

require Exchange approval prior to the installation of any form of telephonic or electronic communication on both the options and equity floors of the Exchange. Currently, pursuant to OFPA F-3, Exchange approval is required before any form of direct private communication may be installed on the options floor of the Exchange.

The Commission supports the Exchange's efforts to continue to review the substance of its rules in response to changes in market structure and technology. In regulating the PCX trading floors and devising their structure, the Commission recognizes the PCX's need to be aware of electronic and telephonic communications that are being installed on its floors. While supporting the Exchange's efforts to monitor the types of communications that are on its trading floors, the Commission expects the PCX to ensure that the rule being approved today is not used to limit access to services offered by the Exchange or applied in a manner inconsistent with sections 6(b)(5)¹⁰ and 6(b)(8)¹¹ of the Act.¹² Specifically, the Commission expects that proposed Rule 4.22 will not be interpreted in a manner that permits unfair discrimination between customers, issuers, brokers, or dealers, or imposes any unnecessary or inappropriate burden on competition, or is otherwise used to limit member access to Exchange services. Finally, the Commission notes that the PCX should not rely solely on Rule 4.22 as currently drafted to establish a broad based restriction on member communications on its trading floors. Rather, the PCX would need to develop specific rules containing clear and objective criteria on which to base such a restriction and submit that criteria for Commission review under section 19(b) of the Act.¹³

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-PCX-98-16) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40840; File No. SR-PCX-98-45]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Opening Transaction Size in Flex Equity Options

December 28, 1998.

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 September 11, 1998, the Pacific Exchange, Inc. ("PCX" 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 Exchange. On October 29, 1998, the Exchange submitted Amendment No. 1 to the proposed rule change.³ The Exchange submitted Amendment No. 2 to the proposed rule change on December 15, 1998.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposal, as amended.

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

The PCX proposes to change the requirement for initiating an opening transaction in any FLEX Equity Option⁵

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Robert Pacileo, Jr., Staff Attorney, PCX, to Joseph Corcoran, Division of Market Regulation ("Division"), Commission, dated October 29, 1998 ("Amendment No. 1"). In Amendment No. 1, the PCX proposes to define the term "Underlying Equivalent Value" for FLEX Equity Options and provides an example demonstrating the need for the proposed rule change. See also note 6, *infra*.

⁴ See Letter from Robert Pacileo, Jr., Staff Attorney, PCX, to Michael A. Walinskas, Division, Commission, dated December 14, 1998 ("Amendment No. 2"). In Amendment No. 2, the Exchange proposes to incorporate the term "Underlying Equivalent Value" into the text of the proposed rule change and to clarify the example demonstrating the need for the proposed rule change, as set forth in the purpose section below.

⁵ FLEX Equity Options are flexible exchange-traded options contracts based on equity securities. FLEX Equity Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices.

series that has no open interest, such that the requirement will now be the lesser of 250 contracts or the number of contracts overlying \$1 million of the underlying securities. The text of the proposed rule change is available at the Office of Secretary, the PCX, 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 PCX 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 III below. The PCX 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 PCX proposes to change the requirement for initiating an opening transaction in any FLEX Equity Option series that has no open interest, such that the requirement will now be the lesser of 250 contracts or the number of contracts overlying \$1 million of the underlying securities.⁶ The Commission recently approved a similar rule change for the Chicago Board Options Exchange ("CBOE").⁷

The Exchange is proposing the rule change because it believes that the current rule, which states that the minimum value size for an opening transaction shall be 250 contracts, is overly restrictive. The Exchange believes that limiting participation in FLEX Equity Options based on the number of contracts purchased may reduce liquidity and trading interest in FLEX Equity Options for higher priced equities. The Exchange believes that the value of the securities underlying the FLEX Equity Options, if set at the right limit, can also prevent the participation of investors who do not have adequate resources. The Exchange believes that

⁶ The Commission notes that under the proposal, the \$1 million of the underlying securities is defined in Amendment No. 1 as "Underlying Equivalent Value." The definition reads: "[t]he term 'Underlying Equivalent Value' in respect of a given number of FLEX equity options is calculated by multiplying the number of contracts times the multiplier (100) times the stock price."

