

information with respect to, and facilitating transactions in securities, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public. Specifically, the Commission finds that the proposal promotes just and equitable principles of trade in that it enhances the ability of Floor Officials to ensure that Floor Brokers represent their orders to the trading crowd in a manner that maximizes order interaction and preserves auction market principles.

The Commission recognizes that the proposal can be fairly implied in existing standards of the Exchange, including Rules 110, 707, 155, and 1063, as described above. Floor officials already have the authority to determine that an order has been clearly communicated. Nevertheless, the Commission concurs with the Exchange that by incorporating the requirements of the proposal into the minor rule violation plan, Floor Officials will be better equipped to facilitate an orderly market, to prevent errors by allowing verification of market quotes and orders by other crowd participants, and to prevent fraudulent and manipulative acts. Furthermore, the Commission concurs with the Exchange that the new requirement is appropriate for the minor rule plan, because it involves actions that are objective and easily verifiable.

Finally, the Commission notes that by including certain provisions of Exchange Rules into Advice C-7, the Exchange is not implying that all violations of Advice C-7 are minor in nature. Rather, as with many other important, substantive provisions in Exchange rules that are codified into advices, this system merely allows for the efficient handling of minor violations. Any violation of the procedure which has been deemed serious by the Phlx will be referred directly to the Exchange's Business Conduct Committee where stronger sanctions may result. As the Phlx notes, however, this language does not affect the other floor procedure advices administered pursuant to the plan which do not specifically contain this statement; infractions cited pursuant to the plan are minor in nature regardless of whether this specific language was added to the advice.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>7</sup> that the proposed rule change (SR-PHLX-97-42) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39610; File No. SR-PHLX-97-52]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Options Trading Rotations

February 2, 1998.

#### I. Introduction

On October 23, 1997, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), 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 proposal to modify its rules governing options trading rotations.<sup>3</sup> The proposed rule change was published for comment in the *Federal Register* on November 24, 1997.<sup>4</sup> No comments were received regarding the proposal. This order approves the proposed rule change.

#### II. Description of the Proposal

The PHLX proposes to make several changes to its rules governing options trading rotations. First, the PHLX proposes to amend paragraph (a) of Exchange Rule 1047, "Trading Rotations, Halts and Suspension," to clarify that opening rotations for equity option contracts, unlike closing rotations, are conducted daily.<sup>5</sup>

Second, the PHLX proposes to replace references to "the Exchange" with references to "two Floor Officials, with the concurrence of a Market Regulation officer" throughout PHLX Rule 1047; in paragraphs (a)(ii), (c), (d), and (f), of PHLX Rule 1047A. "Trading Rotations, Halts or Reopenings;" and in Floor Procedure Advice ("Advice") G-2, "Trading Rotations, Halts or Re-

openings,"<sup>6</sup> in order to specify the approval required to implement options trading halts, modified trading rotations, and other procedures. For example, PHLX Rule 1047(b), as amended, will require the halt or suspension of trading in option contracts whenever two floor officials, with the concurrence of a PHLX market regulation officer, deem such action appropriate in the interest of a fair and orderly market and to protect investors. The PHLX believes that trading rotations present the types of issues and the need for prompt determinations that are particularly suited to floor official approval. In addition, the PHLX believes that requiring the concurrence of a PHLX market regulation officer will help to ensure proper notification of the approval and allow Exchange staff to better monitor the conditions giving rise to rotation-related floor official approval.

Third, the PHLX proposes to delete from PHLX rule 1047, Commentary .01(a) and (d) provisions stating "if both puts and calls covering the same underlying security \*\*\* are traded \*\*\*." The PHLX believes that this language may be confusing because both puts and calls trade on almost all PHLX options. The PHLX also proposes to add the language "except as provided below" to Commentary .01(a) to emphasize that Commentary .01(b) contains exceptions to the normal opening rotation procedures.

Fourth, the PHLX proposes to amend Commentary .01(b) to define modified, reverse and shotgun rotations.<sup>7</sup> Specifically, the PHLX proposes to amend Commentary .01(b) by adding paragraph (i), which will: (1) Define a shotgun rotation as opening rotation where each option series opens in the same manner and sequence as during a regular trading rotation,<sup>8</sup> but is permitted to freely trade once all option series with the same expiration month have been opened;<sup>9</sup> (2) state that modified rotations include reverse and shotgun rotations; and (3) define a reverse rotation as an opening rotation

<sup>6</sup> Advice G-2 does not contain a fine schedule. Accordingly, the proposal does not affect the Exchange's minor rule violation enforcement and reporting plan.

