Exchange to date. Presently, for the 3D Mark, bid and offer quotations for the current foreign exchange spot price are collected from fifteen interbank foreign exchange participants randomly selected from a list of forty active interbank foreign exchange participants.⁷ This group of forty is selected from a larger list of interbank foreign exchange participants who provide continuous quotations for each currency and consists of the most active interbank participants out of the larger list.⁸ According to the PHLX, the actual number of interbank foreign exchange participants used for a particular currency will depend on the current number of interbank participants making active quotes, which is measured by frequency.⁹ After discarding the five highest offers and the five lowest bids of the randomly selected fifteen, the remaining ten bids and offers are arithmetically averaged to arrive at a closing settlement value.¹⁰

⁵ See Securities Exchange Act Release No. 33732 (March 8, 1994), 59 FR 12023 (order approving the listing and trading of cash/spot dollar denominated delivery foreign currency option contracts).

⁶ See Securities Exchange Act Release No. 36505, (November 22, 1995), 60 FR 61277 (order approving listing and trading of 3D foreign currency options on the Japanese yen).

⁷ PHLX rules currently require such list to be selected from a group of twenty-five (25) interbank foreign exchange participants. Amendment No. 4 amends the rule to reflect current practice to use "*at least*" twenty-five (25) interbank participants. See Amendment No. 4.

⁸ Telephone conversation between Nandita Yagnik, Attorney, PHLX, and Heather Seidel, Attorney, Market Regulation, Commission, on February 11, 1997.

⁹ Active interbank participants are defined by PHLX to be "those which provide quotations with the greatest frequency from 2:30 a.m. (the start of the trading day) until 9:30 a.m." See Amendment No. 4.

¹⁰ See Exchange Rule 1057. The Commission approved PHLX filing SR-PHLX-96-11, which allows PHLX to elect to calculate the settlement value in house instead of requiring an agent/vendor to do it. In addition, the new rule limits the liability of the Exchange regarding the accuracy of the settlement value except for intentional misconduct and/or any violations of the federal securities laws. See Securities Exchange Act Release Nos. 37323 (June 18, 1996), 61 FR 32880 (June 25, 1996) (notice) and 38041 (December 11, 1996), 61 FR 66721 (December 18, 1996) (approval order).

The algorithm for calculating the settlement value has a feature that scans the group of fifteen randomly selected quotations and automatically identifies those that are updated every five or more minutes and replaces them with quotations from the original pool of interbank participants¹¹ that are updated more frequently than every five minutes. PHLX's goal is to use quotations that are updated every one to two minutes for settlement value purposes, but the algorithm will not replace quotations until they are being updated every five or more minutes.¹²

The Exchange found that the number of banks that are able to provide active bid and offer quotations for different currencies varies according to the currency. For some of the more widely traded currencies, such as the Deutsche mark, there are many more interbank foreign exchange participants that update the bids and offers more frequently than every five minutes than for the less popular currencies, where the pool of potential contributors of the spot value for the individual currency is much smaller and quotations may be updated less often, although still on a continual basis.

To reflect the fact that there may be variation in the appropriate number of bids and offers that are available for each currency, the Exchange is proposing to make the current settlement value formula more flexible by permitting the Exchange, within certain guidelines, to determine the appropriate number of bids and offers to collect and average on a currency-by-currency basis. The Exchange would randomly select at least five interbank participants from a pool of at least twenty-five active interbank foreign participants. Additionally, as the number of bids and offers may vary across currencies, the existing rule language that requires the five highest offers and the five lowest bids to be discarded would also be modified. Instead, the Exchange proposes to discard one third of the highest offers and one third of the lowest bids and average the remaining bids and offers to arrive at the closing settlement value. The Exchange would set the number for each individual currency prior to commencing trading 3D Options on that

¹¹ As noted above, the rule is being amended to indicate such pool must be at least twenty-five. Currently the PHLX selects from a pool of forty interbank participants for the 3D option on the German Mark and intends to use forty for the 3D option on the Japanese Yen.

¹² See Amendment No. 4.

currency.¹³ In addition, the Exchange will employ the same back up procedures that are outlined for the 3D Mark and the 3D Yen that guard against unreliable or manipulated quotes.¹⁴

The Exchange's Foreign Currency Option Committee ("the Committee") will determine what the appropriate number of bid and offer quotations should be for determining settlement values on each currency within the minimum requirements of the PHLX rule. For example, the Committee will not have the discretion to select less than five interbank foreign exchange participants from which to obtain these bid and offer quotations. In addition, under the rule, the minimum number of bids and offers must still be randomly selected from a pool of at least twenty-five active interbank foreign participants and the Committee will not have the discretion to reduce the pool of participants below this number.

