

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, 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-NYSE-99-02 and should be submitted by February 24, 1999.

V. Commission's Findings and Order Granting Partial Accelerated Approval of Proposed Rule Change

The Commission finds that the proposed rule change relating to the establishment of the Pilot is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission believes the proposal is consistent with the Section 6(b)(5)⁶ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and, in general, to protect investors and the public.⁷

The Commission finds good cause for approving the Pilot prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission believes that the Exchange's listing standard serves as a means for a marketplace to screen Funds and to provide listed status only to bona fide Funds with sufficient net assets. The Commission further believes that the proposed Pilot strikes a reasonable balance between the Exchange's obligation to protect

investors and their confidence in the market and the Exchange's obligation to perfect the mechanism of a free and open market by listing Funds on the Exchange. In addition, the Commission believes that accelerated approval of the Pilot will enable the Exchange to minimize the interruption in its listing of these securities while allowing the Commission adequate time to consider the Exchange's proposal seeking permanent approval of the Pilot.⁸

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁹ that the Pilot program proposed by the Exchange (File No. SR-NYSE-99-02) is approved until April 29, 1999, or until the Commission approves the proposal permanently.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40976; File No. SR-OCC-98-11]

Self-Regulatory Organizations; The Options Clearing Corporation; Order Approving a Proposed Rule Change Regarding the Calculation of the Short Option Adjustment

January 27, 1999.

On September 10, 1998, the Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-OCC-98-11) pursuant to Section 19(b)(1) of the Securities and Exchange Act of 1934 ("Act").¹ Notice of the proposal was published in the **Federal Register** on December 23, 1998.² No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

I. Description

The rule change amends Rules 601 and 602 to enable OCC to use a "sliding scale" to calculate the short option adjustment contained in OCC's

⁸ Approval of the three-month Pilot should not be interpreted as suggesting that the Commission is predisposed to approving the proposal on a permanent basis.

⁹ 15 U.S.C. 78s(b)(2).

¹⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 40800 (December 16, 1998), 63 FR 71179.

Theoretical Intermarket Margin System ("TIMS").³ The short option adjustment is a component of the additional margin calculation in TIMS that imposes a minimum margin amount on deep out of the money short options.

A. Additional Margin Calculation

OCC requires its clearing members to adjust their margin deposits with OCC in the morning of every business day based on OCC's overnight calculations. OCC imposes a margin requirement on short positions in each clearing member account and gives margin credit for unsegregated long positions.⁴ Under TIMS, margin for positions in a class group is based on premium levels at the close of trading on the preceding day and is increased or decreased by the additional margin amount for that class group.⁵

TIMS calculates additional margin amounts using options price theory. TIMS first calculates the theoretical liquidating value for the positions in each class group by assuming either an increase or decrease in the market value of the underlying asset in an amount equal to the applicable margin interval. The margin interval is the maximum one day price movement that OCC wants to protect against in the price of the underlying asset.⁶ Margin intervals are determined separately for each underlying interest to reflect the volatility in the price of the underlying interest.

TIMS then selects the theoretical liquidating value that represents the greatest decrease (where the actual

³ OCC Rule 601 describes TIMS as it applies to equity options ("equity TIMS") and OCC Rule 602 describes TIMS as it applies to non-equity options ("non-equity TIMS").

⁴ A long position is unsegregated for OCC's purposes if OCC has a lien on the position (*i.e.*, has recourse to the value of the position in the event that the clearing member does not perform an obligation to OCC). Long positions in firm accounts and market-maker accounts are unsegregated. Long positions in the clearing member's customers' account are unsegregated only if the clearing member submits instructions to that effect in accordance with Rule 611.

⁵ For purposes of equity TIMS, a class group consists of all put and call options, all BOUNDS, and all stock loan and borrow positions relating to the same underlying security. For purposes of non-equity TIMS, a class group consists of all put and call options, certain market baskets, and commodity options and futures (that are subject to margin at OCC because of a cross-margining program with a commodity clearing organization) that relate to the same underlying asset. A non-equity TIMS class group may also contain stock loan baskets and stock borrow baskets.

