For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[3]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40537; File No. SR–Amex–98–12]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the American Stock Exchange, Inc. Relating to the Trading of Differential Index Options

October 8, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'' or ''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on March 5, 1998, the American Stock Exchange, Inc. (''Amex'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Exchange filed with the Commission amendments to the proposed rule change on April 21, 1998,[3] and September 3, 1998.[4] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

The Amex proposes to trade Differential Index Options, a new type of standardized index option whose value at expiration is based on the relative performance of either a designated index versus a benchmark index, a designated stock versus a benchmark index or a designated stock versus a benchmark stock.

The text of the proposed rule change is available at the Office of the Secretary, Amex 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 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.

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

1. Purpose

The Exchange is proposing to trade a new type of standardized index option, the Differential Index Option, which will offer new investment and hedging opportunities. Differential Index Options will have a value at expiration based on an index, called the ''differential index,'' of the relative performance of a designated index versus a benchmark index over a specific time period (''Index Differential Option''); of a designated stock versus a benchmark index over a specific time period (''Equity Differential Option''); or of a designated stock versus a benchmark stock (''Paired Stock Differential Option'') over a specific time period. If the percent gain in the level of the designated index or stock during the period is greater than the percent gain in the underlying benchmark index or stock, then a Differential Put Option originally struck at the money will have a positive value at expiration and a Differential Put Option originally struck at the money will expire worthless. If the percentage gain in the level of the designated index or stock during the period is less than the percent gain in the underlying benchmark, then a Differential Put Option originally struck at the money will have a positive value at expiration and a Differential Call Option originally struck at the money will expire worthless. Thus, a Differential Index Option affords an investor the opportunity, through a single investment, to participate in the relative outperformance of a designated index or stock versus a benchmark index or stock (a Differential Call Option) or the relative underperformance of a designated index or stock versus a benchmark index or stock (a Differential Put Option) over the life of the option, regardless of the absolute performance of the designated index or stock.

For example, an investor may feel that pharmaceutical companies will outperform the broader market over the next several months, but is unsure whether the overall market will move higher or lower. If the investor were to buy an at-the-money standardized Pharmaceutical Index (''DRG'') call option and the Index declined, the option would expire worthless even if the Index declined by a much smaller percentage than the overall market. On the other hand, if the investor were to purchase an at-the-money Index Differential Call Option on the relative perforce of the Pharmaceutical Index versus the Standard & Poor's 500 Stock Index (''S&P 500''), a benchmark measure of large capitalization stock broad market performance, and DRG declined by a smaller percentage than the S&P 500, the Index Differential Call Option would have a positive value at expiration. Conversely, an investor who believes that DRG will underperform the S&P 500 may purchase at-the-money Index Differential Put Options, perhaps to hedge a portfolio of pharmaceutical stocks against such market underperformance. If DRG

[3] 17 CFR 200.30–3(a)(29).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] *See* Letter to Michael Walinskas, Division of Market Regulation, Commission, from Claire P. McGrath, Amex, dated April 20, 1998 (''Amendment No. 1''). Amendment No. 1 amends the portion of the proposal that refers to settlement values for Differential Index Options where the designated or benchmark security is traded through the Nasdaq system. Amendment No. 1 provides that the price of a Nasdaq security used in determining the settlement value of a Differential Index Option will be equal to the first reported regular-way sale that occurs after the best bid and best offer for that security are unlocked and uncrossed and is greater than or equal to the best bid and less than or equal to the best offer at the time of the reported sale. For designated and benchmark indices, the settlement value of the Differential Index Option will continue to be used on the settlement value for standardized options on the index. Amendment No. 1 also indicates the Exchange's intent to trade flexible exchange-traded options on Differential Index options.

[4] *See* Letter to Richard Strasser, Division of Market Regulation, Commission, from Claire P. McGrath, Amex, dated September 2, 1998 (''Amendment No. 2''). Amendment No. 2 provides information as to what the Exchange will do to make adjustments in value for differential index options contracts when certain corporate events take place in the case of Equity Differential and Paired Stock Differential options, or when significant action has been taken by the publisher of an index in the case of Index Differential options. Amendment No. 2 also clarifies that Differential Index options will open for trading at 10:00 a.m. Furthermore, Amendment No. 2 states that transactions may be effected until 4:15 p.m. for Index Differential options where both the designated and benchmark indexes are broad stock index groups, unless the Board of Governors has established different hours of trading for certain Differential Index options. Amendment No. 2 also provides that, in consultation with the Commission, the Exchange will establish the appropriate option position limit for a Differential Index option, where the Exchange chooses as either a designated or benchmark index, a broad-based index that has been approved by the Commission for index warrant trading only. The position limit for a differential option using a narrow-based index warrant will be established using Amex's narrow-based index option rules. Amendment No. 2 also clarifies that the restrictions of Amex Rule 909I(b) will apply to designated or benchmark stock in Equity Differential or Paired Stock Differential options. Lastly, Amendment No. 2 provides the proposed rule language allowing for flexible exchange-traded options to be traded on Differential Index options.

