

[Release No. 34-35177; International Series Release No. 765; File No. SR-Phlx-94-42]

**Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to an Enhanced Parity Split for the Specialist in the Cash/Spot German Mark Foreign Currency Options**

On August 15, 1994, the Philadelphia Stock Exchange, Inc., ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1994 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to provide an enhanced parity participation ("Enhanced Parity Split") for the specialist trading cash/spot German mark ("3D") foreign currency options ("FCOs").<sup>3</sup> Notice of the Proposed rule change appeared in the **Federal Register** on October 17, 1994.<sup>4</sup> No comment letters were received on the proposed rule change. The Exchange subsequently filed Amendment No. 1 to the proposal on December 9, 1994,<sup>5</sup> and Amendment No. 2 on December 23, 1994.<sup>6</sup> This order approves the Exchange's proposal, as amended.

**I. Description of the Proposal**

The Exchange proposes to amend Exchange Rule 1014(h) to adopt an

Enhanced Parity Split for the 3D FCO specialist. Specifically, the 3D FCO specialist will be entitled to receive 50% of the first 500 contracts in any trade in which the 3d FCO specialist and one or more crowd participants are on parity, as defined in Exchange Rule 1014(h), with the remaining 250 contracts allocated on a pro rata basis to the other crowd participants on parity. All contracts in excess of 500 will be allocated on a pro rata basis among the specialist and the other crowd participants on parity.<sup>7</sup>

The Exchange represents that customers with orders for less than 100 contracts will not be disadvantaged by this proposal. Specifically, Rule 1014(h)(i) provides that all bids/offers of customer accounts for under 100 contracts have time priority over non-customer accounts and, therefore, the Enhanced Parity Split will not apply to customer bids/offers for fewer than 100 contracts.<sup>8</sup>

The purpose of the proposed Enhanced Parity Split, according to the Phlx, is to encourage the 3D FCO specialist to make deeper markets in order to attract order flow to the Exchange. At the end of the first year, the Foreign Currency Option Committee ("Committee") will conduct a review of the performance of the 3D FCO specialist and additional reviews will be conducted by the Committee every six months thereafter. If the Committee elects to terminate the Enhanced Parity Split for the 3D FCO specialist as result of one of these regular reviews, the specialist will be afforded the ability to appeal that decision to the Board of Governors of the Exchange pursuant to the procedures in Article XI, Section 11-1 of the Exchange's by-laws.<sup>9</sup>

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)<sup>10</sup> in that the proposal is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, and to protect investors and the public interest.

Specifically, the Commission finds that the proposal may serve to remove impediments to and perfect the mechanism of a free and open market by encouraging the 3D FCO specialist to maintain tight markets in order to attract order flow to the Exchange. Further, the proposed rule change provides that the Enhanced Parity Split will not disadvantage customer orders for fewer than 100 contracts that are on parity with the 3d FCO specialist.<sup>11</sup>

The Commission notes that several Exchange proposals implementing enhanced parity splits for equity and index option specialist have recently been approved by the Commission.<sup>12</sup> As discussed in connection with those approval orders, specialists, including the 3D FCO specialist, have responsibilities that other crowd participants do not share, such as the staff costs associated with continually updating and disseminating quotes.<sup>13</sup> As a result, the Commission believes it is reasonable for the Exchange to grant certain advantages to specialists, such as the Enhanced Parity Split proposed herein, in order to attract and retain well capitalized specialists at the Exchange. As a result, as long as these advantages do not unreasonably restrain competition and do not harm investors, the Commission believes that the granting of such benefits to specialists, in general, is within the business judgment of the Exchange. Therefore, even though the proposed rule change could arguably have some negative impact on other crowd participants, other than customers with orders for less than 100 contracts, for the reasons stated above, the Commission believes the proposal is consistent with the Act.

Furthermore, the Commission believes that: (1) The review procedures proposed by the Exchange, as discussed above, adequately ensure that the 3D FCO specialist will receive the benefit of the Enhanced Parity Split only if the specialist satisfies its obligations and responsibilities pursuant to Exchange rules; and (2) in cases where the 3D FCO specialist is found to no longer be

<sup>1</sup> 15 U.S.C. 78s(b)(1) (1988).

