available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of OCC. All submissions should refer to the file number SR–OCC–96–02 and should be submitted by March 19, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR–OCC–96–02) be, and hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[6]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–4311 Filed 2–26–96; 8:45 am]

BILLING CODE 8010–01–M

[Release No. 34–36858; File No. SR–PHLX–95–45]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1, 2, and 3 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Industry Index Option Hedge Exemption

February 16, 1996.

On September 18, 1995, the Philadelphia Stock Exchange, Inc. (''PHLX'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''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 1001A, ''Position Limits,'' to establish a hedge exemption from industry (narrow-based) index option position and exercise limits.[3]

The proposed rule change was published for comment in the Federal Register on October 23, 1995.[4] No comments were received on the proposed rule change. On December 20, 1995, on February 14, 1996, and on February 16, 1996, the PHLX amended its proposal.[5]

The PHLX proposes to exempt from position and exercise limits any position in an industry index option that is hedged by share positions in at least 75% of the number of component stocks of that index or securities convertible into such stock.[6] Under the proposal, no position in an industry index option may exceed two times the narrow-based index option position specified in PHLX Rule 1001A(b)(i)[7] and the value of the index option position may not exceed the value of the underlying hedging portfolio. The value of the underlying hedging portfolio is determined as follows: (1) the total market value of the net stock position, less (2) the value of: (a) the notional value[8] of any offsetting calls and puts in the respective index option class; (b) the notional value of any offsetting positions in stock index futures or options; and (c) any economically equivalent positions.[9]

Under the proposal, exercise limits will continue to correspond to position limits, so that investors may exercise the number of contracts set forth as the position limit, as well as those contracts exempted by the proposal, during five consecutive business days.

The proposed exemption requires that both the options and stock positions be initiated and liquidated in an orderly manner. Specifically, a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position.

The proposed exemption will be available to firm and proprietary traders, as well as public customers. According to the PHLX, because customers rely, for the most part, on a limited number of proprietary traders to facilitate large-sized orders, failure to include such traders in the exemption could effectively reduce the benefit of the exemption to customers.

The PHLX believes that the hedge exemption provision is necessary to better meet the needs of investors who would use PHLX industry index options for investment and hedging purposes. The PHLX states that many institutional traders and portfolio managers deal in dollar amounts much greater than permissible under current position limit levels and have expressed that Exchange position limits hamper their ability to fully utilize Exchange index options. As a result, the PHLX believes that many index options are ineffective for such traders, who may as a result choose to

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6 17 CFR 200.30–3(a)(12) (1995).

1 15 U.S.C. 78s(b)(1) (1988).

2 17 CFR 240.19b–4 (1995).

3 Position limits impose a ceiling on the number of option contracts which an investor or group of investors acting in concert may hold or write in each class of options on the same side of the market (*i.e.,* aggregating long calls and short puts or long puts and short calls). Exercise limits prohibit an investor or group of investors acting in concert from exercising more than a specified number of puts or calls in a particular class within five consecutive business days.

4 *See* Securities Exchange Act Release No. 36380 (October 17, 1995), 60 FR 54403.

5 On December 20, 1995, the PHLX amended its proposal to specify certain requirements and monitoring procedures which the Exchange will use in connection with the hedge exemption. *See* Letter from Gerald D. O'Connell, First Vice President, Market Regulation and Trading Operations, PHLX, to Michael Walinskas, Branch Chief, Office of Market Supervision (''OMS''), Division of Market Regulation (''Division''), Commission, dated December 20, 1995 (''Amendment No. 1''). Among other things, Amendment No. 1 indicates that the PHLX will monitor accounts utilizing the hedge exemption on a daily basis; that the hedging portfolio must be previously established and that options must be carried in an account with an Exchange member; that initiating or liquidating positions should not be conducted in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; and that the PHLX's Market Surveillance Department must be notified of any material change in the portfolio or futures positions which materially affects the unhedged value of the portfolio. Amendment No. 2 modifies the proposal by providing that the industry index hedge exemption will be two times the existing position and exercise limit rather than three times the limit because the hedged option position is held in addition to the contracts currently permitted under the Exchange's rules. In addition, Amendment No. 2 indicates that offsetting positions in stock index futures options must be deducted from the total market value of the net stock position to determine the value of the hedging portfolio. *See* Letter from Gerald D. O'Connell, First Vice President, Market Regulation and Trading Operations, PHLX, to Michael Walinskas, Branch Chief, OMS, Division, Commission, dated February 14, 1996 (''Amendment No. 2''). On February 16, 1996, the PHLX amended its proposal by adding subparagraph (C) to paragraph (b)(2) of Commentary .01 in order to make clear that economically equivalent positions must be deducted from the market value of the net stock position to determine the value of the underlying portfolio. *See* Letter from Gerald D. O'Connell, First Vice President, Market Regulation and Trading Operations, PHLX, to Michael Walinskas, Branch Chief, OMS, Division, Commission, dated February 16, 1996 (''Amendment No. 3'').

