

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the publication of notice thereof in the Federal Register. Amendment No. 1 made clarifying, technical changes to the text of the existing rule, and did not propose new substantive provisions to the proposed rule change. Accordingly, the Commission believes that consistent with Section 19(b)(2), good cause exists to accelerate approval of Amendment No. 1.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1 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 Amendment No. 1 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 Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available at the principal office of the NYSE. All submissions should refer to File No. SR-Amex-96-04 and should be submitted by May 2, 1996.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (SR-Amex-96-04), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,
Deputy Secretary.

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membership to any applicant. In such proceedings, the Commission will review the exchange's decision and has the authority to set aside the decision and require the Exchange to admit such applicant to membership.

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 17 CFR 200.30-3(a)(12).

[Release No. 34-37076; File No. SR-PSE-96-07]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Stock Exchange Incorporated Relating to the General Reorganization and Revision of the Exchange's Membership Rules

April 5, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on March 5, 1996, the Pacific Stock Exchange Incorporated ("PSE" 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 PSE proposes to reorganize and revise PSE Rule 1, *Membership*, and to revise PSE rules 2, 4, 5, and 9.

Exhibit A contains the text of Revised PSE Rule 1, Chart I (which depicts the sources of Revised Rule 1), and Chart II (which depicts where the current rules appear in Revised Rule 1). Exhibit B contains the text of the proposed revisions to PSE rules 2, 4, 5, and 9. Although the exhibits are not being published with this notice, they are available for copying at the PSE 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 these revisions to Rule 1 because much of its language is outdated, inapplicable, or both. Revised Rule 1 more accurately reflects the current procedures and requirements of the Exchange's membership department. While many of the provisions of existing Rule 1 have been kept, they have been reorganized so that the provisions concerning Exchange membership are presented in a more logical and chronological order. In addition, much of Rule 1's language has been rephrased for ease of comprehension. The Exchange has made these changes in order to enable readers to quickly identify the provisions related to a particular membership issue.

As part of its review of the existing provisions of Rule 1, the Exchange's staff also reviewed the membership rules of other exchanges. As described more particularly below, certain provisions from the New York Stock Exchange, Inc. ("NYSE"), the Chicago Board Options Exchange, Incorporated ("CBOE"), and the Chicago Stock Exchange, Incorporated ("CHX") are incorporated in Revised Rule 1.

The Exchange also is proposing to make conforming changes to certain provisions in PSE rules 2, 4, 5, and 9, as well as retitling Rule 9. A summary of the changes, organized by reference to the proposed section numbers, is set forth below.

Rules 1.1(a)-(o); Definitions

A "Definitions" section was added to Revised Rule 1 to provide an explanation of the terms used by the PSE in relation to membership. Many of the definitions already were contained in the PSE Constitution and PSE Rule 4, but the Exchange determined that it would be more practical to place these definitions in alphabetical order at the beginning of Revised Rule 1. The sources for the definitions contained in the proposal are listed in Chart I. The discussion below notes any significant additions or changes to these defined terms.

The definition for "Affiliate" is based on the same definition in SEC Rule 405.² The proposed definition of an "Allied Member" utilizes language from Article V, Section 6, of the PSE Constitution and adds language to cover

² 17 CFR 230.405 (setting forth the definitions applicable to the registration of securities).

¹ 15 U.S.C. 78s(b) (1).

employees and principal executive officers of limited liability companies. The definition for "Approved Person" is based on language from PSE Rule 4.1(n), which was rephrased and includes language to cover persons who contribute 5% or more of a partnership's capital. The definition for "Associated Person," which is based on Article V, Section 7 of the PSE Constitution, adds "member of a limited liability company" and "trustee of a business trust." The definition for "Control," combines language from PSE Rule 4.1(s) and Form BD, Uniform Application for Broker-Dealer Registration. The definition for "Floor Member" is based on existing PSE Rule 1.1(a). The definition of "Good Standing" is based on the definition in Article II, Section 2.2, of the CBOE Constitution.