underperforms the S&P 500, the Index Differential Put Options will have a positive value at expiration, regardless of whether the DRG index level itself has increased or decreased on an absolute basis.

a. *Differential Calculation.* The underlying security for a Differential Index Option is an index (called the ''differential index'') of the performance of the designated stock or index relative to the benchmark stock or index. The differential index is calculated as follows: on December 31 of each year, prior to the listing of a Differential Index Option series, base reference prices are established for the designated index or stock and the benchmark index or stock (typically, the closing levels on a designated business day). Thereafter, percent changes from the base values of both the designated index or stock and the benchmark index or stock are continuously calculated and the percent change in the benchmark is subtracted from the percent change in the designated index or stock, providing a positive number if the designated index or stock has either out-gained or suffered a lesser percentage decline than the benchmark, and a negative number if the benchmark has out-gained the designated index or stock or suffered a lesser percent loss.

The percentage differential in the relative gain or loss is then multiplied by 100 and added to a fixed base index value (typically 100) to yield the differential index which will underlie the Differential Index Options:

$D_t=((I_t/I_{0)-(Bt}/B_0))\times100+F$

Where:

D=differential index
I=designated index or security;
B=benchmark index or security;
t=current or settlement value of index or security;
0=base reference value of index or security;
F=a fixed base index value, typically 100.

Thus, if the designated index or security has outperformed the benchmark by 7%, and the fixed value, F, is set at 100, the differential index value will be 107; if it has underperformed by 7%, the differential index value would be 93. The base reference values will remain in effect for a predetermined, fixed period (expected to be between six months and two years). Similar to other index values published by the Exchange, the value of each differential index will be calculated continuously and disseminated under separate symbol every 15 seconds over the Consolidated Tape Association's Network B.

b. *Designated Indexes, Designated Stocks, Benchmark Indexes and Benchmark Stocks.* Only stocks which meet the current Exchange Rules for listing standardized equity options will be eligible designated stocks in Equity Differential Options. Only stocks which meet the current Exchange Rules for listing standardized equity options will be eligible designated stocks or benchmark stocks in Paired Stock Differential Options. In this way, only the most liquid, actively traded stocks will be considered.

Similarly, only indexes which meet the current Exchange Rules for listing standardized index options and have been approved for options or warrant trading by the Commission will be eligible for designation either as designated indexes or benchmark indexes in Equity and Index Differential Options. In this way, only those indexes already deemed by the Commission to be suitable for options trading will be considered.

c. *Expiration and Settlement.* The proposed Differential Index Options will be European style (*i.e.*, exercises permitted at expiration only), and cash settled. Index Differential Options in which both the designated or benchmark indexes are broad-based will trade between the hours of 10:00 a.m. and 4:15 p.m., New York time.[5] All other Differential Index Options will trade between 10:00 a.m. and 4:02 p.m., New York time. Differential Index Options will expire on the Saturday following the third Friday of the expiration month (''Expiration Friday''). The last trading day in an expiring option series will normally be the second to last business day preceding the Saturday following the third Friday of the expiration month (normally a Thursday). Trading in expiring options will cease at the close of trading on the last trading day.

While the Exchange seeks approval to list series of Differential Index Options as set forth in Rule 9031(a)(i), (ii) and (iii), it is anticipated that the Exchange will initially list only five series with expirations corresponding to the four calendar months in the March cycle in the current calendar year, and a fifth series expiring in March of the following calendar year.

The exercise settlement value for Differential Index Options will be calculated based on the respective exercise settlement values for standardized options on each of the designated and benchmark indexes expiring on the same day. The exercise settlement value for Equity Differential Options will be calculated based on the primary exchange regular-way opening sale price of the designated stock, or, if the stock is traded through the Nasdaq system, the first reported regular-way sale that occurs after the best bid and best offer for that security are unlocked and uncrossed and is greater than or equal to the best bid and less than or equal to the best offer at the time of the reported sale,[6] and the exercise settlement value for standardized options on the benchmark index expiring on the same day. The exercise settlement value for Paired Stock Differential Options will be calculated based on the primary exchange regular-way opening sale prices of the designated and benchmark stocks, or, if the stock is traded through the Nasdaq system, the first reported regular-way sale that occurs after the best bid and best offer for that security are unlocked and uncrossed and is greater than or equal to the best bid and less than or equal to the best offer at the time of the reported sale.[7]

d. *Applicable Exchange Rules.* AMEX Rules 900I through 9800I will apply to the trading of Differential Index Option contracts. These Rules cover issues such as surveillance, exercise prices, and position limits. Surveillance procedures currently used to monitor trading in each of the Exchange's options will also be used to monitor trading in Differential Index Options. In addition, Differential Index Options will be subject to the Exchange's sales practice and suitability rules applicable to standardized options.