6 The PHLX permits the use of convertible securities in its equity option hedge exemption. *See* Securities Exchange Act Release No. 32174 (April 20, 1993), 58 FR 25687 (April 27, 1993) (order approving File No. SR–PHLX–92–22). Similarly, other options exchange permit the use of convertible securities in broad-based index hedge exemptions. *See* Securities Exchange Act Release No. 35738 (May 18, 1995), 60 FR 27573 (May 24, 1995) (File Nos. SR–Amex–95–13, SR–CBOE–95–13, SR–NYSE–95–04, SR–PSE–95–05, and SR–PHLX–95–10) (permanently approving hedge exemption pilot programs).

7 PHLX Rule 1001A(b)(i) provides the following position limits for industry index options: 6,000 contracts if any single stock accounted, on average, for 30% or more of the index value during the 30-day period preceding the review; 9,000 contracts if any single stock accounted, on average, for 20% or more of the index value or any five stocks together accounted, on average, for more than 50% of the index value, but no single stock in the group accounted on average, for 30% or more of the index value during the 30-day period preceding the review; or 12,000 contracts if none of the above conditions apply. *See* Securities Exchange Act Release No. 36194 (September 6, 1995), 60 FR 47637 (order approving File No. SR–PHLX–95–16) (increasing position limits for industry index options to 6,000, 9,000 or 12,000 contracts).

8 Notional values are determined by adding the number of contracts and multiplying the total by the multiplier, expressing that number in dollar terms.

9 *See* Amendment Nos. 2 and 3, *supra* note 5.

use futures instruments.[10] Thus, the PHLX believes that the proposed hedge exemption should alleviate the situation where investors with substantial hedging needs are discouraged from participation in the options markets by existing position limits.

The PHLX believes that the proposed narrow-based index option hedge exemption should not increase the potential for disruption or manipulation in the markets for the stocks underlying each index. In this regard, the proposal incorporates several surveillance safeguards, which the PHLX will employ to monitor the use of this exemption. Specifically, the Exchange will require that an application for exemption be filed by member firms and their customers who seek hedge exemptions. The Exchange will review the application and approve only those applications that satisfy the hedge exemption requirements. The Exchange's Market Surveillance Department will monitor trading activity in PHLX-traded index options and the stocks underlying those indexes to detect potential frontrunning and manipulation abuses, as well as review such trading to ensure that the closing of positions subject to an exemption is conducted in a fair and orderly manner.[11]

The PHLX also notes that the provision itself contains several built-in safeguards. First, the hedge must consist of a position in at least 75% of the stocks underlying the index. Thus, the ''basket'' of stocks constituting the hedge resembles the underlying index.[12] Second, the proposal provides a ceiling on the maximum size of the option position by providing that positions established under the proposal may not exceed two times the limits established under PHLX Rule 1001A(b)(i). Third, both the options and stock positions must be initiated and liquidated in an orderly manner, meaning that a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position. Lastly, the value of the industry index option position cannot exceed the dollar value of the underlying hedging portfolio. The purpose of this requirement is to further ensure that stock transactions are not used to manipulate the market in a manner benefiting the option position. In addition, these safeguards prevent the increased positions from being used in a leveraged manner by ensuring that the options position subject to the increased position limit is properly ''covered'' by the hedge.

For the above reasons, the PHLX believes that the proposed industry index hedge exemption should increase the depth and liquidity of the markets for narrow-based index options and allow more effective hedging with underlying stock portfolios without increasing the potential for market manipulation or disruption, consistent with the purposes of position and exercise limits.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) thereunder.[13] The Commission concludes that providing for increased position and exercise limits for narrow-based index options in circumstances where those excess positions are fully hedged with offsetting stock positions will provide greater depth and liquidity to the market and will allow investors to hedge their stock portfolios more effectively, without significantly increasing concerns regarding intermarket manipulations or disruptions of either the options market or the underlying stock market.

Specifically, the PHLX proposal contains safeguards that should make it difficult to use the exempted positions to disrupt or manipulate the market. First, requests for the exemption must be approved by the PHLX, which should ensure that the hedges are appropriate for the position being taken and are in compliance with PHLX rules. Second, the stock portfolio must consist of at least 75% of the number of component securities underlying the index, and must correspond in value to the value of the options position hedged, so that the increased positions are less likely to be used in a leveraged manner in any manipulative scheme. As noted above the value of the hedging portfolio is equal to (1) The total market value of the net stock position; less (2) the value of (a) any offsetting calls and puts in the index option; (b) any offsetting positions in related stock index futures or options; and (c) any economically equivalent positions.[14] Third, both the options and the stock positions must be initiated and liquidated in an orderly manner. Moreover, a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position, thereby helping to ensure that the stock transactions are not used to impact the market so as to benefit the options positions. Fourth, the PHLX's Market Surveillance Department must be notified in writing for approval prior to liquidating or initiating any such position and the PHLX's Market Surveillance Department must also be notified of any material change in the portfolio or futures positions which materially affects the value of the qualified portfolio. Fifth, the maximum hedge exemption position is two times the existing limit. The ''two times the limit'' is not automatic and the PHLX has the authority to approve a hedge limit for less than that amount.

