

liquidating value is positive) or increase (where the actual liquidating value is negative) in liquidating value compared with the actual liquidating value based on the premium levels at the close of trading on the preceding day. The difference between that theoretical liquidating value and the actual liquidating value is the additional margin amount for that class group unless the class group is subject to the short option adjustment.

B. Short Option Adjustment

For net short positions⁷ in deep out of the money options, little or no change in value would be predicted given a change in value of the underlying interest equal to the applicable margin interval. As a result, TIMS normally would calculate additional margin amounts of zero or close to zero for deep out of the money short options. However, volatile markets could cause such positions to become near to or in the money and thereby could create increased risk to OCC. OCC protects against this risk with an adjustment to the additional margin calculation known as the short option adjustment.⁸

Currently, the short option adjustment requires a minimum additional margin amount equal to twenty-five percent of the applicable margin interval for all unpaired⁹ net short positions in options series for which the ordinary calculation of the additional margin requirement would be less than twenty-five percent of the applicable margin interval. As a result, clearing members are required to deposit margin in excess of the risk presented by some unpaired net short positions in out of the money options.

To address these situations, the rule change establishes a sliding scale short option adjustment methodology. Using the sliding scale, the short option adjustment percentage will be applied to a particular series according to the extent to which the series is out of the money. In addition, OCC will use

different sliding scales for put options and for call options.

The proposed rule change modifies Rules 601 and 602 to provide that the short option adjustment to be applied to any unpaired short position will be determined using a percentage that OCC deems to be appropriate.¹⁰

II. Discussion

Section 17A(b)(3)(F) of the Act¹¹ requires that the rules of a clearing agency be designed to assure the safeguarding of securities and funds which are in its custody or control or for which it is responsible. The Commission believes that the rule change is consistent with OCC's obligations under Section 17A(b)(3)(F) because it should reduce overcollateralization of OCC's clearing members' positions without impairing OCC's overall protection against member default.

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 with Section 17A of the Act¹² 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-98-11) be and hereby is approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40981; File No. SR-OCC 98-15]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Definition of Stock Fund Shares

January 26, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on November 16, 1998, The Options Clearing Corporation ("OCC") 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 primarily by OCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

The proposed rule change modifies the definition of "stock fund shares."

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 such statements.²

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

The purpose of the proposed rule change is to clarify the definition of "stock fund shares" as currently defined in Section 1 of Article 1 of OCC's By-laws³ by replacing the term "common

⁷ A net position in an option series in an account is the position resulting from offsetting the gross unsegregated long position in that series against the gross short position in that series. After netting, an account will reflect a net short position or a net long position for each series of options held in the account.

⁸ The short option adjustment is described in Rule 601(c)(1)(C)(1) for equity options and Rule 602(c)(1)(ii)(C)(1) for non-equity options. OCC recently amended Interpretation .06 to Rule 602 so that net short non-equity option positions can be paired off against net long non-equity positions whose underlying interests exhibit price correlation of at least seventy percent. Securities Exchange Act Release No. 40515 (September 30, 1998), 63 FR 53970.

⁹ The term unpaired is defined in Interpretation .04 to Rule 601 for equity options and Interpretation .06 to Rule 602 for non-equity options.

¹⁰ A schedule of the sliding scales that OCC intends to use is attached as Exhibit A to its filing, which is available for inspection at the Commission's Public Reference Room and through OCC. OCC will always specify a minimum short option adjustment percentage. OCC will inform its members of the initial schedule of the sliding scales through an Important Notice and will notify its members of any changes to the schedule.

¹¹ 15 U.S.C. 78q-1(b)(3)(F).

¹² 15 U.S.C. 78q-1.

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² The Commission has modified the text of the summaries prepared by OCC.

³ This definition was introduced in a recently approved rule change. Securities Exchange Act Release No. 40595 (October 23, 1998), 63 FR 58438 [File No. SR-OCC-98-08] (order approving rule change relating to OCC's rules and by-laws which govern options on publicly traded interests in unit investment trusts, investment companies, or similar entities holding portfolios or baskets of common stock).

stocks" with the phrase "equity securities" in the definition. When the definition was originally drafted, the term "common stock" was intended to be interpreted broadly enough to include other equity securities such as ADRs.⁴ The substitution of the term "equity securities" will make it clear that stock fund shares includes interests in entities holding portfolios or buckets of equity securities other than common stocks.

