

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 Section, 450 Fifth Street, N.W., Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the Amex.

All submissions should refer to File No. SR-Amex-95-56 and should be submitted by February 28, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-36785; File No. SR-Phlx-95-69]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc; Relating to the Bid Test Exemption

January 29, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on January 2, 1996, 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 Organizations' Statement of the Terms of Substance of the Proposed Rule Change

The Phlx proposes to amend its Rule 1072, Reporting Requirements Applicable to Short Sales in NASD/NM Securities, which establishes specific criteria exempting Phlx specialists and

Registered Option Traders ("ROTs") from the National Association of Securities Dealers, Inc. ("NASD") "bid test" applicable to National Market ("NM") securities. The NASD bid test, with certain exceptions, prohibits short sales at or below the current insider bid when that bid is below the previous inside bid.² Specifically, the Phlx proposes to extend its market maker exemption to: (1) Permit an off-floor option or stock option order hedged contemporaneously with an NM security to be eligible for the exemption, with prior Floor Official approval and filing of a written report; and (2) allow the exemption to apply to a company that is involved in a publicly announced merger or acquisition ("M&A") with an NM security.

First, sub-paragraph (A) of Phlx Rule 1072(c)(2)(ii) is proposed to be added to permit a ROT to facilitate an off-floor options or combination order and contemporaneously hedge the resulting option position with a short sale in the applicable NM securities as if such securities were designated securities pursuant to the Rule. The ROT must obtain written Floor Official approval and file with the Market Surveillance Department of the Exchange a written report in a form required by the Exchange. Such ROT must retain a copy of the report to demonstrate that the transaction was bid test exempt.

Second, sub-paragraph (B) of Phlx Rule 1072(c)(2)(ii) is proposed to be added to state that exempt hedge transactions include short sales in M&A securities effected by a qualified Exchange options market maker to hedge, and which in fact serves to hedge, an existing or prospective position in an Exchange-listed option overlying a designated NM security of another company that is a party to the M&A. M&A securities are defined as the securities of a company that is a party or prospective party to a publicly announced merger or acquisition with an issuer of an NM security that underlies an Exchange-listed option.

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

In 1994, the NASD adopted a bid test rule applicable to NM securities traded through Nasdaq prohibiting short sales of NM securities at or below the current inside bid when that bid is below the previous inside bid.³ An exemption from this rule exists for option market makers hedging positions with the underlying securities of that option; qualifying short sales are referred to as "exempt hedge transactions." Pursuant to this market maker exemption, the Phlx adopted Rule 1072 establishing specific criteria for a short sale to qualify as an "exempt hedge transaction" in "designated" NM issues.⁴ Generally, option specialists may rely on the exemption for short sales in NM securities underlying their specialist equity options, and index options if at least 10% of the value of the index is comprised of NM securities. In addition, ROTs must be assigned in that option to rely on the exemption and may only use the exemption in 20 designated NM issues.

The Phlx now proposes to permit the facilitation of certain off-floor orders pursuant to the market maker exemption. The Phlx also proposes to expand the definition of "exempt hedge transaction" to include securities involved in an M&A transaction with NM securities. These amendments to the Exchange's exemptive rule are similar to recent changes by other options exchanges.⁵

Facilitating Orders

The Phlx proposes to permit certain hedge transactions in NM securities by a ROT to be considered executed in "designated" issues for purposes of qualifying as exempt hedge transactions.

³ Securities Exchange Act Release No. 34277 (June 6, 1994), 59 FR 34885 (granting temporary approval).

⁴ Securities Exchange Act Release No. 34632 (September 2, 1994), 59 FR 46999. The other options exchanges adopted rules similar to Phlx Rule 1072. See Chicago Board Options Exchange ("CBOE") Rule 15.10, New York Stock Exchange ("NYSE") Rule 759A, American Stock Exchange ("Amex") Rule 957, and Pacific Stock Exchange ("PSE") Rule 4.19. *Id.*

⁵ Respecting facilitation orders, see Securities Exchange Act Release No. 35281 (January 26, 1995), 60 FR 6575 ("CBOE"); and respecting M&A securities, see Securities Exchange Act Release Nos. 35211 (January 10, 1995), 60 FR 3887 (Amex, CBOE, and PSE) as well as 36019 (July 24, 1995), 60 FR 39035 (NYSE).

