

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38755; File No. SR-PHLX-97-19]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. To Amend Specialist and Registered Options Trader Trading Requirements

June 23, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on April 23, 1997, 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

Phlx proposes to amend Floor Procedure Advice ("Advice") B-3, Trading Requirements, and delete Advice A-4, Specialist as Registered Option Trader ("ROT"), in order to count specialist trading activity toward the quarterly ROT trading requirements.

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

Pursuant to Rule 1014, a Phlx ROT is permitted to trade options for his own account on the trading floor. ROTs are subject to certain market making obligations, including that their transactions constitute a course of dealings reasonably calculated to

contribute to the maintenance of a fair and orderly market. ROTs are also prohibited from entering into transactions or making bids/offers inconsistent with such a course of dealings. Further, ROTs are assigned to certain options, which take precedence respecting their trading activity. In assigned options, ROTs must fulfill additional obligations, including bidding/offering within established quotation spread parameters. Currently, ROTs are subject to two quarterly trading requirements, pursuant to Rule 1014 and Advice B-3: (1) In-Person: quarterly requirement to trade the greater of 1,000 contracts or 50% of contract volume in person (and not through the use of orders); and (2) Assigned: quarterly requirement to trade 50% of contract volume in assigned options. Heightened requirements apply to off-floor orders.¹

Specialists are also subject to extensive Exchange requirements. Pursuant to Rule 1020, specialists are required to engage in a course of dealings to assist in the maintenance of a fair and orderly market, including contributing to price continuity with reasonable depth and minimizing the effects of a temporary disparity between supply and demand. Further, Rule 1019 requires specialists to afford precedence to orders entrusted to the specialist as agent. Advice A-4 currently states that specialists who are also ROTs shall not have their specialist activity included in the calculation for required trading as an ROT.

The purpose of these ROT and specialist requirements is to ensure that "market maker" status under Section 11(a) of the Act² and "specialist" status under Regulation T of the Federal Reserve Board³ are properly afforded. Pursuant to Section 11(a), members are generally prohibited from executing on an exchange transactions for their own account. Market maker status is an exception for dealers acting in the capacity of a market maker and enables ROTs to act as such on the Exchange trading floor. Secondly, under Regulation T and pertinent Exchange rules, a member of an exchange who is registered and acting as a specialist is exempt from the margin requirements normally applicable to customers, and

can be extended "good faith" credit for transactions in a security in which the specialist makes a market. Exchange trading requirements are intended to ensure that market makers comply with their market making obligations, including adding liquidity and contributing to the maintenance of a fair and orderly market on the Exchange. Compliance with these obligations is integral to the determination that margin treatment respecting option transactions initiated and effected by the ROT on the floor in the capacity of an ROT is appropriately extended. Trading requirements thus help ensure the stability and orderliness of exchange markets.

The Exchange proposes to delete Advice A-4, and adopt the following language into Advice B-3 as paragraph (c): Specialists who are also ROTs may have their Specialist activity included in the calculation for the trading requirements above. The Exchange has found that some specialist also maintain ROT accounts in order to provide liquidity in other Phlx options, whether in person in neighboring options, or through a floor broker. In these situations, the specialists/ROTs would have difficulty satisfying the in-person trading requirement by either not trading the required 1,000 contract minimum in person (because their ROT activity was executed using floor brokers), or by trading more than 1,000 contracts, but not 50% in-person. The Exchange proposes to count specialist activity towards all of the trading requirements of Advice B-3, including the in-person, in-assigned and off-floor requirements.

The purpose of this proposal is to facilitate a specialist acting as an ROT in non-specialty issues, which Phlx believes promotes depth and liquidity on the Exchange. The Exchange believes that, in light of the requirements for specialist and ROT status, the proposal is both necessary and appropriate. The Exchange recognizes the important role that specialist/ROTs play in providing liquidity to the marketplace, noting that, as specialists, they are consistently present on the trading floor. Phlx believes that because specialists are present and making markets on the Exchange floor, counting specialist activity toward the trading requirements of specialist/ROTs is consistent with this important purpose of trading requirements. The Exchange understands that specialist/ROTs may meet their trading requirements primarily through specialist activity and thus, receive market maker treatment for transactions in non-specialty options, without meeting a separate trading

¹ Phlx ROTs entering orders from off-floor may receive market maker margin for such orders, provided they execute each calendar quarter the greater of 1,000 contracts or 80% of contract volume in person, as well as 75% in assigned options. Securities Exchange Act Release No. 36137 (August 23, 1995), 60 FR 44923 (August 29, 1995) (SR-Phlx-95-14).