<sup>7</sup> Because PHLX Rule 1047A(b) allows specialists to conduct a rotation in accordance with PHLX Rule 1047, Commentary .01(b) and (c), the proposed amendments to Commentary .01(b) and (c) also will apply to index options trading.

<sup>8</sup> PHLX Rule 1047, Commentary .01(a) describes a regular trading rotation as opening the series with the nearest expiration, proceeding to the next most distant expiration, and so forth, until all series have been opened.

<sup>9</sup> This definition currently describes a modified rotation.

<sup>8</sup> 17 CFR 200-30-3(a)(12).

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

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

<sup>3</sup> A trading rotation is a series of brief time periods during which bids, offers and transactions can be made only in specified series.

<sup>4</sup> See Securities Exchange Act Release No. 39332 (November 17, 1997), 62 FR 62652.

<sup>5</sup> Closing rotations in equity options are conducted only at expiration.

<sup>7</sup> 15 U.S.C. 78s(b)(2).

where the specialist first opens series of options of a given class with the most distant expiration, then proceeds to the next nearest expiration and ends with the nearest expiration, until all series have been opened.

Fifth, the PHLX proposes to adopt Commentary .01(b)(ii), which will require the use of a reverse rotation in connection with openings and reopenings involving a heavy influx of orders, unless exempted by two floor officials, with the concurrence of a PHLX market regulation officer. The PHLX states that because most order flow and open interest is generally in the nearest expiration months, starting a rotation with the nearest months may mean that the nearest expiration months are outdated when free trading opens, and, accordingly, will require a subsequent rotation in order to update them. The reverse rotation is designed to produce more prompt openings by eliminating the need for a subsequent rotation of the nearest expiration months. For purposes of this provision, a heavy influx of orders will be determined on a case-by-case basis, in light of order flow through the PHLX's Automated Options Market ("AUTOM") system, the number of floor brokers in the trading crowd indicating handheld orders for the opening, and the number of orders placed on the book, relative to normal conditions for that option.<sup>10</sup>

Sixth, the PHLX proposes to amend Commentary .01(b)(ii) to require that two floor officials, with the concurrence of a PHLX market regulation officer, approve any second or subsequent rotations to ensure that they occur only when warranted. According to the PHLX, subsequent rotations are conducted in situations where the rotation is so time-consuming that certain series, such as those earlier in the rotation, become inundated with additional order flow or become priced incorrectly as the underlying stock price changes. The purpose of this change is to expressly permit additional rotations, but to require floor official approval to ensure proper and limited use.

Seventh, the PHLX proposes to amend Commentary .01(b)(ii) to allow specialists to employ a modified rotation when there is a delayed opening, halt or suspension in trading or other unusual market conditions. The modified rotation a specialist may employ includes, but is not limited to,

<sup>10</sup>The specialist will determine the existence of a heavy influx of orders. Telephone conversation between Michelle Weisbaum, Associate General Counsel, PHLX, and Yvonne Fraticelli, Attorney, OMS, Division, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, on January 22, 1998 ("January 22 Conversation").

a reverse or shotgun rotation.<sup>11</sup> According to the PHLX, this change is intended to facilitate a prompt opening by permitting, although not requiring, a modified rotation in response to certain market conditions. The PHLX believes that floor official approval should ensure that expedited rotations are employed where warranted.

Eighth, the Exchange proposes to amend PHLX Rule 1047, Commentary .01(d). Commentary .01(d) currently provides that when the PHLX's Options Committee decides to conduct a closing rotation on the trading day prior to expiration in an equity option for which the underlying equity did not trade, the rotation must commence as immediately as practicable following the time when the option normally ceases free trading (4:02 p.m.). The proposal will permit an earlier closing rotation for such options. The PHLX believes that, under certain circumstances (e.g., when an underlying stock has not traded for a length of time and there is little chance that the stock will reopen that day), it would be more orderly to conduct the closing rotation during the trading day because the time after the close of trading is particularly hectic, due to final confirmation of all trading activity and the preparation of exercise decisions. The Exchange would notify members of the earlier closing rotation through an announcement on the Exchange's floor.<sup>12</sup>

### 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),<sup>13</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.<sup>14</sup>

Specifically, the Commission believes that the PHLX's proposal to amend PHLX Rule 1074(a) to indicate that opening rotations for equity options are conducted daily will clarify the PHLX's

<sup>11</sup> A specialist must obtain floor official approval to use a modified rotation other than a reverse or shotgun rotation. See January 22 Conversation, *supra* note 10.

