

department or by the exchanges, which use their research departments to monitor the underlying securities and the issuers of the underlying securities. OCC's economic research department regularly scans Bloomberg, Reuters, and Dow Jones newswires for announcements of adjustment events. When it learns of such an event, OCC contacts the options exchanges, the primary market for the underlying, and the issuer of the underlying to obtain more information about the event and to monitor the event. Likewise, the research departments at the various options exchanges scan a variety of newswires and employ different news alert services to monitor for adjustment events. When the exchanges learn of an adjustment event, they alert OCC and contact the primary market for the underlying security to obtain more information about the event to monitor the event.

Through these procedures, the likelihood that a potential adjustment event will escape notice is minimized. However, the possibility of such an occurrence can never be completely estimated. Accordingly, OCC wishes to make clear that neither it nor its securities committee will have liability for any failure to act or for any delay in acting on events not known to the securities committee.

The rule change also clarifies that adjustment determinations are made in light of circumstances known at the time the determination is made. For example, if the securities committee does not learn of an event for which an adjustment would normally be made until after the ex-date, the fact that options trading and/or exercise activity has taken place in circumstances suggesting that there would be no adjustment could tip the balance of fairness against making an adjustment.

## II. Discussion

For the reasons set forth below, the Commission believes that OCC's rule change is consistent with OCC's obligations under section 17A(b)(3)(F)<sup>4</sup> of the Act which requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible. The rule change minimizes OCC's exposure to liability for a delay or failure to adjust an outstanding option contract for an event which it would otherwise have made an adjustment where OCC does not learn or does not learn in a timely manner of the event. By explicitly stating that OCC has

no liability in such situations beyond its control, OCC's rule change allows OCC to focus its resources on safeguarding the securities and funds for which OCC is responsible.

## 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 Section 17A of the Act 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-00-10) be and hereby is approved.

For the Commission by the Division of Market Regulations, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44371; File No. SR-OCC-00-09]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Specific Deposit and Escrow Deposit Programs

May 31, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), notice is hereby given that on, September 8, 2000, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which items have been prepared primarily by OCC. The Commission is publishing this notice and order to solicit comments on the proposed rule change from interested parties and to grant accelerated approval.<sup>1</sup>

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

The proposed rule change adds a provision to OCC's rules to describe specifically how OCC would handle a closing purchase transaction submitted to it in the name of a suspended clearing

member that had been effected to close out or reduce a covered short position. The proposed rule also updates and clarifies OCC's rules that describe how OCC proceeds after suspending a clearing member.

#### 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 these statements.

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

The principal purpose of the proposed rule change is to add a provision to OCC's rules to describe specifically how OCC would handle a closing purchase transaction submitted to it in the name of a suspended clearing member that had been effected to close out or reduce a covered short position. A secondary purpose of the proposed rule change is to update and clarify a few other rules that describe how OCC proceeds after suspending a clearing member. These changes are described under the heading "Other Changes" below.

The rules governing both OCC's escrow deposit program and its specific deposit program permit OCC to have recourse to a deposit if an exercise is assigned to the short position that is covered by the deposit and if the clearing member does not perform on the assignment.<sup>2</sup> Both programs are intended to provide OCC with protection against the risk associated with short positions. The escrow deposit program is intended also to provide the clearing member and the clearing member's correspondent broker, if there is one for a particular customer, with recourse if the clearing

<sup>2</sup> Under OCC's rules, an "escrow deposit" is a deposit made by a clearing member's customer with a bank that has been approved by OCC (referred to as an "escrow bank"), and a "specific deposit" is a deposit made by a clearing member at The Depository Trust Company. When OCC accepts an escrow deposit or a specific deposit, it does so in lieu of requiring the clearing member to deposit margin with OCC, and OCC therefore looks to the deposit to make itself whole if the clearing member fails to perform on an assignment on the short position that is covered by the deposit.

<sup>5</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> A copy of the text of OCC's proposed rule change and the attached exhibit are available at the Commission's Public Reference Section or through OCC.

<sup>4</sup> 15 U.S.C. 78q-1(b)(3)(F).

member or broker performs on an assignment to the covered short position and the customer fails to make settlement with the clearing member or broker.