² 15 U.S.C. 78k(a).

³ 12 CFR 220.12.

requirement solely for non-specialty options. Nevertheless, Phlx believes that specialist/ROTs warrant market maker status because they are subject to market making obligations. For instance, such ROTs could be requested to provide markets pursuant to Rule 1014. The Exchange recognizes that, although specialist are constrained from departing from the trading crowd of their specialty options, specialist/ROTs may provide markets where requested by way of Floor Broker representation. The Exchange may also assign an ROT to a particular option, pursuant to Rule 1014, Commentary .05. Thus, the proposed changes to specialist/ROT trading requirements preserve the obligation to provide markets in assigned options.

Phlx believes that this proposal is necessary to permit specialist/ROTs to retain their ROT status and, in turn, provide liquidity in Phlx options. Specifically, specialist/ROTs utilizing Floor Brokers to enter orders to facilitate customer interest play a crucial role in providing liquidity. Specifically, units often possess the large capital required to trade large sizes, where liquidity is most often needed. The Exchange believes that specialist /ROTs regularly improve the size, and sometime the price, of markets made on the Phlx floor. This proposal is a reasonable effort to accommodate the needs of specialist/ROTs to meet their market making responsibilities.

In approving changes to trading requirements, the Commission has previously stated that trading requirements reduce the extent to which traders can effectively function as privileged investors by entering the trading floor long enough to drop off orders with a Floor Broker, without actually making competitive quotations or otherwise affirmatively functioning as market makers.⁴ The Exchange does not believe that this proposal raises such concerns, because specialist/ROTs have specialist-related requirements to be present on the trading floor. Thus, the Exchange believes that the proposal balances the need to protect against misuse of market maker status with the liquidity-providing role that specialist/ROTs play in today's marketplace. The Exchange emphasizes that specialist/ROTs will continue to be subject to market making obligations, including the requirement to contribute to the maintenance of a fair and orderly market. The existence of substantive obligations should ensure that

specialist/ROTs act as bona fide market makers and do not otherwise use the Exchange floor.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act in general, and in particular, with Section 6(b)(5),⁵ in that it is designed to promote just and equitable principles of trade, and protect investors and the public interest, by supporting the liquidity-providing role of specialist/ROTs without diminishing market maker status.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

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, 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 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-Phlx-97-19 and should be submitted by July 18, 1997.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38752; File No. SR-Phlx-97-16]

Self-Regulatory Organizations; Philadelphia Stock Exchange, Inc.; Order Approving Proposed Rule Change Relating to Option Quote Spread Parameters

June 20, 1997.

I. Introduction

On April 2, 1997, the Philadelphia Stock Exchange, Inc., ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder² a proposed rule change relating to option quote spread parameters. The proposed rule change was published for comment in Securities Exchange Act Release No. 38576 (May 6, 1997), 62 FR 25985 (May 12, 1997). The Commission received no comment letters in response to the proposal.

II. Description of the Proposal

The purpose of the proposed rule change is to update the Exchange's equity and index option quote spread parameters, in view of the parameters applicable on other options exchanges. First, the Exchange is proposing to eliminate the maximum quote spread of $\frac{1}{8}$, currently applicable to options where the bid is less than \$.50, such that the maximum quote spread for options where the bid is less than \$2.00 will be $\frac{1}{4}$. This is identical to the quote

⁴ Securities Exchange Act Release No. 35786 (May 31, 1995), 60 FR 30122 (June 7, 1995) (SR-Amex-94-514).

⁵ 15 U.S.C. 78f(b)(5).

¹ 15 U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.