<sup>2</sup> 17 CFR 240.19b-4 (1992).

<sup>3</sup> 3D FCOs are cash-settled, European-style, cash/spot FCO contracts on the German mark that trade in one-week and two-week expirations. See Securities Exchange Act Release No. 33732 (March 8, 1994), 59 FR 52337 (March 15, 1994).

<sup>4</sup> See Securities Exchange Act Release No. 34814 (October 7, 1994), 59 FR 52337 (October 17, 1994).

<sup>5</sup> Amendment No. 1 provides that if the 3D FCO specialist is denied the Enhanced Parity Split provided herein as a result of the periodic reviews of specialist performance by the Foreign Currency Option Committee, the specialist will be afforded the ability to appeal that decision to the Exchange's Board of Governors pursuant to the procedures in Article XI, Section 11-1 of the Exchange's by-laws. Amendment No. 1 also amends Rule 509(a) in order to make that rule consistent with Rule 1014, which was recently amended to expand the enhanced parity split applicable to equity option specialists to also include index option specialists. See Letter from Michele Weisbaum, Associate General Counsel, Phlx, to Brad Ritter, Senior Counsel, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated December 9, 1994 ("Amendment No. 1").

<sup>6</sup> In Amendment No. 2, the Exchange proposes to amend the proposed language in Rule 1014(h), as described herein, to clarify the manner in which Enhanced Parity Split will be applied. See Letter from Michele Weisbaum, Associate General Counsel, Phlx, to Brad Ritter, Senior Counsel, OMS, Division, Commission, dated December 23, 1994 ("Amendment No. 2").

<sup>7</sup> *Id.*

<sup>8</sup> Phlx Rule 1014(h) does not confer time priority on customer orders (as compared to non-customer orders) for 100 or more FCO contracts. Consistent with this, the 3D FCO specialist will be entitled to receive the full Enhanced Parity Split on parity trades with customer orders for 100 or more FCO contracts. Telephone conversation between Michele Weisbaum, Associate General Counsel, Phlx, and Brad Ritter, Senior Counsel, OMS, Division, Commission, on December 8, 1994.

<sup>9</sup> See Amendment No. 1, *supra* note 5.

<sup>10</sup> 15 U.S.C. 78f(b)(5Z) (1988).

<sup>11</sup> See *supra* note 8.

<sup>12</sup> See Securities Exchange Act Release Nos. 34109 (May 25, 1994), 59 FR 28570 (June 2, 1994) (providing an enhanced parity split for new equity option specialist units trading newly listed option classes) ("Exchange Act Release No. 34109"), 34606 (August 26, 1994), 59 FR 45741 (September 2, 1994) (providing an enhanced parity split applying to equity option specialists, other than new specialist units, for certain assigned option classes), and 35028 (November 30, 1994), 59 FR 63151 (December 7, 1994) (expanding the enhanced parity split in the foregoing orders to include index option specialists as well as equity option specialists) ("Exchange Act Release No. 35028").

<sup>13</sup> See Exchange Act Release No. 34109, *supra* note 12.

eligible for the Enhanced Parity Split, the appeals procedures proposed by the Exchange adequately protect the due process rights of the specialist. The Commission believes that these criteria balance the competing interests of the Exchange and the 3D FCO specialist by ensuring regular review of specialist performance and that the specialist's due process rights are protected in cases where the Committee makes a determination that the Enhanced Parity Split should be denied.

Finally, the Commission notes that even though the Enhanced Parity Split will have a negative impact, in certain circumstances,<sup>14</sup> on customer orders for more than 100 contracts, the Commission believes that this does not raise significant regulatory concerns in the context of the 3D FCO market. The FCO market, in general, is dominated by institutions and sophisticated corporate investors who typically trade in large numbers of FCO contracts, *i.e.*, 100 contracts or more at a time. The Commission believes that non-institutional investors who participate in the FCO market generally enter into transactions for far fewer contracts. The Exchange's rules, as approved by the Commission, already acknowledge this distinction by affording time priority for trades that would otherwise be on parity only for customer orders for fewer than 100 contracts.<sup>15</sup> As a result, because the negative impact of the rule on customers will be limited substantially to institutions and sophisticated corporate FCO investors trading 3D FCOs, the Commission believes that the benefits of the proposal discussed above outweigh the negative impact of the rule change on this class of FCO customers.

