

expand the coverage of the Member Death Benefit Program to cover any individual who (i) was an active member within 90 days prior to the date of his or her death and (ii) was an active member during at least 274 out of the 365 days preceding the date of his or her last termination from active member status. This expanded coverage would be in addition to the Program's current coverage of any individual who is an active member at the time of his or her death. Second, the Exchange proposes to establish a defined member death benefit under the Program of \$50,000. This \$50,000 benefit would replace the current member death benefit under the Program which is based on the number of active members at the time of a member's death. Accordingly, instead of being billed \$25 by the Exchange after a member death benefit payout has occurred, under the proposed rule change each active member will be assessed an amount equal to \$50,000 divided by the number of active members at the time of the assessment.

The proposed rule change also makes two clarifications concerning the administration of the Member Death Benefit Program. First, the proposed rule change clarifies that in no event shall more than one member death benefit be paid by reason of the death of an individual who is eligible to receive the member death benefit. Second, the proposed rule change clarifies that the active members who will be assessed after a member death benefit has been paid by the Exchange will be those individuals who are active members at the time of the assessment. The actual date upon which such assessments will occur will be at the discretion of the Exchange. Finally, the proposed rule change makes certain editorial changes to Rule 3.24 that do not affect its substance.

The purpose of the Member Death Benefit Program is to provide a death benefit to the designated beneficiaries of active members. The Exchange believes that the proposed rule change will further that purpose and provide for a fairer and more appropriate way to provide the member death benefit. For example, currently if an individual who has been an active member for three quarters of the previous year temporarily leaves his seat in order to take a short vacation, that individual would not be covered by the Member Death Benefit Program in the event that the individual were to pass away while on vacation. The same is true if the individual were to temporarily leave his seat because of an illness or accident and then were to pass away shortly thereafter. The proposed rule change is

intended to cover these types of individuals under the Member Death Benefit Program because they have been active members for much of the year preceding the time of their death.

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act, in general, and furthers the objectives of Sections 6(b)(4) and 6(b)(5) of the Act in particular, in that it is designed to (i) provide for the equitable allocation of reasonable dues, fees, and other charges among Exchange members and (ii) remove impediments to and perfect the mechanism of a free and open market and a national market system by serving to assist the Exchange in attracting and retaining active members through the enhancement of the financial security of their families in the event their death.

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

The Exchange believes that the proposed rule change will impose no 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 solicited or received with respect to the proposed rule change.

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 findings or (ii) as to which the Amex 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 persons, 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. 20549. 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-CBOE-96-13 and should be submitted by April 10, 1996.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.³

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-36964; File No. SR-CBOE-95-68]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to an Expansion of the Firm Facilitation Exemption to All Non-Multiply-Listed Exchange Option Classes

March 13, 1996.

I. Introduction

On November 16, 1995, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("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 expand the firm facilitation exemption for position and exercise limits that is currently available for the Standard & Poor's ("S&P") 500 Index ("SPX") options and for interest rate options to all non-multiply-listed Exchange option classes.

Notice of the proposed rule change appeared in the Federal Register on December 27, 1995.³ No comments were received on the proposed rule change. The Exchange subsequently filed Amendment No. 1 to the proposed rule

³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. § 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 36609 (December 20, 1995), 60 FR 67002 (December 27, 1995).

change on March 12, 1996.⁴ This order approves the CBOE's proposal, as amended.

II. Background and Description

The CBOE has previously established firm facilitation⁵ exemptions for SPX index options (Rule 24.4.03)⁶ and for interest rate options (Rule 23.3(c)).⁷ Exchange member firms have expressed to the CBOE's Department of Market Regulation their belief that the current firm facilitation exemptions that are available in these option classes, which allow member firms to meet the investing needs of their customers in such options, should be expanded floor-wide. The CBOE has also noted situations in which a member firm was willing to accommodate a large customer order⁸ that could not be filled by the trading crowd, but was prevented from facilitating the order because of a position limit constraint. In light of the above, the CBOE proposes that the firm facilitation exemption be made available to all non-multiply-listed Exchange options classes.⁹

The CBOE proposes to expand the firm facilitation exemption by incorporating it as new Interpretation and Policy .06 to Rule 4.11, the general position limit rule.¹⁰ By including the firm facilitation exemption within Rule 4.11, the exemption would be available to equity, broad-based index, narrow-

based index, Flexible Exchange ("FLEX"), interest rate, and government securities option classes to the extent and at the levels specified therein.¹¹

As is the case with the SPX and interest rate firm facilitation exemptions, Exchange Rule 6.74(b) procedures for crossing a customer order with a firm facilitation order must be followed. In this regard, before a customer order can be crossed with a firm facilitation order, the trading crowd must be given reasonable opportunity to participate. Moreover, only after it has been determined that the trading crowd will not fill the order, may the firm's customer order be crossed with the firm's facilitation order.