The definition for "Inactive Lessor" is based on the "inactive member" language currently in the "Member" definition in Article V, Section 3, of the PSE Constitution. The definition for "Inactive Lessor" was further amended by the Board of Governors on January 25, 1996 to eliminate the broker-dealer registration requirement for firms (partnerships, corporations, limited liability companies) acting solely as lessors and who are not conducting business for which broker-dealer registration is required. Under the existing definition for "Inactive Member," broker-dealer registration is not required for individual seat owners, but is required for all others. A review of other exchanges' rules disclosed that the CBOE and the American Stock Exchange, Inc. ("Amex") do not require broker-dealer registration for inactive lessors, regardless of whether they were individuals, partnerships, corporations, or other entities.³

The definitions for "Member," "Member Firm," and "Member Organization" are from the PSE Constitution, Article V, Sections 3, 4, and 5, respectively. The definition for "Nominee" simply refers the reader to Article VIII, Section 2(d), of the PSE Constitution. The definition for "Non-Resident Member Organization" was included because of the new provision in Revised Rule 1.16, *Responsibilities of Non-Resident Member Organizations*. The definition is based on the definition of Non-Resident Broker Dealers in SEC

Rule 17a-7.⁴ The definition for "Parent" is new and is based on the same definition in SEC Rule 405.⁵ Finally, the definition for "Person," based on PSE Rule 4.1(t), adds "limited liability company" and "trustee of a trust fund" to the definition.

Rules 1.2 and 1.3: Public Securities Business

Revised Rule 1.2, *Public Securities Business*, is new to the PSE. This new language was included to require members to use their memberships for trading, either directly or indirectly through the execution of a lease agreement. This provision, which is based on CBOE Rule 3.1, is designed to assist the Exchange in addressing problems associated with unassigned memberships. The proposal reserves Rule 1.3 for future use.

Rules 1.4 to 1.9: Qualifications and Application for Membership

The existing provisions relating to qualification and application for membership were completely reorganized to set forth the Membership Department's requirements in a more orderly and chronological manner. The reorganization is designed to make the provisions easier to follow and understand. In addition to the PSE's current membership requirements, the proposal also adds proposed rules 1.4, 1.5, 1.7, and 1.8.

Revised Rule 1.4, *Qualifications of Individual Members*, which is based on CBOE Rule 3.2 and Article VI, Section 1 of the PSE Constitution, and Revised Rule 1.5, *Qualifications of Member Organizations*, which is based on CBOE Rule 3.3, establish some of the basic requirements necessary for Exchange membership. They require that all members and member organizations, except "Inactive Lessors," must be registered pursuant to Section 15⁶ of the Act.⁷ In addition, Revised Rule 1.5(b) requires member firms who own or lease a membership to designate a natural person as its member. When a member confers the privileges of membership on a member firm, Revised Rule 1.5(c) requires that member to be the firm's designated representative and prohibits members from representing more than one member organization.

In addition to the authority contained in Current Rule 1.4, Revised Rule 1.7,

Denial of and Conditions to Membership, which is based on PSE Rule 1.4 and CBOE Rule 3.4, grants the Membership Committee greater discretion when reviewing applications. The proposal contains two new grounds for denying or conditioning membership—an applicant, either directly or indirectly, has engaged in conduct that would bring the Exchange into disrepute or any other reasonable cause the Membership Committee may decide. In addition, the Membership Committee may toll the approval process while an applicant is the subject of an investigation by any self-regulatory organization or government agency and may take action against a member if any of the reasons for denying or conditioning membership comes into existence after a member has been approved and has become effective.

Revised Rule 1.8, *Effectiveness of Membership Applications*, which is based on CBOE rules 3.10 and 3.11, requires all approved applications to be activated by the applicant within six months⁸ and requires the Exchange to provide all members with notice of all newly effective memberships.

The proposal reserves 1.9 for future use.

Rules 1.10 to 1.20: Requirements of Membership

This new section pulls together the obligations of members and member organizations from different locations and describes particular requirements for sole proprietors, corporations, partnerships, and limited liability companies. New to the PSE are proposed rules 1.10(a), 1.10(b), 1.11(a)–(c), 1.16, and 1.17(a). The proposal reserves 1.13, 1.15, and 1.20 for future use.

Revised Rule 1.10(a), which is based on CHX Article I, Rule 1(b), prohibits sole proprietors from carrying public customer accounts, and Revised Rule

⁸ The Commission notes that Revised Rule 1.8(a) conflicts with Article VI, Section 3, of the PSE Constitution. The proposal states that approved applications must be activated by the applicant within six months, while the PSE Constitution provides that admission to membership automatically becomes effective after an approved application has been posted for 10 days.