<sup>12</sup> Telephone conversation between Michelle Weisbaum, Associate General Counsel, PHLX, and Yvonne Fraticelli, Attorney, OMS, Division, Commission, on November 21, 1997 ("November 21 Conversation").

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> In approving this rule change, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

rule with regard to the frequency of opening rotations. Similarly, the Commission believes that deleting references in PHLX Rule 1047, Commentary .01 (a) and (d) to puts and calls traded on the same underlying security will clarify the PHLX's rules and eliminate potential confusion. Likewise, the addition of the language "except as provided below" to the description in Commentary .01(a) of a specialist's normal procedures during opening rotations will provide additional clarity by emphasizing that Commentary .01(b) provides exceptions to the normal opening rotation procedures.

The Commission also believes that it is reasonable for the PHLX to replace references to "the Exchange" in PHLX Rules 1047 and 1047A and in Advice G-2 with references to "two Floor Officials, with the concurrence of a Market Regulation officer" in order to specify the authority required to approve options trading halts, modified trading rotations, and other procedures. According to the PHLX, the reference to approval by two floor officials will modify the Exchange's rules to reflect the PHLX's current procedures, and requiring the concurrence of a PHLX market regulation officer will ensure prompt notification of the approval and facilitate monitoring by the PHLX staff of the conditions giving rise to the floor officials' approval. The Commission notes that the rules of other options exchanges provide floor officials with similar discretion.<sup>15</sup>

The Commission believes that the amendments to Commentary .01(b) regarding modified trading rotations are reasonable and consistent with the Act. As noted above, the PHLX proposes to amend Commentary .01(b) to revise the definition of a modified rotation and to define reverse and shotgun rotations. The Commission believes that defining reverse and shotgun rotations will help to clarify the PHLX's rules, while defining a modified rotation to include rotations other than reverse and shotgun rotations will provide the PHLX with greater flexibility in conducting modified trading rotations in response

<sup>15</sup> See e.g., CBOE Rule 6.2 (allowing two floor officials to direct that one or more trading rotations be employed on any business day to aid in producing a fair and orderly market; CBOE Rule 6.3 (allowing two floor officials to halt trading in any security in the interests of a fair and orderly market); and American Stock Exchange, Inc. ("Amex") Rule 918, Commentary .01(b) (allowing two floor officials to approve the use of a modified trading rotation in circumstances other than in connection with a delayed opening, halt or suspension of the underlying stock or after delayed openings, halts or suspensions of an option series listed on the Amex).

to market conditions. The Commission notes that the rules of the Chicago Board Options Exchange, Inc. ("CBOE") provide similar flexibility with regard to modified trading rotations.<sup>16</sup>

The Commission also believes that it is reasonable for the PHLX to adopt Commentary .01(b)(ii) which, among other things, will require the use of a reverse trading rotation in connection with openings or reopenings involving a heavy influx of orders, unless exempted by two floor officials with the concurrence of a PHLX market regulation officer.<sup>17</sup> According to the PHLX, the rotation of the nearest expiration months first under normal opening rotation procedures may result in the need for subsequent rotations in order to update the first-rotated months when there is a heavy influx of orders. The reverse rotation is designed to eliminate the need for subsequent rotations of the nearest expiration months by opening the most distant expiration first, then opening the next nearest expiration, until the nearest expiration opens last. The Commission previously has noted the importance of completing opening rotations as quickly as possible in order to allow free trading to commence.<sup>18</sup> Accordingly, the Commission believes that it is reasonable for the PHLX to require a reverse rotation when there is a heavy influx of orders in order to produce a more prompt opening. The Commission believes that it is appropriate for the PHLX to allow flexibility in applying the rule by allowing two floor officials, with the concurrence of a PHLX market regulation officer, to provide an

exemption from the use of a reverse rotation.