In addition, except for the existing SPX and interest rate firm facilitation exemptions which are set at higher levels, the expanded firm facilitation exemption will be twice the standard limit.¹²

The CBOE notes that the firm facilitation exemption will be in addition to and separate from the standard limit, as well as other exemptions available under Exchange position limit rules. For example, if a firm desires to facilitate customer orders in the XYZ option class, which is assumed to be a class of options that is not multiply-listed and has a 25,000 contract standard position limit, the firm may qualify for a firm facilitation exemption of up to twice the standard limit (50,000 contracts), as well as an equity hedge exemption of up to twice the standard limit (50,000 contracts), in addition to the 25,000 contract standard limit. If both exemptions are allowed, the facilitation firm may hold or control a combined position of up to 125,000 XYZ contracts on the same-side of the market.

The CBOE notes, however, that the firm facilitation exemption will not presently extend to all option classes listed on the Exchange. Rather, until coordinated intermarket procedures are developed, the exemption will be extended only to non-multiply-listed option classes.¹³

¹¹ The CBOE notes that the structuring of the rule proposal in this manner is important because the special position limits for broad-based index options (Rule 24.4), for narrow-based index options (Rule 24.4A), for FLEX options (Rule 24A.7), for interest rate options (Rule 23.3), and for government securities options (Rule 21.3) each mandate compliance with Rule 4.11. CBOE Rule 4.11 also specifically governs the position limits applicable to equity option classes.

¹² The CBOE notes that this filing does not propose to change the existing SPX and interest rate firm facilitation exemptions.

¹³ The CBOE notes, however, that the Intermarket Surveillance Group ("ISG") is currently working on developing such procedures.

Under the CBOE's proposal, the facilitation firm must receive approval from the Exchange's Exemption Committee prior to executing facilitating trades. Although Exchange approval may be granted on the basis of verbal representations, the facilitation firm is required to furnish to the Exchange's Department of Market Regulation, within two business days or such other time period designated by the Exchange,¹⁴ forms and documentation substantiating the basis for the exemption. Within five business days after the execution of a facilitation exemption order, a facilitation firm must hedge all exempt options positions that have not previously been liquidated, and furnish to the Exchange's Department of Market Regulation documentation reflecting the resulting hedging positions. In meeting this requirement, the facilitation firm must liquidate and establish its customer's and its own options and stock positions or their equivalent in an orderly fashion, and not in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes. In addition, a facilitation firm is not permitted to use the facilitation exemption for the purpose of engaging in index arbitrage. Moreover, the facilitation firm is required to promptly provide to the exchange any information or documents requested concerning the exempted options positions and the positions hedging them, as well as to promptly notify the Exchange of any material change in the exempted options position or the hedge.

III. Discussion

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, with the requirements of Section 6(b)(5).¹⁵ Specifically, the Commission believes that the CBOE's proposal is reasonably designed to accommodate the needs of investors and other market participants without substantially increasing concerns regarding the potential for manipulation and other trading abuses. The Commission also believes that the proposed rule change has the potential to enhance the depth and liquidity of the options market by providing Exchange members greater flexibility in executing large customer orders.

¹⁴ Telephone conversation between Mary Bender, Senior Vice President, Division of Regulatory Services CBOE, and Matthew S. Morris, Attorney, Office of Market Supervision, Division of Market Regulation, Commission, on March 6, 1996.

¹⁵ 15 U.S.C. § 78f(b)(5) (1988).

⁴ In Amendment No. 1, the CBOE deleted reference to a facilitating firm's ability to receive a position limit exemption when hedging a facilitation exemption order with opposite side of the market option contracts. In addition, Amendment No. 1 clarified the Exchange's proposal by stating that facilitation exempted positions are to be viewed in the aggregate. See letter from Mary L. Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Holly Smith, Associate Director, Division of Market Regulation, Commission, dated March 12, 1996 ("Amendment No. 1").

⁵ The CBOE defines a facilitation trade as a transaction that involves crossing an order of a member firm's public customer with an order for the member firm's proprietary account.

⁶ See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (approval order for File No. SR-CBOE-92-09).

⁷ See Securities Exchange Act Release No. 33106 (October 26, 1993), 58 FR 58358 (November 1, 1993) (approval order for File No. SR-CBOE-93-21).

⁸ The CBOE notes that the SPX facilitation exemption defines a customer order as one that is entered, cleared, and in which the resulting position is carried on behalf of the customer with the firm.

⁹ The CBOE's general exercise limit provisions (Rule 4.12) also will be amended to increase exercise limits to the levels permitted by the firm facilitation exemption. Several other non-substantive, editorial changes to the position and exercise limit rules, interpretations, and policies will be made as well.