In addition, Revised Rule 1.6(b) conflicts with Article VI, Section 2, of the PSE Constitution. The PSE Constitution requires that the name of the applicant be posted after it has been approved. The proposal, however, requires the name of all applicants to be posted within a reasonable time after receipt and before being approved.

The Exchange anticipates rectifying this situation in September of 1996. Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Anthony P. Pecora, Attorney, SEC (Mar. 22, 1996).

³ See American Stock Exchange Guide (CCH) ¶ 9174 (excepting applicants desiring only to own a membership from the broker-dealer registration requirement); CBOE Rule 1.1 (ff) (prohibiting lessors from conducting a public securities business); CBOE Rule 3.2 (excluding lessors from the broker-dealer registration requirement).

⁴ 17 CFR 240.17a-7 (setting forth additional recordkeeping requirements that are applicable to nonresident brokers and dealers).

⁵ 17 CFR 230.405 (setting forth the definitions applicable to the registration of securities).

⁶ 15 U.S.C. 78o.

⁷ See discussion *supra* concerning the new definition of "Inactive Lessor."

1.10(b) prohibits sole proprietors from registering a membership in the name of a nominee.

Revised rules 1.11(a)–(c), which are based on NYSE rules 311(a) and 312(a), are designed to give the Exchange greater oversight of allied members and approved persons. Revised Rule 1.11(a) provides that allied members and approved persons are subject to Exchange approval and that the Exchange must receive written notice, all applicable fees, and all necessary information before an allied member or approved person will be admitted. Revised Rule 1.11(b) prohibits a firm from remaining a member firm unless all persons required to be approved are in fact approved, and the member firm continues to meet all of the prescribed membership requirements. Revised 1.11(c) requires that the Exchange promptly receive written notice of the dissolution of a member firm, as well as written notice of the death, retirement, or other termination of any member, allied member, or approved person.

Revised Rule 1.16, *Responsibilities of Non-Resident Member Organizations*, is based on CHX Article I, Rule 1(g) and, in accordance with SEC Rule 17a–7,⁹ places additional requirements on members that do not maintain an office in the United States that is responsible for preparing and maintaining financial and other reports required to be filed with the SEC.

Revised Rule 1.17(a), which is based on CHX Article III, Rule 4, codifies and clarifies the continuing obligation of member firms to file copies of amendments to their formation documents with the Exchange.

Rules 1.21 to 1.25: Purchase, Sale, Transfer, and Lease of Membership

The provisions relating to the purchase and sale of memberships are essentially unchanged in substance. Of particular note, however, are proposed rules 1.21(b), 1.22(a), and 1.23 because they either are new to the PSE or modify existing responsibilities.

Revised Rule 1.21(b), which is based on CBOE Rule 3.13(b), requires the Exchange to post the highest bid with the earliest submission date on the Exchange bulletin board for six months. Likewise, Revised Rule 1.22(a), which is based on CBOE Rule 3.14(a), requires the Exchange to post the lowest offer with the earliest submission date on the

Exchange bulletin board for six months. When a bid filed in accordance with the provisions of Revised Rule 1.21, *Purchase of Membership*, is matched with an offer filed in accordance with the provisions of Revised Rule 1.22, *Sale of Membership*, neither can be changed or withdrawn.

In addition to the types of transfers already defined in the PSE rules, Revised Rule 1.23, *Transfer of Membership*, adds "Succession of member organization" to the list of permissible interfirm transfers. This rule, which is based on CBOE Rule 3.14(c) and PSE Rule 1.10(a), allows a membership to be transferred from a member organization to an organization that succeeds through statutory merger, exchange of stock, or acquisition of assets to the business of the transferring membership organization.

The proposal reserves 1.25 for future use.

Rules 1.26–1.27: Employees of Member Organizations

Revised rules 1.27 (a), (b), (c), and (d) represent language new to the Exchange. Revised Rule 1.27(a), which is based on PSE Rule 5.1(a) and NYSE Rule 35, clearly states that all employees of member organizations seeking admission to the Floor must first be approved by the Exchange. Revised Rule 1.27(c) is based on NYSE rules 35 and 346(f) and requires every member organization to take reasonable care to determine the existence of a statutory disqualification.¹⁰ To assist member organizations in fulfilling this duty, Revised Rule 1.27(b), which is based on CSE Article V, Rule 3, Interpretation .2 and NYSE Rule 35, supplementary material .60, requires all floor employees to submit fingerprints and to complete an application form that includes those questions from the Form U–4 that would aid member organizations in determining whether an individual is subject to a statutory disqualification. In addition, the application must be signed by the member firm. Revised Rule 1.27(d) codifies the Exchange's policy requiring a member firm with an employee on one of the PSE's trading floors to have at least one member present on the trading floors at all times. The Exchange believes these provisions will help member organizations and the PSE identify persons who are subject to a statutory disqualification and, in