Although the Committee will have the ability to increase or decrease the number of bids and offers randomly selected from the larger pool of at least twenty-five bids and offers, to determine the settlement value for 3D options, the Exchange has stated it does not anticipate this occurring very frequently. The Exchange will periodically review the contributing interbanks to assure that the number has not materially increased or decreased. The Committee will then have the discretion to act upon this information within the rule's requirements. Notice of any change, however, to the number of contributor bank quotations used must be provided to the membership and public at least one week prior to settlement of the 3D currency option.

The Committee has determined to continue to collect fifteen bid and offer quotations from a pool of forty for the 3D Mark.¹⁵ For the 3D Yen, however, there are fewer banks that diligently provide quotes that are updated more frequently than every five minutes. This results in the algorithm not being able to replace quotes updated every five minutes or more with more frequently updated quotes because there are not enough quotes that are less than five minutes old.¹⁶ Therefore, the Committee has determined that a more accurate

¹³ The Exchange would have the ability to obtain bids and offers from more than five interbank foreign exchange participants as determined by the Foreign Currency Option Committee.

¹⁴ See Securities Exchange Act Release Nos. 33732 (March 8, 1994), 59 FR 12023 (March 15, 1994) (3D Mark approval order) and 36505 (November 22, 1995), 60 FR 61277 (November 29, 1995) (3D Yen approval order).

¹⁵ See Amendment No. 4.

¹⁶ See Amendment No. 4.

representation of the Japanese Yen Market would be derived from collecting ten bid and ask quotations from a group of forty active interbank participants and discarding the three highest offers and the three lowest bids prior to averaging them.

The Exchange maintains that in proposing any new 3D Foreign Currency Option contracts for listing and trading on the Exchange, the Exchange will identify the appropriate number of bank quotations that will be collected to arrive at the settlement value in the rule filing submitted pursuant to Section 19(b) and Rule 19b-4 of the Act. As noted above, the number of interbank participants from which the quotations are collected cannot be less than five. Further, the Exchange will provide at least one week notice of the number of contributor bank quotations used to derive the settlement value prior to listing and trading the 3D options on the new currency.

III. Discussion

The Commission believes 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).¹⁷ The Commission finds that the proposed rule change promotes just and equitable principles of trade, prevents fraudulent and manipulative acts and practices, and protects investors and the public interest because it will provide the Exchange with greater flexibility to ensure that settlement values for 3D foreign currency options are an accurate reflection of the most current and active contributor interbank participants. This should benefit investors trading these products, thereby facilitating transactions in foreign currency options in accordance with Section 6(b)(5) of the Act.

The Commission believes that the proposed rule change will more accurately reflect the foreign currency spot price for each individual currency because it allows the Exchange to tailor the number of interbank foreign exchange participants to the active spot market in each individual currency. The Commission finds that PHLX's amended procedures for calculating the settlement value for the 3D Options, and the competitive nature of the spot market for foreign currencies, should help to ensure that the settlement values accurately reflect the spot price for each

foreign currency.¹⁸ In addition, the Commission believes that PHLX's amended procedure will continue to guard against unreliable or manipulated quotes because the designated agent(s) will continue to randomly choose interbank foreign exchange participants for the purpose of collecting quotes, and those randomly chosen quotes will then be averaged to arrive at the final settlement value. In addition, as described above, although the change does give PHLX some flexibility in the number of bids and offers randomly selected, the current methodology for eliminating less frequent quotes will remain the same. This should continue to ensure settlement values are on an accurate reflection of the most current quotes.

The Commission also believes that the inability of the Exchange to decrease the number of bid and offer quotations for each currency that will be randomly selected from the larger pool of at least twenty-five to less than five interbank foreign exchange participants guards against potential manipulation by ensuring that the final settlement value is an average of a minimum number of interbank quotations and is not determined by one or two banks. By requiring bid and offer quotations from at least five interbank participants and allowing only one third of the highest and one third of the lowest bids and offers to be discarded, the amended rule requires that, at a minimum, the final settlement value for any 3D Option must be calculated from at least three bid and offer quotations.¹⁹ Additionally, the Commission finds that the requirement that the Exchange provide notice (at least one week in advance of settlement of the 3D Option) to its membership and public of any change in the number of contributor bank quotations used to calculate the final settlement value for that 3D Option helps to ensure that the investors are aware of the terms of the 3D Option and how the settlement value will be calculated before the expiration of that option.