The Exchange currently intends to create Differential Index Options using, among others, indexes it has licensed from the Standard & Poor's Corporation. Thus, Rule 902I includes in paragraph (c) a limitation of liability for the Standard & Poor's Corporation. If the Exchange enters into license arrangements with other organizations it may amend Rule 902I to include a similar limitation of liability for other organizations.

Differential Index Options are ''securities'' under Section 3(a)(10) of the Exchange Act, and therefore are exempt pursuant to Section 28(a) of the Exchange Act from any state law that prohibits or regulates the making or promoting of wagering or gaming contracts, or the operation of ''bucket shops'' or other similar or related activities. Differential Index Options will be traded pursuant to the Exchange's rules and rule amendments

[5] *See also* Amendment No. 2, *supra,* note 4.

[6] *See* Amendment No. 1, *supra,* note 3.

[7] *See* Amendment No. 1, *supra,* note 3.

discussed herein, which are subject to prior approval by the Commission.

e. *Position Limits.* The Exchange proposes that the position limits for Index Differential Options be set at the lower of the separate positions limits for standardized index options trading on the designated index and the benchmark index. In the event that one or both of the indexes is not currently the subject of standardized index options trading, but rather has been approved for index warrant trading only, then the Exchange will establish position limits as the lesser of those that would be in effect for standardized options on the indexes if such options were trading.[8] For Equity Differential Options, the Exchange proposes that the position limits be set at the position limit of standardized equity options trading on the designated stock. In the event that standardized options currently do not trade on the designated stock, then the Exchange will establish a position limit at the level that would be in effect if standardized options did trade on such stock. For Paired Stock Differential Options, the Exchange proposes that the position limits be set at the lower of the separate position limits of standardized equity options trading on the designated and benchmark stocks. In the event that one or both of the stocks is not currently the subject of standardized options trading, then the Exchange will establish positions limits as the lesser of those that would be in effect for standardized options on the stocks if such options were trading.

The Exchange also proposes, for position and exercise limit purposes, to require that positions in Differentials with the same designated or benchmark stock or narrowbased index be aggregated. For example, if a Paired Stock Differential option has been created using Intel Corporation stock as the benchmark and Motorola, Inc. as the designated stock, positions in that differential option will be aggregated for position and exercise limit compliance purposes with positions in other Paired Stock Differentials that use one of these two stocks. Furthermore, Equity Differential options using narrow-based indexes versus either Intel or Motorola as the benchmark or designated stocks also will be aggregated for position and exercise limit compliance purposes with positions in Paired Stock Differential options using one of those two stocks. However, with respect to the use of board-based indexes as either the benchmark or designated index in an Equity or Index Differential, no aggregation of positions will be required. For example, if Equity Differentials are created using the S&P 500 Index as the benchmark index and Apple Computer, Inc., Philip Morris Companies, Inc. and Telecommunications, Inc. as designated stocks, members will not be required to aggregate positions in those differentials to determine whether an account is in compliance with position and exercise limit rules.

The Exchange further proposes that Differential Index Options not be aggregated with other standardized options on the underlying designated stock or index nor on the underlying benchmark stock or index for purposes of determining whether an account is in compliance with position and exercise limit rules. The Exchange believes this policy is appropriate for the following reasons. First and foremost, the value Differential Index Options will be calculated in a different manner from the value of other currently trading standardized equity and index options. In fact, because of the subtraction of the benchmark from the designated stock or index, the value of a Differential Index Options may appreciate (depreciate) even as the value of the corresponding standardized option on the designated stock or index decreases (increases). Further, the value of a Differential Index Option is in part a function of the correlation between the designated stock or index and the benchmark (*i.e.,* the tendency of the designated stock or index and the benchmark to move currently). This correlation component of the Different Index Option price is not considered in determing the value of other standardized options on either the designated or benchmark stock or index. As a result, the Differential Index Options is likely to be more or less sensitive to movements in the designated stock or index than the other standardized options on that stock or index, and changes in the Differential Index Option may be in the opposite direction from changes in other standardized options prices. Therefore, any attempt to aggregate Differential Index Options with other standardized options for determination of position limits would be combining contracts which, by nature, can change in value quite differently.