¹⁰ Through the rule proposal, the firm facilitation exemption provisions contained in Rule 24.4.03 (for SPX index options) and in Rule 23.3(c) (for interest rate options) would be eliminated.

Accordingly, as discussed below, the Commission believes that the rule proposal is consistent with the requirements of Section 6(b)(5) that exchange rules facilitate transactions in securities while continuing to further investor protection and the public interest.

The CBOE proposal contains several safeguards in connection with the expanded facilitation exemption that will serve to minimize any potential disruption or manipulation concerns. These safeguards are very similar to the structure and process that is currently employed in obtaining a facilitation exemption in SPX and interest rate options.¹⁶

First, the facilitation firm must receive approval from the Exchange's Exemption Committee prior to executing facilitating trades. Although Exchange approval may be granted on the basis of verbal representations, the Commission believes that trading abuses are unlikely because the facilitation firm is required to furnish to the Exchange's Department of Market Regulation, within two business days or such other time period designated by the Exchange, forms and documentation substantiating the basis for the exemption.

Second, a facilitation firm must, within five business days after the execution of a facilitation exemption order, hedge all exempt options positions that have not previously been liquidated, and furnish to the Exchange's Department of Market Regulation documentation reflecting the resulting hedging positions. In meeting this requirement, the facilitation firm must liquidate and establish its customer's and its own options and stock positions or their equivalent in an orderly fashion, and not in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes. In addition, a facilitation firm is not permitted to use the facilitation exemption for the purpose of engaging in index arbitrage. The Commission believes that these requirements will help to ensure that the facilitation exemption will not have an undue market impact on the options or any underlying stock positions.

Third, the facilitation firm is required to promptly provide to the Exchange any information or documents requested

¹⁶In approving the firm facilitation exemptions for SPX and interest rate options, the Commission expressed its opinion that providing member organizations with exemptions for the purpose of facilitating large customer orders would better serve the needs of the investing public. At that time, the Commission also noted that safeguards were built into the exemption to minimize any potential disruption or manipulation concerns. See *supra* notes 6 and 7.

concerning the exempted options positions and the positions hedging them, as well as to promptly notify the Exchange of any material change in the exempted options position or the hedge.

Fourth, neither the member's nor the customer's order may be contingent on "all or none" or "fill or kill" instructions, and the orders may not be executed until Exchange Rule 6.74(b) procedures have been satisfied and crowd members have been given a reasonable time to participate in the trade.

Fifth, in no event may the aggregate exempted position under this interpretation exceed the number of contracts specified in the exemption's table, *i.e.*, twice the applicable standard limit, excluding SPX and interest rate options.¹⁷

Sixth, the facilitation firm may not increase the exempted options position once it is closed, unless approval from the Exchange is again received pursuant to a reapplication under Interpretation .06.

In summary, the Commission believes that the safeguards built into the facilitation exemption process discussed above should serve to minimize the potential for disruption and manipulation concerns, while at the same time benefitting market participants by allowing member firms greater flexibility to facilitate large customer orders. This structure substantially mirrors the process that has existed for granting firm facilitation exemption requests for SPX and interest rate options, and the CBOE has surveillance procedures to surveil for compliance with the rule's requirements. Accordingly, the Commission believes it is appropriate to extend the benefits of the SPX and interest rate option facilitation exemptions to other option classes traded on the CBOE.

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 1 deletes reference to a facilitating firm's ability to receive a position limit exemption when hedging a facilitation exemption order with opposite side of the market option contracts. In addition, Amendment No. 1 clarifies the Exchange's proposal by stating the facilitation exempted positions are to be viewed in the aggregate. Both revisions

¹⁷The Commission notes that for SPX options, the facilitating exemption is 100,000 contracts, and for interest rate options, the facilitating exemption is three times the applicable standard limit. These levels are the same as under the current rules.

narrow the scope of the proposed rule change, thereby reducing concerns regarding the potential for manipulation or market disruption. Accordingly, the Commission believes that it is consistent with Section 6(b)(5) of the Act to approve Amendment No. 1 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1 to the rule proposal. 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 at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-95-68 and should be submitted by April 10, 1996.

V. Conclusion

For the foregoing reasons, the Commission finds that the CBOE's proposal to expand the firm facilitation exemption for position and exercise limits to all non-multiply-listed Exchange option classes is consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁸ that the proposed rule change (SR-CBOE-95-68), including Amendment No. 1, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegate authority,¹⁹

Margaret H. McFarland,
Deputy Secretary.

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¹⁸ 15 U.S.C. § 78s(b)(2) (1988).

¹⁹ 17 CFR 200.30-3(a)(12) (1994).