addition, enhance the overall security on the PSE's trading floors.¹¹

Provisions Removed from Existing PSE Rule 1

In updating the PSE's rules, Revised Rule 1 omits certain requirements that presently are contained in Rule 1. Specifically, the proposal is deleting provisions from 1.1(b), 1.1(c), 1.1(d), 1.1(f), 1.6(a), 1.6(e), 1.10, 1.14, 1.16(e), and 1.17(f).

Rule 1.1(b), *Eligibility*, requires, among other things, that a Floor Member have at least six months experience on the Floor of the Exchange, unless such experience requirement is waived by the Floor Trading Committee. Rule 1.1(c), *Registration of Floor Members*, provides for the possibility of a written exam for floor members; these requirements are not contained in Revised Rule 1 because they are beyond the scope of this rule. These requirements concern

qualifications to act on the Floor and, therefore, should be covered by the Floor Trading Committee's rules.¹²

Rule 1.1(d), which requires Board approval of applications to become a Floor Member, and Rule 1.1(f), which requires member organizations to cancel approved Floor Member applications in writing, are both being deleted because the Exchange considers them unnecessary.

Rule 1.6(a)(1) requires that a majority of a member's Board of Directors be either members or allied members. Rule 1.6(a)(2) requires that at least one director of a member firm be a member of the Exchange. The proposal deletes both of these requirements.¹³

The proposal omits Rule 1.6(e)'s prohibition on member firms acting as floor brokers from having any freely transferable security outstanding. The Exchange believes this requirement is unnecessary because it does not anticipate being the Designated Examining Authority for these types of firms.

In order to avoid the confusion caused by having some of the PSE's fees listed in both its rules and in its fee schedule, the proposal omits all references to the fees currently enumerated in Rule 1.10.¹⁴ Also, the fee reductions in Rule

¹¹ See Securities Exchange Act Release No. 33045 (Oct. 14, 1993), 58 FR 54179 (approving File No. SR-NYSE-93-28).

¹² Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Glen Barrentine, Team Leader, SEC (Nov. 24, 1995).

¹³ The Commission notes that the proposal would permit a majority of a member firm's directors to be approved persons, and a member firm's Board could be devoid of members.

¹⁴ Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Anthony P.

⁹ 17 CFR 240.17a–7 (requiring nonresident brokers and dealers to maintain books and records in the United States that comply with all of the Commission's rules and regulations or to grant the Commission an irrevocable power of attorney to demand such books and records be provided within 14 days after the Commission's written request).

¹⁰ See 15 U.S.C. 78c(a)(39) (listing categories of people that are statutorily disqualified).

1.10 that pertain to the Options Funding Plan of 1975 are being deleted because they are no longer relevant.¹⁵

The rules pertaining to "Special Memberships," rules 1.14 (a)–(c), are being deleted because they are no longer necessary.¹⁶

Rule 1.16(e) allows the Exchange to waive certain rules concerning officers and employees, as long as the member or member organization is a member of another national securities exchange having comparable requirements. The rules, however, do not permit the waiver of the requirement that members and member organizations promptly notify the Exchange of the employment or termination of employment of a registered employee in California. The proposal deletes this reporting obligation.

Rules 1.17(f) and 1.17(g) pertain to the giving of gifts and gratuities by members to employees of other members and to employees of the Exchange. The rules currently require that the Exchange and, when relevant, the recipient's employer give their prior consent. The proposal modifies this policy by requiring prior Exchange consent only when a member wants to give a gift to an Exchange employee. The Exchange has not been requiring members to obtain the Exchange's prior consent when members were giving gifts to employees of other members.¹⁷ Therefore, the Exchange proposes to conform its rules to its current practice.