Differential Index Options also have certain terms not found in many other standard equity and index options. Differential Index Options are cash settled, based on opening prices of the designated stock or index and the benchmark and feature European exercise. Each Differential Index Option contract changes in value as a function of the differential performance of a $10,000 long position in the designated stock or index and a $10,000 short position in the benchmark. Many standardized equity options are settled by physical delivery of 100 shares of the underiving stock, worth $5,000 per contract for a $50 stock, and feature American exercise. Standardized index options typically feature European exercise, cash settlement and represent approximately $25,000 worth of a basket of stocks (with the index at the 250 level). Any meaningful aggregation of positions in contracts with different terms would be difficult to established as a simple rule, and would require a case-by-case analysis of the terms for each Differential Index Option contract compared to other standardized contracts on the designated and/or benchmark stock or index.

The Exchange also believes that the aggregation of position limits hinders the probability of success of any new product. The aggregation of positions in Differential Options with positions in standardized options will result in the new product competing with the establishing product for a limited amount of potential volume. Thus, in the Exchange's view, with aggregated position limits, new products cannot ''grow the pie'' and increase overall liquidity in all the products; they start at a disadvantage which may be impossible to overcome.

f. *Customer Margin.* Since Differential Index Options are similar to other index options, the Exchange proposed to apply standard index options margin treatment to Differential Index Options. Index Differential Options on the relative performance of one broad-based index versus another will be margined as broad-based index options and short positions therein will require margin equal to the current market value of the Differential Index Options plus an amount equal to 15% of the market value of the Differential Index reduced by any out of the money amount to a minimum of the current market value of the option plus 10% of the Index. All other Index Differential Options, Equity Differential Options and Paired Stock Differential Options will be margined as narrow-based index options and short

[8] In the event that one or both of the indexes is the subject of index warrant trading only, the position limit for a differential option using a narrow-based index warrant will be established using Amex's narrow-based index option rules. *See* Amex Rule 904C(c). The Exchange will consult with the Commission to establish a position limit for a differential option using a broad-based index warrant. Telephone call between Claire P. McGrath, Vice President and Special Counsel, Amex, and Christine Richardson, Attorney, Commission, September 29, 1998. *See also* Amendment No. 2, supra, note 4.

positions therein will require an amount equal to the current market value of the Differential Index Option plus an amount equal to 20% of the market value of the Differential Index reduced by any out of the money amount to a minimum of the current market price of the options plus 10% of the Index.

The Exchange believes that this method of determining customer margin is appropriate since the range of volatilities expected for Differential Indexes should not be significantly different than the expected range for other indexes and equities. The volatility of a Differential Index is based upon the volatilities of the designated and benchmark indexes or stock and the correlation of these components. The Exchange has constructed two-year Differential Index series for 44 of its most actively traded equity option stocks versus the S&P 500 and for two different index pairs. These combinations cover the range for negatively correlated pairs through uncorrelated pairs to highly correlated pairs. The table included in the Exchange's proposal demonstrates that the volatilities of the Differential Indexes are not significantly different than the underlying indexes and equities, and thus should be margined similarly.

2. Basis

The Exchange believes that the proposal is consistent with Section 6(b) [9] of the Act, in general, and Section 6(b)(5) [10] of the Act, in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments on the proposed rule change were neither solicited nor received.

[9] 15 U.S.C. 78f(b).

[10] 15 U.S.C. 78f(b)(5).

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. 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 in the Commission's Public Reference Room, located at the above address. Copies of such filing will also be available for inspection and copying at the principal office of the self-regulatory organization. All submissions should refer to File No. SR–Amex–98–12 and should be submitted by November 10, 1998.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[11]

Margaret H. McFarland,

Deputy Secretary.

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[11] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–40546; File No. SR–NASD–98–73]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Fees for Subscribers Who Receive Nasdaq Level 1 and Last Sale Data Through Automated Voice Response Services

October 13, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 1, 1998, the National Association of Securities Dealers, Inc. (''NASD''), through its wholly-owned subsidiary, the Nasdaq Stock Market, Inc. (''Nasdaq'') 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 NASD. 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

Nasdaq is proposing to amend Rule 7010 of the NASD to make permanent its current monthly pilot fee for subscribers who receive Nasdaq Level 1 and Last Sale data through automated voice response services. Below is the text of the proposed rule change. Proposed new language is in italics.

* * * * *

(p) Automated Voice Response Service Fee

The monthly charge to be paid by the subscriber for access to Nasdaq Level 1 Service and Last Sale Information Service through automated voice response services shall be $21.25 for each voice port.

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

In its filing with the Commission, Nasdaq 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. Nasdaq has prepared

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.