

exchange's displayed price of  $2\frac{3}{4}$  while that floor trader sends a mirror-image order to an exchange displaying an offer price of  $2\frac{5}{8}$ . The floor trader sends such order under his own broker-dealer give-up. The receiving exchange's floor traders do not know that the order is for the benefit of a customer and are under no obligation to provide the order with its exchange customer guarantee. Consequently, the order may not be executed and the quote, in accordance with the "trade or fade" rules on the options exchanges, may then be changed to a  $2\frac{3}{4}$  offer. Once the quote has faded to  $2\frac{3}{4}$ , the customer is deprived of an opportunity to receive a  $2\frac{5}{8}$  fill, as the floor trader who sent the order may then fill the customer at his own exchange's displayed price of  $2\frac{3}{4}$ , without the concern of creating a trade-through.

As proposed herein, the P/A designator would serve to inform receiving markets that a customer order is being represented by the floor trader's order.<sup>4</sup> Knowledge that the order is for the benefit of a customer will form the basis for such orders to be provided with those customer volume guarantees currently afforded to customer orders received directly by the various exchanges. Use of the P/A designator therefore will ensure that the customer receives the volume guarantee provided on the exchange displaying the superior price and will reverse the deleterious effects the trade-or-fade rules may have had in promoting fades of such prices, at least in instances where a customer order is involved. By providing orders placed in the name of floor traders, but for the benefit of customers, with public customer volume guarantees, the proposal promotes objectives of the national market system in the options marketplace. Specifically, the proposal promotes the practicability of brokers executing investors' orders in the best market.<sup>5</sup> In addition, the proposal is intended to assure the economically efficient execution of securities transactions.<sup>6</sup>

As an interim step toward implementing these national market system objectives in the equity options marketplace, the use of the P/A designator would be adopted on a voluntary basis by Phlx floor traders and

<sup>4</sup> The Phlx will surveil for compliance with the provision to assure that its traders are sending orders on behalf of a bona fide customer account prior to such customer order being executed on the exchange where that order was routed to receive the benefit of the better price available on that exchange. The Phlx expects equivalent surveillance to be conducted on all participating exchanges.

<sup>5</sup> 15 U.S.C. 78k-1(a)(1)(C)(iv).

<sup>6</sup> 15 U.S.C. 78k-1(a)(1)(C)(i).

available to any reciprocating floor traders on other national options exchanges who have agreed to execute Phlx P/A orders in the same multiply-listed options on the same basis. In preparation for such implementation, the Exchange has identified its multiply-listed options participating in the voluntary P/A designation.

To qualify as a P/A order, the mirror-image order sent by the floor trader must be for no more than the number of contracts on the customer's order in-hand and must be either a market or a marketable limit order. An order would not qualify as a P/A order if the customer's order has already been executed prior to the time the mirror-image order is sent to the Phlx. To qualify as "customer," the account for which price improvement is sought must be a non-broker-dealer account.

The proposed rule change is consistent with Section 6(b)(5) of the Act<sup>7</sup> in that it is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, remove impediments to and perfect the mechanism of a free and open market and a national market system, as well as to protect investors and the public interest, by improving the execution procedure for principal-acting-as-agent orders in multiply-listed options.

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

The Phlx 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*

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 date of 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 Phlx consents, the Commission will:

(A) by order approve such 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, 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 Room. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR-Phlx-95-66 and should be submitted by October 19, 1995.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority, 17 CFR 200.30-3(a)(12).

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-36263; File No. SR-Phlx-95-32]

#### **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to Broker-Dealer Orders on PACE**

September 21, 1995.

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 June 12, 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. On September 19, 1995, the Exchange submitted to the Commission Amendment No. 1 to the proposed rule change, which is also described below.<sup>1</sup> The Commission is

<sup>1</sup> See letter from Gerald D. O'Connell, First Vice President, Phlx, to Glen Barrentine, Team Leader,

<sup>7</sup> 15 U.S.C. § 78f.