Pecora, Attorney, SEC (Mar. 22, 1996). The Commission notes that numerous discrepancies between the PSE's rules and its fee schedule currently exist. For example, the initial membership fee in PSE Rule 1.10(a)(i)(A) is "5 percent of the average purchase price *plus* the two preceding seat sales," while the fee schedule sets the initial membership fee at "5 percent of the *average* price of the last *three* membership sales, with a minimum of \$1,000 and a maximum of \$4,000." (Emphasis added). See also PSE Rule 1.10(c)(i) (no minimum or maximum); PSE Rule 1.10(c), cmt. 01 (\$350 minimum and \$3,500 maximum).

¹⁵ Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Glen Barrentine, Team Leader, SEC (Nov. 24, 1995).

¹⁶ Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Glen Barrentine, Team Leader, SEC (Nov. 24, 1995). Special Memberships were special nonvoting memberships created by the PSE in 1987 that allowed the holder to trade only in options overlying the Financial News Composite Index, the PSE High Technology Index, and such other new products as may be determined by the Exchange's Board. These memberships were scheduled to expire on December 29, 1987. See Securities Exchange Act Release No. 24516 (May 27, 1987), 52 FR 20659 (approving the issuance of the Special Memberships).

¹⁷ Telephone conversation between Rosemary A. MacGuinness, Senior Counsel, PSE, and Anthony P. Pecora, Attorney, SEC (Mar. 22, 1996).

PSE Rules 2, 4, 5, and 9

In order to accommodate the revisions to Rule 1, certain changes need to be made to other existing PSE rules. Rules 1.6(b), *Owners of 5% or More Equity Securities*, 1.6(d), *Change in Stockholder Status*, 1.6(g), *Trading in Firm's Securities*, 1.6(h), *Change in Capitalization*, 1.6(j), *Conditions for Issuance of Freely Transferable Securities*, 1.6(k), *Limitations on Issuance of Freely Transferable Securities*, 1.6(l), *Voting Agreement*, and 1.6(o), *Participation in Member Firms*, are being relocated to Rule 2.3. Rule 1.8, *Fidelity Bonding Requirements*, is being relocated to Rule 2.25.

Because certain provisions already appear in Revised Rule 1, the following duplicative sections are being deleted from the current rules: 4.1(h), *Member*, 4.1(i), *Member Firm*, 4.1(j), *Member Organization*, 4.1(n), *Approved Person*, 4.1(s), *Control*, 4.1(t), *Person*, and 5.1(a), *Floor Clerks*.

Rule 9 is being retitled from "Conduct of Accounts" to "Conducting Business with the Public." In addition, rules 1.15(a), *Register with Exchange*, 1.15(b), *Joint Quarters*, 1.15(c), *Office Supervision*, 1.15(d), *Employee Supervision*, 1.17(a), *Guarantees*, 1.17(b), *Sharing Profits—Losses*, 1.17(c), *Compensation Rebate*, 1.17(d), *Member Compensation Only*, are being relocated to Rule 9.1. Also, rules 9.1(a)–(c) are being renumbered 9.2(a)–(c). Finally, Rule 9.2 is being renumbered to 9.3(a), and Rule 9.3 is being renumbered to 9.3(b).

Exhibit B depicts all of these changes along with the required renumbering changes.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) ¹⁸ of the Act in general and furthers the objectives of Section 6(b)(5) ¹⁹ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

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

The Exchange believes the proposed rule change will impose no 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

Revised Rule 1 was submitted to the Membership Committee for their review. Exchange Staff met with members of the Membership Committee to discuss their recommendations, many of which are incorporated into Revised Rule 1.

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

Within 35 days of the 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 the 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., 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 at the Commission's Public Reference Section, 450 Fifth Street NW., Washington, D.C. 20549. Also, copies of such filing will be available for inspection and copying at the principal office of the PSE. All submissions should refer to File No. SR-PSE-96-07 and should be submitted by May 2, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

²⁰ 17 C.F.R. 200.30-3(a)(12).

Margaret H. McFarland,
Deputy Secretary.
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[Release No. 34-37077; File No. SR-Phlx-95-86]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Index Options Exercise Advices

April 5, 1996.

I. Introduction

On December 28, 1995, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend Phlx Rule 1042A, Exercise of Option Contracts, and Floor Procedure Advice ("Advice") G-1, Exercise Requirements. The Phlx proposes to extend the deadline for the receipt or preparation of a memorandum to exercise, as well as the submission of an exercise advice form, from five minutes after the close of trading to 4:30 p.m. In addition, as minor changes to paragraph (ii) will result in the inclusion of the National Over-the-Counter Index option, Phlx Rule 1042A(a)(iii) will be deleted.