OCC has identified an area in which the protection afforded to OCC by the two deposit programs should be strengthened. The weakness relates to closing purchase transactions.<sup>3</sup>

Although OCC's rules permit OCC to have recourse to a specific deposit or an escrow deposit if an exercise is assigned to the covered short position and the clearing member fails to perform on the assignment, the rules do not provide OCC with express recourse to the deposit if the clearing member closes out the covered short position by means of a closing purchase transaction and then fails to pay the premium for the closing purchase transaction. When OCC's deposit programs were originally established, OCC's rules permitted it to reject any transaction for which the purchaser failed to pay the premium. If a clearing member failed to pay the premium for a closing purchase transaction covered by a specific deposit or an escrow deposit, OCC could have rejected the closing purchase transaction and caused the short position to remain on OCC's books until it was assigned in which case OCC could have used the deposit to perform on the assignment or until it expired unassigned. Some years ago, however, OCC amended its rules so that it cannot reject trades for nonpayment of premiums.<sup>4</sup> An unintended result of that amendment was to leave OCC without specific authority in its rules to have recourse to a specific deposit or escrow deposit if a clearing member closed out a covered short position and then defaulted on payment of the premium.

In order to remedy this concern, OCC is adding an Interpretations and Policies .01 to Rule 1105 to provide that if a clearing member fails to make premium settlement for an account on any day on which it is obligated to settle a closing purchase transaction in any series in the account, first, OCC will deem the closing transaction first to have closed out any uncovered short positions in the series and second, if the number of cleared securities involved in the transaction exceeds the number of

uncovered short positions in the account, OCC will deem the transaction to be an opening purchase transaction to the extent of the excess even if there are covered short positions carried in the account. The effect of the interpretation would be to expressly allow OCC to maintain the covered short position on OCC's books until the position is assigned or expires unassigned.<sup>5</sup>

#### Other Changes

1. *Rule 1105.* The proposed change in the first paragraph of Rule 1105 is to make clear that Rule 1105 applies to any pending transaction of a suspended clearing member and not just those affected after the time at which the clearing member was suspended.

2. *Rule 1106.* The changes in Rule 1106(a) are to make non-substantive improvements in the language of the rule and to add a reference to any rule that replaces or supplements Rule 1107. This change conforms Rule 1106(a) to the change in the language following Rule 1807 that is described below.

The changes in Rule 1106(b)(2): (1) Eliminate a reference to Rule 1107(a)(2) (because virtually all equity options are settled through the facilities of a designated clearing corporation and therefore subject to Rule 1107(a)(1)); (2) replace a reference to Rule 1807 with a reference to "a provision of the Rules that is specified in the Rules as replacing or supplementing Rule 1107 with respect to particular classes of options" (because Rule 1107 is currently replaced or supplemented by Rule 1705 for yield-based treasury options and by Rule 2306 for cash-settled foreign currency options as well as by Rule 1807 for index options); and (3) add the word "covered" to clarify the intended meaning of the rule.

3. *Rule 1107 and Rule 1807.* The changes in Rules 1107 and 1807 have closely related purposes. Rule 1107(a)(2)

<sup>5</sup> A parallel concern with closing purchase transactions exists for the escrow deposit program at the "clearing/member broker" level. (As stated in the text, the escrow deposit program is designed to provide protection for clearing members and their correspondent brokers as well as for OCC.) OCC's Rule 613(j) as currently in effect and the form of agreement currently used by OCC with banks that act as escrow depositories ("escrow agreement") do not expressly permit the clearing member or correspondent broker to have recourse to an escrow deposit if the customer fails to pay the premium for a closing purchase transaction to the clearing member or broker. The cure for this "clearing member/broker" level weakness requires an amendment to the form of the escrow agreement as well as an amendment to OCC's rules. OCC is preparing a restated form of escrow agreement that will address this concern as well as will make a number of other changes in the form of escrow agreement. OCC intends to file that amended form, together with amendments to Rule 613(j), in the near future.

is amended to delete language currently in that rule that seems to address the closeout of assigned covered index option contracts. This language has no effect because Rule 1807 expressly replaces Rule 1107(a) with respect to index options. The explanatory sentence following Rule 1807 that currently states, "Rule 1807 supplements Rule 1104 and replaces Rule 1107," will be amended to state, "Rule 1807 supplements Rule 1104 and Rule 1107(b) and replaces Rule 1107(a) and (c)." This change is to reflect that Rule 1107(b) is intended to apply to the close-out of assigned covered index option contracts. (Rule 1107(b) authorizes OCC to allocate an assignment if OCC cannot determine promptly upon the suspension of a clearing member whether the clearing member allocated the assignment to a short position for which a specific deposit or an escrow deposit has been made. This concept is relevant for covered index option contracts.) New paragraph (b) to Rule 1807(b) incorporates sentences parallel to the final two sentences of Rule 1107(a)(2). These sentences are simpler than their Rule 1107(a)(2) counterparts because index options are cash-settled and the "delivery" concept is not relevant to index options.

The proposed rule change is consistent with the requirements of Section 17A of the Act and the rules and regulations thereunder applicable to OCC because it enhances OCC's ability to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible.