The Commission notes that the PHLX's surveillance procedures are designed to detect as well as deter manipulation and market disruptions. In particular, the PHLX will monitor the options position of a person utilizing the hedge exemption on a daily basis to ensure that each option contract is hedged by the equivalent dollar amount of component securities.[15] In addition, the PHLX's Market Surveillance Department will monitor trading activity in PHLX-traded index options and their underlying component stocks to detect potential frontrunning and manipulation, and to ensure that the closing of positions subject to the exemption is conducted in a fair and orderly manner. Violation of any of the provisions of the industry index hedge exemption, absent reasonable justification or excuse, will result in the withdrawal of the hedge exemption and

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[10] Under rules promulgated by the Commodity Futures Trading Commission, futures positions that are deemed to be bona fide hedging transactions (as defined) are exempted from position limit rules. *See* Securities Exchange Act Release No. 25739 (May 24, 1988), 53 FR 20204, (June 2, 1988) (order approving File No. SR–CBOE–87–25).

[11] *See also* Amendment No. 1, *supra* note 5.

[12] To determine the share amount of each component required to hedge an index option position: index value × index multiplier × component's weighing = dollar amount of component. That amount divided by price = number of shares of component. Conversely, to determine how many options can be purchased based on a certain portfolio, divide the dollar amount of the basket by the index value × index multiplier.

[13] 15 U.S.C. 78f(b)(5) (1988 & Supp. V 1993).

[14] *See* Amendment Nos. 2 and 3, *supra* note 5. According to the PHLX, ''economically equivalent'' positions are instruments whose prices fluctuate in tandem. The PHLX believes, for example, that National Over-the-Counter Index options and Nasdaq 100 Index options are economic equivalents, and that stock and bonds issued by the same company may be economic equivalents. Telephone conversation between Edith Hallahan, Special Counsel, Regulatory Services, PHLX, and Yvonne Fraticelli, Attorney, OMS, on February 14, 1996.

[15] Market participants granted a hedge exemption are also required to keep their application forms for the hedge exemption current and promptly provide the PHLX with any information concerning the dollar value and composition of the stock portfolio, the current hedged and aggregate option positions, and any stock index futures positions, or economically equivalent positions.

subsequent denial of an application for a hedge exemption thereunder.

Finally, the Commission believes that it is reasonable for the PHLX to allow firm and proprietary traders, as well as public customers, to utilize the proposed hedge exemption. The Commission believes that extending the narrow-based index option hedge exemption to firm and proprietary traders may help to increase the depth and liquidity of the market for industry index options and may help to ensure that public customers receive the full benefit of the exemption. Moreover, the PHLX's monitoring procedures, as described above, should be able to detect abuses and ensure that the options position, whether firm, proprietary trader, or customer, is properly hedged.

The Commission finds good cause for approving Amendment Nos. 1, 2, and 3 to the proposed rule change prior to the thirtieth day after the date of publication of the notice thereof in the Federal Register. Specifically, Amendment No. 1, is designed to protect investors and the public interest by providing additional requirements and surveillance procedures which the Exchange will use in monitoring the narrow-based index option hedge exemption. Amendment No. 2 clarifies the Exchange's proposal by indicating that the hedge exemption allows a market participant to hold up to two times, rather than three times, the current position limit because the hedged position is held in addition to the contracts permitted under PHLX Rule 1001A. In addition, Amendment No. 2 strengthens the PHLX's proposal by providing that options on stock index futures must be deducted when calculating the value of the hedging portfolio. Amendment No. 3 strengthens the PHLX's proposal by making technical revisions that clarify, among other things, that economically equivalent positions must be deducted when calculating the value of the hedging portfolio. Accordingly, the Commission believes that there is good cause, consistent with Sections 6(b)(5) and 19(b)(2) of the Act, to approve Amendment Nos. 1, 2, and 3 to the proposal on an accelerated basis.

Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 1, 2, and 3. 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 at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to the file number in the caption above and should be submitted by March 19, 1996.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[16] that the proposed rule change (SR–PHLX–95–45), as amended, is approved.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–4313 Filed 2–26–96; 8:45 a.m.]

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[Release No. 34–36862; File No. SR–Phlx–95–86]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Index Options Exercise Advices

February 20, 1996

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 December 28, 1995, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') 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 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 Phlx, pursuant to Rule 19b–4 of the Act, proposes to amend Phlx Rule 1042A, Exercise of Option Contracts, and Floor Procedure Advice (''Advice'') G–1, Exercise Requirements, by extending 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) is being deleted. The text of the proposed rule change is available at the Office of the Secretary, the Phlx, and 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 Phlx 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 Phlx has prepared summaries, set forth in Section 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

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 broadbased 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 on 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

[16] 15 U.S.C. 78s(b)(2) (1982).

[17] 17 CFR 200.30–3(a)(12) (1995).

[1] 15 U.S.C. § 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4 (1994).