⁶ Some combinations of positions can present a greater net theoretical liquidating value at an intermediate value than at either of the endpoint values. As a result, TIMS also calculates the theoretical liquidating value for the positions in each class group assuming intermediate market values of the underlying asset.

⁶ 15 U.S.C. 78f(b)(5).

⁷ In approving this rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

liquidating value is positive) or increase (where the actual liquidating value is negative) in liquidating value compared with the actual liquidating value based on the premium levels at the close of trading on the preceding day. The difference between that theoretical liquidating value and the actual liquidating value is the additional margin amount for that class group unless the class group is subject to the short option adjustment.

B. Short Option Adjustment

For net short positions⁷ in deep out of the money options, little or no change in value would be predicted given a change in value of the underlying interest equal to the applicable margin interval. As a result, TIMS normally would calculate additional margin amounts of zero or close to zero for deep out of the money short options. However, volatile markets could cause such positions to become near to or in the money and thereby could create increased risk to OCC. OCC protects against this risk with an adjustment to the additional margin calculation known as the short option adjustment.⁸

Currently, the short option adjustment requires a minimum additional margin amount equal to twenty-five percent of the applicable margin interval for all unpaired⁹ net short positions in options series for which the ordinary calculation of the additional margin requirement would be less than twenty-five percent of the applicable margin interval. As a result, clearing members are required to deposit margin in excess of the risk presented by some unpaired net short positions in out of the money options.

To address these situations, the rule change establishes a sliding scale short option adjustment methodology. Using the sliding scale, the short option adjustment percentage will be applied to a particular series according to the extent to which the series is out of the money. In addition, OCC will use

⁷ A net position in an option series in an account is the position resulting from offsetting the gross unsegregated long position in that series against the gross short position in that series. After netting, an account will reflect a net short position or a net long position for each series of options held in the account.

⁸ The short option adjustment is described in Rule 601(c)(1)(C)(1) for equity options and Rule 602(c)(1)(ii)(C)(1) for non-equity options. OCC recently amended Interpretation .06 to Rule 602 so that net short non-equity option positions can be paired off against net long non-equity positions whose underlying interests exhibit price correlation of at least seventy percent. Securities Exchange Act Release No. 40515 (September 30, 1998), 63 FR 53970.

⁹ The term unpaired is defined in Interpretation .04 to Rule 601 for equity options and Interpretation .06 to Rule 602 for non-equity options.

different sliding scales for put options and for call options.

The proposed rule change modifies Rules 601 and 602 to provide that the short option adjustment to be applied to any unpaired short position will be determined using a percentage that OCC deems to be appropriate.¹⁰

II. Discussion

Section 17A(b)(3)(F) of the Act¹¹ requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible. The Commission believes that the rule change is consistent with OCC's obligations under Section 17A(b)(3)(F) because it should reduce overcollateralization of OCC's clearing members' positions without impairing OCC's overall protection against member default.

III. Conclusion

On the basis of the foregoing, the Commission finds that the proposed rule change is consistent with the requirements of the Act and in particular with Section 17A of the Act¹² and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-98-11) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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¹⁰ A schedule of the sliding scales that OCC intends to use is attached as Exhibit A to its filing, which is available for inspection at the Commission's Public Reference Room and through OCC. OCC will always specify a minimum short option adjustment percentage. OCC will inform its members of the initial schedule of the sliding scales through an Important Notice and will notify its members of any changes to the schedule.

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² 15 U.S.C. 78q-1.

¹³ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40981; File No. SR-OCC 98-15]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Definition of Stock Fund Shares

January 26, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on November 16, 1998, The Options Clearing Corporation ("OCC") 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 OCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The proposed rule change modifies the definition of "stock fund shares."

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

In its filing with the Commission, OCC 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. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.²

(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 clarify the definition of "stock fund shares" as currently defined in Section 1 of Article 1 of OCC's By-laws³ by replacing the term "common

¹ 15 U.S.C. 78s(b)(1).

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

³ This definition was introduced in a recently approved rule change. Securities Exchange Act Release No. 40595 (October 23, 1998), 63 FR 58438 [File No. SR-OCC-98-08] (order approving rule change relating to OCC's rules and by-laws which govern options on publicly traded interests in unit investment trusts, investment companies, or similar entities holding portfolios or baskets of common stock).