⁷ See Securities Exchange Act Release No. 40451 (September 18, 1998) 63 FR 51393 (September 25, 1998) (order approving File No. SR-CBOE-98-21).

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ 15 U.S.C. 78f(b)(8).

¹² See e.g., *William J. Higgins*, 48 S.E.C. 713 (1987).

¹³ See e.g., Securities Exchange Act Release No. 40577 (Oct. 20, 1998), 63 FR 57721 (Oct. 28, 1998) (Order approving File No. SR-PSE-97-02); and Amex Rule 220, Commentaries .01-.04.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).

the number of contracts overlying \$1 million in underlying securities is adequate to provide the requisite amount of investor protection.

While it appears that the minimum contract size fulfilled its purpose, the Exchange believes that the result of the existing rule is to require a much greater dollar investment for options on higher priced stocks than for options on lower priced stock. For example, an investor can purchase 250 contracts in a FLEX equity series on low priced stocks (i.e., those worth less than \$40) meeting the minimum contract requirement without even investing a minimum of \$1 million, while an investor prepared to invest \$1 million may be unable to purchase contracts in a FLEX equity series in higher priced stocks (i.e., those worth more than \$40). For example, an opening transaction in a FLEX equity series on a stock priced above \$40 would reach the \$1 million limit before it would reach the contract size limit, i.e. 249 contracts times the multiplier (100) times the stock price (\$41.00) totals \$1,020,900 in underlying value.⁸

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)(5) of the Act⁹ in that it is designed to perfect the mechanisms of a free and open market, to promote just and equitable principles of trade, to facilitate transactions in securities, and in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will result in any 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

Written comments on the proposed rule change were neither solicited nor received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. 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 in the Commission's Public Reference Room. Copies of such filings will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR-PCX-98-45 and should be submitted by January 28, 1999.

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

The Commission believes that the proposed rule change is consistent with the Act and rules and regulations thereunder applicable to a national securities exchange, and, in particular, with Section 6(b)(5)¹⁰ which requires, among other things, that the rule of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the proposed rule, which provides a minimum dollar amount for an opening transaction in FLEX Equity Options as an alternative to the existing 250 fixed contract requirement, facilitates transactions in securities while continuing to provide investor protection and foster the public interest. Specifically, the Commission notes the minimum size requirement of 250 contracts for an opening transaction in FLEX Equity Options was designed to ensure that FLEX Equity Options were primarily used by sophisticated, high net worth investors rather than retail investors. Although it appears that the minimum contract size fulfilled its purpose, the Commission agrees with the PCX that the result of the existing rule is to require a greater dollar investment for options on higher priced stocks than for options on lower priced stocks. Under the existing rule, an investor could have purchased 250 FLEX contracts in a stock priced below \$40 a share without reaching \$1 million.

However, under the current rule, an investor wanting to purchase 249 FLEX contracts in a stock priced over \$40 a share would not be allowed to enter this FLEX opening transaction even though the investor would have a position valued at over \$1 million.

Based on the foregoing, the Commission believes the \$1 million minimum amount for an opening transaction in FLEX Equity Options is an appropriate alternative to the 250 fixed contract requirement. In approving the \$1 million alternative, the Commission recognizes that an individual can meet the 250 contract limit without purchasing \$1 million of FLEX Equity Option contracts. Nevertheless, the Commission believes that the alternative requirements are appropriate because they will provide flexibility to investors and will not unduly restrict access to the FLEX Equity Options market. Further, the Commission believes that the alternative requirements could increase liquidity in the FLEX Equity Options market while continuing to provide for investor protection.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notices that the proposed rule is similar to one previously approved by the Commission for another exchange.¹¹ The Commission also notes that the previous filing was submitted for the full 21-day notice and comment period, and the Commission received no public comments. Additionally, the proposed rule change raises no new issue of regulatory concern. The Commission believes, therefore, that granting accelerated approval to the amended proposed rule change is appropriate and consistent with Section 6 of the Act.¹²

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-PCX-98-45), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,

Deputy Secretary.

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⁸ See Amendment No. 2, *supra* note 4.

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ *Id.*

¹¹ See *supra* note 7.

¹² 15 U.S.C. 78f.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).