The proposed rule change appeared in the Federal Register on February 27, 1996.³ No comments were received on the proposed rule change. This order approves the Phlx's proposal.

II. Background and Description

Phlx Rule 1042A and Advice G-1 govern the exercise of index options. These provisions state that with respect to index option contracts, clearing members are required to follow the procedures of the Options Clearing Corporation ("OCC") for tendering exercise notices. Phlx member organizations are also required to comply with the following procedures. First, a memorandum to exercise any American-Style index option must be received or prepared by the Phlx member organization no later than five minutes after the close of trading on the day of exercise. Thus, the current deadline is 4:15 p.m. for narrow-based index options and 4:20 p.m. for broad-based index options. Second, when exercising 25 or more American-style

index option contracts, other than an option contract on the National Over-the-Counter Index, submission of an exercise advice form to the Exchange is required no later than five minutes after the close of trading on the day of exercise. Third, with respect to options on the National Over-the-Counter Index, the deadline for compliance with the above provisions is 4:20 p.m. or five minutes after the close of trading.

Pursuant to Phlx Rule 1042A(b), however, the above requirements are not applicable with respect to any series of stock index options on the last day of trading prior to the expiration date of such series of options. The above stated requirements are also not applicable to European-style index options which, by definition, cannot be exercised prior to expiration. Lastly, the Exchange notes that the procedures for exercising equity option contracts contained in Phlx Rule 1042, are not affected by this rule proposal.

The Phlx proposes to establish a 4:30 p.m. deadline for both a memorandum to exercise and exercise advice forms for all index options. This will extend the cut-off time by 15 minutes for narrow-based index options and by 10 minutes for broad-based index options. According to the Phlx, the purpose of this rule change is to provide additional time for the preparation and transmission of the required exercise information. After the close of trading, index option position holders are not instantly aware of their final positions, including hedges in the underlying security and futures contracts. According to the Phlx, knowing the exact, final position is often crucial to making a determination of whether to exercise.

In addition, the current procedure for these submissions presents logistical problems for compliance within five minutes after the close of trading. For example, the distance between trading stations for certain index options on the Phlx trading floor (e.g., Gold/Silver Index) and the depository for advice submissions is not easy to traverse within five minutes, especially at the close of trading when there is a great deal of movement on the trading floor. If a trade occurs during the final minute of trading, this situation is exacerbated since additional time might be used to ensure that the trade ticket and participation was properly submitted. And, as stated above, reports from futures orders placed to hedge option positions must still be ascertained, usually by going to another location on the floor (e.g., the booth where telephones and clerks are located). The

Phlx believes that it is in the interest of order and safety to change this process.

The Phlx believes that the current deadline not only creates time pressure and uncertainty, but may also force index option traders not to participate in large or complex trades, especially near the close, thereby hampering liquidity. The Phlx believes that the extra time is reasonable under these circumstances.

Lastly, to improve clarity, the Exchange proposes to delete paragraph (a)(iii) of Phlx Rule 1042A and incorporate the exercise requirements pertaining to options on the National Over-the-Counter Index in paragraph (a)(ii).

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, with the requirements of Section 6(b)(5),⁴ in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and will serve to protect investors and the public interest. Specifically, the Commission believes that the amendments to Phlx Rule 1042A and Advice G-1 to extend the deadline for submitting exercise advice forms will benefit market participants by allowing them to make investment decisions based on the evaluation of their final positions after having completed trading for the day.

The Commission also believes that the proposal will benefit the market in general by fostering higher quality markets at the close of the trading day. First, market makers will not be preoccupied with the process of submitting exercise advice forms prior to the actual close of the market and, therefore, can concentrate more fully on proving a quality market at the close. Second, market participants will be able to determine whether or not their orders on other related markets were executed, such as orders intended to hedge their options positions. If their hedging transactions in other markets are not executed by 4:30 p.m., then, under the proposal, market participants will still be able to exercise their options positions and not remain in an unhedged position. Third, the proposal will give market participants additional time to evaluate the closing prices of the stocks that are used to calculate the indexes and determine whether or not to exercise their positions.

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 36862 (February 20, 1996), 61 FR 7297 (February 27, 1996).

⁴ 15 U.S.C. 78f(b) (1988).