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

OCC does not believe that the proposed rule change would impose any 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 not and are not intended to be solicited with respect to the proposed rule change, and none have been received.

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

Section 17A(b)(3)(F) of the Act requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is

<sup>3</sup> A "closing purchase transaction" is a transaction in which the purchaser's intention is to eliminate ("close out") or reduce a short position in the series of options involved in the transaction.

<sup>4</sup> Securities Exchange Act Release No. 29853 (October 23, 1991), 56 FR 55968 [File No. SR-OCC-90-05] (approving OCC's proposed rule change relating to the earlier guarantee of options transactions).

responsible.<sup>6</sup> For the reasons set forth below, the Commission believes that OCC's proposed rule change is consistent with OCC's obligations under the Act.

OCC has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of the notice of filing. The Commission finds good cause for so approving the proposed rule change because accelerated approval will permit OCC to immediately give OCC the benefit of protection against such failures to settle. Accordingly, the Commission finds that the rule change is consistent with OCC's obligations to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible because it should provide OCC with strengthened protection against the risk of a suspended member's failure to settle by providing OCC with express recourse to the suspended member's deposits.

#### 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 20549-0609. 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of OCC. All submissions should refer to File No. SR-OCC-00-09 and should be submitted by June 28, 2001.

#### V. 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 Section 17A of the Act 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-00-09) be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 44372; File No. SR-Phlx-2001-59]

#### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Dealing Directly With Specialist and Registered Options Traders in Foreign Currency Options

May 32, 2001.

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> notice is hereby given that on May 30, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III, below, which Items have been prepared by the self-regulatory organization. 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 Exchange proposes to adopt new Phlx Rule 1089 entitled "Dealing Directly With Specialist and Registered Options Trader in Foreign Currency Options" on a one-year pilot basis. The pilot will expire on May 31, 2002.<sup>3</sup> Proposed new language is in *italics*.

\* \* \* \* \*

#### *Dealing Directly With Specialist and Registered Option Trader in Foreign Currency Options*

*Rule 1089.(a) Applicability. The provisions in this Rule are applicable to options on*

<sup>7</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> Telephone conversation between Edith Hallahan, First Vice President & Deputy General Counsel, Phlx, and Florence Harmon, Senior Special Counsel, Division of Market Regulation ("Division"), Commission on May 31, 2001.

foreign currencies and supercede any Rules of general applicability to trading of options which are or may be construed as contrary to or inconsistent with these Rules.

(b) *Non-Customized Foreign Currency Options. In the event that there is no floor broker present to accept and execute orders for non-customized foreign currency options on the trading floor for such options:*

(1) *Market and Limit Orders. Foreign currency options participants and foreign currency options participant organizations may transmit market and limit orders for such options directly to the specialist by telephone or other means. In addition, any person who is not a foreign currency options participant or participant organization may, pursuant to authorization of a foreign currency options participant organization and subject to the consent of the specialist, transmit limit orders, marketable limit orders and market orders for such options directly to the specialist by telephone or other means.*

(2) *Complex Orders. Foreign currency options participants and foreign currency options participant organizations may contact the specialist directly by telephone to negotiate the total debit or credit for transacting a complex order, provided that the specialist is responsible for complying with Rules 1033 and 1066 in setting the price of the individual option legs of the order. In addition, a person who is not a foreign currency options participant or participant organization may, (provided that such person's account is not with the specialist's firm) pursuant to authorization of a foreign currency options participant organization and subject to the consent of the specialist, contact the specialist directly by telephone to negotiate the total debit or credit for transacting a complex order, provided that the specialist is responsible for complying with Rules 1033 and 1066 in setting the price of the individual option legs of the order. Complex orders include orders consisting of two or more option series of non-customized foreign currency options such as spreads, straddles and combinations. In no event shall the specialist accept complex orders for representation or placement onto the specialist's book.*

(c) *Customized Foreign Currency Options. In the event that there is no floor broker present to accept and execute orders for customized foreign currency options on the trading floor for such options; foreign currency options participants and foreign currency options participant organizations may submit a request for quote ("RFQ") under Rule 1069 for a customized foreign currency option directly to an ROT on the floor by telephone or other means, and, if applicable, negotiate a transaction with an ROT. In addition, a person who is not a foreign currency options participant or participant organization may, pursuant to authorization of a foreign currency options participant organization and subject to the consent of the ROT, submit an RFQ under Rule 1069 for a customized foreign currency option directly to an ROT on the floor by telephone or other means, and if applicable, negotiate a transaction with an ROT.*

\* \* \* \* \*

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).