The Commission finds good cause for approving Amendment Nos. 1 and 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register** in order to allow the 3D FCO specialist to begin receiving the benefits of the Enhanced Parity Split without delay. The Commission notes that the appeal procedures provided in Amendment No. 1 are consistent with those available to equity and index option specialists who are denied the enhanced parity participation available to those specialists pursuant to prior

<sup>14</sup> The Enhanced Parity Split will have a negative impact on customer orders for 100 or more contracts only where the customer is on parity with the 3D FCO specialist and one or more other crowd participants. In cases where only a customer and the 3D FCO specialist are on parity, the Enhanced Parity Split will have no effect. See Amendment No. 2, *supra* note 6.

<sup>15</sup> See Phlx Rule 1014 (h) (i).

Commission approval orders.<sup>16</sup> Further, the Commission finds that the proposal in Amendment No. 1 to Rule 503 merely makes this rule consistent with Rule 1014 and therefore does not raise any regulatory issues that were not addressed when Rule 1014 was amended.<sup>17</sup> Finally, Amendment No. 2 merely clarifies the manner in which the Enhanced Parity Split will be applied. Accordingly, the Commission believes that Amendment No. 2 should serve to minimize the potential for confusion regarding the application of the proposed rule change.

Based on the foregoing, the Commission believes it is consistent with Section 6(b)(5) of the Act to approve Amendment Nos. 1 and 2 to the Phlx's proposal on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 1 and 2. Persons making written submissions should fix 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. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to the File No. SR-Phlx-94-42 and should be submitted by January 30, 1995.

<sup>16</sup> See *supra* note 12. The Commission notes that equity and index options traded at the Exchange are assigned to specialists by the Exchange's Allocation Committee and that the Exchange's by-laws provide specific procedures regarding appeals of decisions by the Allocation Committee. See Phlx By-laws, Article XI, Section 11-1(c). Under this proposal, however, the FCO Committee will be making the determination to deny the Enhanced Parity Split to the 3D FCO specialist. As a result, the appeals process pursuant to this proposal will vary, procedurally, from that available to equity and index option specialists who are denied the enhanced parity splits available to those specialists. See Phlx By-laws, Article XI, Section 11-1(a). Telephone conversation between Michele Weisbaum, Associate General Counsel, Phlx, and Brad Ritter, Senior Counsel, OMS, Division, Commission, on December 8, 1994. Despite the procedural differences, the Commission believes that the appeal rights available to the 3D FCO specialist, as proposed herein, provide adequate due process protection to the 3D FCO specialist.

<sup>17</sup> See Exchange Act Release No. 35028, *supra* note 12.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-Phlx-94-42), as amended, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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[Release No. 34-35183; File No. SR-Phlx-94-41]

**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to an Extension of the Automated Options Market ("AUTOM") Pilot Program**

December 30, 1994.

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 November 21, 1994, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which items have been prepared by the Exchange. The Exchange subsequently filed Amendment No. 1 to the proposal on December 1, 1994.<sup>1</sup> 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 proposes to extend the Exchange's Automated Options Market ("AUTOM") pilot program until December 31, 1995. The text of the proposal is available at the Office of the Secretary, the Phlx, and the Commission.

<sup>18</sup> 15 U.S.C. 78s(b)(2) (1988).

<sup>19</sup> 17 CFR 200.30-3(a)(12) (1993).

<sup>1</sup> In Amendment No. 1, the Exchange requested accelerated approval of the proposed rule change. See Letter from Edith Hallahan, Special Counsel, Phlx, to Michael Walinskas, Branch Chief, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated December 1, 1994 ("Amendment No. 1").