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 Rule 229, Philadelphia Stock Exchange Automated Communication and Execution System ("PACE"), to permit non-agency orders under certain circumstances. Specifically, Supplementary Material .02 is proposed to be amended to permit non-agency orders in situations where a Specialist Agreement is in effect. The Specialist Agreement is an Exchange form signed by a Phlx equity specialist who has agreed to accept non-agency orders through PACE. The Agreement shall identify the member firms responsible for the orders and shall set forth the execution parameters applicable to the orders. The text of the proposed rule change is available at the Exchange 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 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

The purpose of the proposed rule change is to amend Rule 229 to permit non-agency orders on the PACE System. PACE is the Exchange's system for the automatic delivery and execution of orders on the Phlx equity floor. Currently, Supplementary Material .02 to Rule 229 states that only agency orders are eligible under PACE. Further, agency orders are defined as orders entered on behalf of public customers, which are not for the account of a broker-dealer or any account in which a broker-dealer or an associate person of

a broker-dealer has any direct or indirect interest.

At this time, it is proposed that under certain circumstances non-agency orders be permitted over PACE. Phlx specialists may file a Specialist Agreement with the Exchange to allow the receipt and execution of such orders.<sup>2</sup> A Specialist Agreement is an Exchange form signed by a Phlx equity specialist who has agreed to accept non-agency orders through PACE. The Agreement shall identify the member firms responsible for the orders and shall set forth the execution parameters applicable to the orders (*i.e.*, order size guarantees).<sup>3</sup> The execution parameters need not include volume guarantees in excess of firm quote obligations to buy on the displayed bid or sell on the displayed offer for the displayed size in accordance with existing rules for orders not currently on PACE.

Moreover, the Exchange would require that any specialist who has entered into a Specialist Agreement to facilitate broker-dealer orders on PACE, pursuant to the proposed provision, must also provide the same execution parameters to any other member broker-dealer that desires the same parameters (*i.e.*, same order size guarantees) with that specialist.<sup>4</sup> This requirement is to

<sup>2</sup> According to the Exchange, Phlx equity specialists who agree to accept non-agency orders through PACE would have the option of agreeing to execute non-agency orders on either a manual or automatic basis. Specifically, specialists who agree to accept such orders for manual execution would be using the PACE system as an order routing system and would be required to execute such orders manually in accordance with existing Phlx rules. Where the specialist agrees to provide for the automatic execution of non-agency orders, such orders would be executed automatically pursuant to the PACE execution parameters for public customer orders under Phlx Rule 229. Telephone conversation between Jerry O'Connell, Phlx, and Glen Barrentine and Jennifer Choi, SEC, on September 12, 1995.

<sup>3</sup> According to the Exchange, specialists who agree to accept non-agency orders through PACE would have the option of setting different size guarantees for agency and non-agency orders. For example, a specialist could agree to provide automatic execution of all agency orders up to 2,000 shares while limiting the size guarantee for non-agency orders to 1,000 shares. Conversely, a specialist could agree to provide a larger size guarantee to non-agency orders than to agency orders. Telephone conversation between Jerry O'Connell, Phlx, and Glen Barrentine and Jennifer Choi, SEC, on September 12, 1995. Except for such different size guarantees, a specialist who agrees to provide for the automatic execution of non-agency orders through PACE would not be allowed to vary any other PACE execution parameters. Accordingly, such specialist would be required to execute such orders through PACE in all other respects in the same manner as public agency orders are currently executed through PACE. Telephone conversation between Jerry O'Connell and Edith Hallahan, Phlx, and Glen Barrentine and Jennifer Choi, SEC, on September 20, 1995.

<sup>4</sup> As a result, a specialist who agrees to provide automatic execution for one member's non-agency

ensure that all broker-dealers are afforded the opportunity to receive the same treatment by a specialist which that specialist has bestowed on any other individual broker-dealer. Lastly, the Exchange notes that the order designator "P" will be utilized by the PACE system to indicate when an order is for the account of a broker-dealer.

The purpose of permitting non-agency orders onto PACE is to extend the benefits of PACE to Phlx member firms for their proprietary as well as customer orders. The Exchange believes that allowing such orders onto PACE should serve the important function of adding liquidity and trading opportunities to the Phlx marketplace. In addition, the Exchange believes that PACE provides efficiencies to the Exchange's marketplace, which reduces costs incurred through the handling of orders on a more manual basis. This proposal contemplates that such savings can now be realized for proprietary as well as customer orders.

###### 2. Statutory Basis

The proposed rule change is consistent with Section 6 of the Act in general, and in particular, with Section 6(b)(5), in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, as well as to protect investors and the public interest, by reducing the costs and increasing the efficiencies of handling proprietary orders.

##### 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 other 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

orders, must be willing to provide automatic execution for such orders of any other member who requests it. Telephone conversation between Jerry O'Connell, Phlx, and Glen Barrentine and Jennifer Choi, SEC, on September 12, 1995.