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1) (1988).

² NASD Rules of Fair Practice, Art. III, Section 48.

Such a transaction must contemporaneously hedge an option position resulting from the facilitation of an option or stock-option order originating from off-floor. The Exchange believes that this provision is consistent with the NASD's interpretation regarding hedging activities associated with the facilitation of customer transactions in options, as cited by the Commission in its approval of a similar CBOE provision.⁶ To ensure that the transaction qualifies for the proposed provision, the filing of a written report with the Market Surveillance Department of the Exchange, indicating Floor Official approval, is required. Floor Official approval is intended as a monitoring technique. Similarly, the Phlx believes that the written report should aid surveillance efforts regarding Rule 1072 in general, and, more specifically, the requirements of this proposed provision. Surveillance capabilities should be further enhanced by the requirement that a ROT relying on this provision maintain a copy of the report. Thus, the Phlx believes that this facilitation provision should operate consistently with the purposes of the market maker exemption contained in the Rule. Exempting such hedge transactions should promote facilitation orders in the option marketplace as well as liquidity in the underlying NM security.

M&A Transactions

The Phlx proposes to expand the definition of "exempt hedge transaction" in its market maker exemption to permit short sales in securities involved in a publicly announced M&A with a designated NM security in order to foster liquidity and promote effective hedging. The Exchange notes that the proposed expansion of the market maker exemption must involve a publicly announced M&A.⁷ The Exchange also notes that the NASD provides an exemption from the bid test for risk arbitrageurs who take positions in stocks involved in M&A transactions,⁸ and that the other option exchanges have adopted this change to their respective rules.⁹

⁶ See Securities Exchange Act Release No. 35281, *supra* note 5.

⁷ Once an M&A has been publicly announced, a qualified market maker in one of the two affected securities may immediately register as a qualified market maker in the other security, and thus rely on the market maker exemption in such other security. See NASD Rules, Art. III, Section 48(1)(3)(iii).

⁸ See Securities Exchange Act Release No. 34277, *supra* note 3.

⁹ See Securities Exchange Act Release Nos. 35211 and 36019, *supra* note 5.

As applied to the Phlx specialist, the proposed exemption would apply to short sales of a company that is party to an M&A with a company whose NM security underlies a speciality stock option (or qualified index option). As applied to a Phlx ROT, the exemption would extend to a company that is party to an M&A with a company whose NM security underlies an option designated by such ROT. The Phlx believes that specialists and ROTs may need to hedge option positions with the securities involved in an M&A with the underlying security, whether or not the security of such other company has overlying listed options. This ability to hedge is central to the market making function, and should thereby promote liquidity in the markets for the option as well as both securities.

The Exchange believes that the proposal is consistent with the NASD's bid test rule and addresses the limitations established by the NASD concerning the applicability of the market maker exemption. Specifically, the Phlx believes that the ability to hedge facilitated off-floor option orders constitutes legitimate hedging activity by a ROT with resulting benefits to the marketplace, while restricting the expansion of the exemption to *bona fide*, Exchange-monitored transactions. The Exchange also believes that expanding the definition of exempt hedge transaction to include M&A securities should enable effective hedging in the often-volatile markets surrounding M&A events, which should, in turn, promote liquidity.

For these reasons, the Exchange believes that its 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 promote just and equitable principals of trade, prevent fraudulent and manipulative acts and practices, 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 promoting options trading where an M&A is involved or an off-floor order seeks facilitation, which, in turn, creates a hedging need, thereby promoting liquidity and the essence of the market making function.

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

The Phlx 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

Written comments on the proposed rule change were neither solicited nor 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 self-regulatory organization 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, 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 Section, 450 Fifth Street NW., Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to File No. SR-Phlx-95-69 and should be submitted by February 28, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,
Deputy Secretary.

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¹⁰ 17 CFR 200.30-3(a)(12) (1994).