OCC believes that the proposed rule change is consistent with the requirements of Section 17A of the Act⁵ and the rules and regulations thereunder because it promotes the prompt and accurate clearance and settlement of transactions in stock fund options by eliminating any potential ambiguity as to the definition of "stock fund shares."

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

OCC does not believe that the proposed rule change will impose 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

No comments on the proposed rule change were solicited or received.

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

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(i)⁶ of the Act and pursuant to Rule 19b-4(e)(1)⁷ promulgated thereunder because the proposal constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule. At any time within sixty days of the filing of such rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of

investors, or otherwise in furtherance of the purposes of the Act.

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. 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-98-15 and should be submitted by February 24, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40980; File No. SR-PCX-98-55]

Self-Regulatory Organizations; Pacific Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 Relating to Crossed Market Adjustments

January 26, 1999.

I. Introduction

On November 5, 1998, the Pacific Exchange, Inc. ("PCX" 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 clarify its rules on the automatic execution of options orders. Amendment No. 1 was submitted to the Commission on November 30, 1998.³ The proposed rule change was published for comment in the **Federal Register** on December 9, 1998.⁴ The Commission did not receive any comments on the proposal. This order approves the proposal, as amended.

II. Description of the Proposal

The Exchange proposes to clarify its rules on the automatic execution of orders when the PCX market and the market of a competition exchange are crossed or locked (*i.e.*, the bid disseminated through the facilities of one exchange is higher than or equal to the offer disseminated through the facilities of another exchange). The Exchange believes the proposal will make consistent the handling of electronic orders in such circumstances.

On September 8, 1998, the Commission approved a PCX proposal to amend PCX Rule 6.87(d) regarding the automatic execution of options orders.⁵ The rule change provided that the Exchange's Options Floor Trading Committee ("OFTC") may designate electronic orders in an option issue to receive automatic executions at prices reflecting the National Best Bid or Offer ("NBBO"). The rule change further provided that the OFTC may designate a customer order to exit the automatic execution system and receive floor broker representation in the trading crowd if the NBBO is crossed (*e.g.* 6 $\frac{1}{8}$ bid, 6 asked) or locked (*e.g.* 6 bid, 6 asked).

After the Commission approved the amendment to PCX Rule 6.87(d), the Exchange became aware that the rule implied that the OFTC could designate an option issue for floor broker representation in crossed or locked markets only if the issue was eligible to receive automatic execution at the NBBO. The Exchange's intention was to allow OFTC the discretion to designate orders in an option issue for floor broker representation if the NBBO is crossed or

⁴ The intention to cover ADRs was apparent in the original filing which approved a rule change permitting OCC to issue, clear, and settle options on unit investment trust interests and investment company shares that hold portfolios or baskets of common stock. The filing noted that underlying stock fund shares would include World Equity Benchmark Shares ("WEBs"). WEBs represent interests in funds whose holdings consist of or include ADRs. Securities Exchange Act Release No. 40132 (June 25, 1998), 63 FR 36467 [File No. SR-OCC-97-02].

⁵ 15 U.S.C. 78q-1.

⁶ 15 U.S.C. 78s(b)(3)(A)(i).

⁷ 17 CFR 240.19b-4(e)(1).

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The proposed rule change was originally filed pursuant to Section 19(b)(3)(A)(ii) of the Act. The amendment converted the proposed rule change to a filing pursuant to Section 19(b)(2) of the Act. Letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX to Kelly McCormick, Attorney, Division of Market Regulation, SEC, dated November 27, 1998 ("Amendment No. 1").

⁴ Securities Exchange Act Release No. 40734 (December 1, 1998), 63 FR 67971 (December 9, 1998).

⁵ Securities Exchange Act Release No. 40412 (September 8, 1998), 63 FR 49626 (September 16, 1998) (File No. SR-PCX-98-27).