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, 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 at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. 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-95-32 and should be submitted by October 19, 1995.

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

Margaret H. McFarland,  
Deputy Secretary.

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[Release No. 34-36257; File No. SR-PHLX-95-31]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Compliance with Position and Exercise Limits for Non-PHLX Listed Options

September 20, 1995.

On March 22, 1995, the Philadelphia Stock Exchange, Inc. ("PHLX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act

of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend PHLX Rules 1001, "Position Limits,"<sup>3</sup> and 1002, "Exercise Limits,"<sup>4</sup> to require PHLX members who trade non-PHLX listed options and who are not members of the exchange where the options transactions are effected to comply with the applicable option position and exercise limits of the exchange where the options transactions are effected.

Notice of the proposed rule change appeared in the Federal Register on June 26, 1995.<sup>5</sup> No comments were received on the proposed rule change.<sup>6</sup>

The PHLX states that the purpose of the proposal is to eliminate a loophole in position and exercise limit jurisdiction among the options exchanges. According to the Exchange, a PHLX member entering into an opening transaction on another exchange in an option not listed on the PHLX and who is not a member of the exchange where the transaction is effected escapes the jurisdiction of both the PHLX and the other exchange for purposes of position limit compliance. The loophole occurs because Exchange Rule 1001 applies only to options dealt in on the PHLX. At the same time, the exchange where the options transaction is effected cannot enforce its position limit rule against a non-member.

The PHLX believes that the proposed amendments to PHLX Rule 1001 should enable the PHLX to exercise jurisdiction over a PHLX member violating the position or exercise limits in non-PHLX listed equity and index options. In pursuing such position and exercise limit violations, the PHLX will apply the position and exercise limits of the other exchange, together with any

applicable exemption, interpretation or policy, to transactions in non-PHLX options by a PHLX member.<sup>7</sup> When a PHLX member enters into an opening transaction on another exchange in a PHLX-listed option, the PHLX will continue to apply the position and exercise limits and exemptions set forth in the PHLX's rules.

The Exchange believes that the proposal is consistent with Section 6 of the Act, in general, and, in particular, with Section 6(b)(5), in that it is designed to remove impediments to and perfect the mechanism of a free and open market as well as to protect investors and the public interest by expanding option exchange position and exercise limit jurisdiction to uniformly cover excessive transactions.

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>8</sup> in that it is designed to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest. Specifically, the PHLX has noted that Exchange rules do not currently prohibit PHLX members from exceeding the position and exercise limits set by another exchange for non-PHLX listed option contracts. Thus, if the PHLX member is not a member of the exchange which lists the options, then neither the PHLX or the exchange that lists the options is able to enforce its position and exercise limits against the PHLX member. The proposal eliminates this loophole and strengthens the Exchange's rules by requiring a PHLX member who trades non-PHLX listed option contracts on another exchange, and who is not a member of that exchange, to comply with the option position and exercise limits set by the exchange where the transactions are effected.<sup>9</sup>

As the Commission has noted in the past,<sup>10</sup> options position and exercise limits are intended to prevent the establishment of large options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the

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

<sup>2</sup> 17 CFR 240.19b-4 (1994).

<sup>3</sup> 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).

<sup>4</sup> 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.

<sup>5</sup> See Securities Exchange Act Release No. 35864 (June 19, 1995), 60 FR 33025.

<sup>6</sup> On July 6, 1995, the PHLX clarified the text of its proposal by (1) deleting a reference to "stock" in PHLX Rule 1001; and (2) adding a reference in PHLX Rule 1002 to options not dealt in on the Exchange and noting that index option position and exercise limits are governed by PHLX Rules 1001A and 1002A. Letter from Gerald D. O'Connell, First Vice President, Market Regulation and Trading Operations, PHLX, to Michael Walinskas, Branch Chief, Office of Market Supervision, Division of Market Regulation, Commission, dated July 6, 1995 ("Amendment No. 1").

<sup>7</sup> The Commission notes that the position and exercise limits in equity options are uniform among all options markets.

<sup>8</sup> 15 U.S.C. 78f(b)(5) (1988 & Supp. V 1993).

<sup>9</sup> As noted above, the PHLX will also apply the exemptions, interpretations, and policies of the exchange where the options transactions are effected.

<sup>10</sup> See, *e.g.*, Securities Exchange Act Release No. 33283 (December 3, 1993), 58 FR 65204 (December 13, 1993) (order approving File No. SR-CBOE-93-43).