The Commission finds good cause for approving Amendment No. 4 prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Among other

¹⁸ The Commission has previously found that the interbank foreign currency spot market, in general, is an extremely large, diverse market comprised of banks and other financial institutions worldwide. The foreign currency spot market is supplemented by equally deep and liquid markets for standardized options and futures on foreign currencies and options on those futures. There is also an active over-the-counter market for foreign currency options. See Securities Exchange Act Release No. 31627 (December 21, 1992), 57 FR 62399.

¹⁹ See Amendment No. 4.

things, Amendment No. 4 amends PHLX's rules to allow the number of interbank exchange participants to be chosen from a pool of twenty-five participants or more, rather than a pool of only twenty-five, by adding the words "at least." The Commission believes good cause exists to accelerate approval of Amendment No. 4 because this amendment may provide a more accurate final settlement value, by providing more quotes for the calculation. The algorithm will still replace any quotes that are updated five minutes or more with more frequently updated quotes if they are available. In addition, in approving the 3D Japanese Yen options, the Commission understood that PHLX may use more than twenty-five interbank foreign exchange participants. Also, the amendment further explains the process for calculating the settlement value for 3D Options and clarifies the Exchange's purpose for the proposed rule change. Further, the proposal to change the formula for calculating the settlement value for 3D options was noticed previously in the Federal Register for the full statutory period and the Commission did not receive any comments. Accordingly, the Commission believes that it is consistent with Sections 6 and 19(b)(2) of the Act to approve Amendment No. 4 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 4 to the proposed rule change. 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 rules change that are filed with the Commission, and all written communications relating to the Amendment No. 4 between the Commission and any persons, 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 in the Commission's Public Reference Room. Copies of such filing will also be available at the principal office of the Exchange. All submissions should refer to File No. SR-PHLX-96-44 and should be submitted by March 18, 1997.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act²⁰ that the proposed rule change (SR-PHLX-96-44), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²¹

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-38306; File No. SR-SCCP-96-13]

Self-Regulatory Organizations; Stock Clearing Corporation of Philadelphia; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Consolidate and Restate its Fee Schedule

February 19, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on December 23, 1996, the Stock Clearing Corporation of Philadelphia ("SCCP") 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 primarily by SCCP. 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 purpose of the proposed rule change is to consolidate and restate SCCP's schedule of fees and charges (Exhibit A).

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

In its filing with the Commission, SCCP included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule changes. The text of these statements may be examined at the places specified in Item IV below. SCCP has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.²

²⁰ 15 U.S.C. 78s(b)(2).

²¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by SCCP.

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

The purpose of the proposed rule change is to consolidate and restate SCCP's schedule of fees and charges. SCCP proposes to revise its volume discounts applicable to trade recording fees and value charges for PACE CNS trades settling at SCCP. SCCP currently provides a flat \$0.77 per side discount for 4,000 or more trades per month. SCCP's discounts have been revised into the following schedule: \$0.77 per side for 4,000 to 6,000 trades per month; \$0.55 per side for 6,001 to 8,000 trades per month; and \$0.35 per side for over 8,000 trades per month.³

Additionally, SCCP proposes to consolidate and restate existing fees and charges. This filing is being made in accordance with SCCP's policy to annually file a comprehensive schedule of all existing fees and charges.

SCCP believes the proposed rule change is consistent with Section 17A of the Act⁴ and the rules and regulations thereunder because it will provide for the equitable allocation of dues, fees, and other charges among participants.

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

SCCP does not believe the proposed rule change will impose a burden on competition.

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

Written comments were neither solicited nor received with respect to the proposed rule change.

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

The foregoing rule change has become effective pursuant to Sections 19(b)(3)(A)(ii)⁵ of the Act and pursuant to Rule 19b-4(e)(2)⁶ promulgated thereunder because the proposal establishes a due, fee, or other charge. At any time within sixty days of the filing of such 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,

³ This is not a graduated rate schedule. Once a volume threshold is reached, all trades receive such volume discount rate.

⁴ 15 U.S.C. 78q-1

⁵ 15 U.S.C. 78s(b)(3)(A)(ii).

⁶ 17 CFR 240.19b-4(e)(2).