Commentary .01(b)(ii) also will allow two floor officials, with the concurrence of a PHLX market regulation officer, to approve a second rotation. According to the PHLX, a subsequent rotation may be conducted when an opening rotation was so time-consuming that some series become inundated with additional order flow or became priced incorrectly as the underlying stock price changed. The Commission believes that allowing floor officials to approve a second rotation will help the PHLX to maintain fair and orderly markets by permitting a second trading rotation when market conditions warrant a second rotation. The Commission believes that requiring the approval of two floor officials, with the concurrence of a PHLX market regulation officer, will help to ensure that second rotations are used appropriately. The Commission notes that the rules of the CBOE also permit additional trading rotations.<sup>19</sup>

Commentary .01(b)(ii) also authorizes the use of a modified rotation in connection with delayed opening, halts, or suspensions of options trading or other unusual market conditions. With floor official approval, specialists may use modified trading rotations other than those defined in Commentary .01(b)(i) (i.e., shotgun and reverse rotations). According to the PHLX, this provision is designed to facilitate a prompt opening by allowing specialists to use a modified rotation in response to certain market conditions. The Commission believes that it is reasonable to provide PHLX specialists with the flexibility to evaluate market conditions and to modify trading rotations in order to facilitate a prompt opening. The Commission believes that proper exercise of this authority should contribute to the protection of investors and the public interest by allowing specialists to respond appropriately to current market conditions. In addition, the Commission notes that the rules of the other options exchanges contain similar provisions requiring or permitting the use of modified trading rotations.<sup>20</sup>

<sup>19</sup> See CBOE Rule 6.2 (allowing two floor officials to direct that one or more trading rotations be employed on any given business day to aid in producing a fair and orderly market).

<sup>20</sup> Amex Rule 918, Commentary .02(b), for example, requires the use of a modified trading rotation in connection with all delayed openings, halts, or suspensions of the underlying stock and after delayed openings, halts or suspensions of any option series listed for trading on the Amex, unless two floor officials approve otherwise. The Amex's rule also permits the use of a modified rotation in other circumstances or in a manner different from

Because PHLX Rule 1047A(b) allows specialists in index options to conduct rotations in accordance with PHLX Rule 1047, Commentary .01 (b) and (c), the changes described in PHLX Rule 1047, Commentary .01 (b) and (c) also will apply to index options trading. The Commission believes it is reasonable to apply these changes to index options in order to provide flexibility in the trading of index options as well as equity options.

Finally, the Commission believes that it is reasonable for the PHLX to amend PHLX Rule 1047, Commentary .01(d) to permit an earlier closing rotation for certain equity options. According to the PHLX, there are circumstances (e.g., when the underlying stock has not traded for a length of time and there is little likelihood that the stock will reopen that day) in which it would be more orderly to conduct a trading rotation during the trading day.<sup>21</sup> Accordingly, the Commission believes that it is appropriate to provide the PHLX with the discretion to conduct an earlier closing rotation in order to help the PHLX to maintain a fair and orderly market.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (File No. SR-PHLX-97-52) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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the procedures described in Commentary .02(b) if two floor officials determine that the procedure should be implemented due to unusual market conditions, such as a heavy influx of orders. See also CBOE Rule 6.2, Interpretation and Policy .01(b) (allowing a Board Broker, Designated Primary Market Maker, or OBO to conduct a modified trading rotation with the approval of two floor officials or at the direction of the appropriate CBOE Floor Procedure Committee); and CBOE Rule 24.13 (allowing an OBO, with the approval of two floor officials, to deviate from any rotation policy or procedure issued by the appropriate Floor Procedure Committee when they conclude in their judgment that such action is appropriate in the interests of a fair and orderly market).

<sup>21</sup> The PHLX will notify members of the earlier closing rotation through an announcement on the Exchange's floor. See November 21 Conversation, *supra* note 12.

<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).

<sup>16</sup> Under CBOE Rule 6.2, for example, an Order Book Official ("OBO") may deviate from any rotation policy or procedure with the approval of two CBOE floor officials. CBOE Rule 6.2, Interpretation and Policy .04 provides that an abbreviated rotation is CBOE Rule 6.2, Interpretation and Policy .04 provides that an abbreviated rotation is one of the deviations from rotation policy or procedure and one of the modifications of the rotation order and manner permitted under CBOE Rule 6.2.

<sup>17</sup> For purposes of this provision, the specialist will determine the existence of a heavy influx of orders on a case-by-case basis, in light of order flow through the PHLX's AUTOM system, the number of floor brokers in the trading crowd indicating handheld orders for the opening, and the number of orders placed on the book.

<sup>18</sup> See Securities Exchange Act Release No. 29869 (October 28, 1991), 56 FR 56537 (November 5, 1991) (order approving File No. SR-PHLX-91-04) (Series Opening Request Ticket procedures adopted by the PHLX will decrease the time required to obtain opening market quotations and allow free trading to commence as quickly as possible after the opening; expedited free trading will allow market makers and customers to engage in various options strategies and will result in the prompt execution of customer orders).