

class, which is assumed not to be multiply-listed and also assumed to have 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.

Initially, the Exchange intends to provide the facilitation exemption to member firms only for positions in equity options that are solely listed on the Exchange and not for multiply-listed equity options. The reason for this temporary limitation is to allow the options exchanges, working through the Intermarket Surveillance Group ("ISG"), to develop uniform procedures to assure that all market participants at each exchange are given an opportunity to participate in an order before a member firm is given an exemption from the position limit rules.

Under the proposal, member firms must receive approval from the Exchange prior to executing the facilitating order which would result in the firm exceeding position limits. Although permission may be obtained based on oral representations, the facilitation firm is required to furnish to the Exchange, within two business days or such other time period designated by the Exchange, forms and documentation substantiating the basis for the exemption. Further, to remain qualified for the exemption, the member firm must, within five business days after the execution of the exempted order, hedge all exempt option positions that have not previously been liquidated, and furnish to the Exchange documentation reflecting the resulting hedging position. In meeting this requirement, the facilitation firm must liquidate and establish its customer's and its own option 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 option positions and the positions hedging them, as well as to promptly notify the Exchange of any material change in the exempted option positions or the hedge.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act in general and furthers the objectives of Section 6(b)(5) in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and is not designed to permit unfair discrimination between customers, issuers, brokers, and dealers.

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

The Exchange does not believe 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*

The Exchange has neither solicited nor received written comments with respect to the proposed rule change.

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

Because the foregoing proposed rule change: (1) does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; (3) was provided to the Commission for its review at least five business days prior to the filing date; and (4) does not become operative for 30 days from April 9, 1996, the date on which it was filed, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4(e)(6) thereunder. In particular, the Commission believes that the proposal qualifies as a "noncontroversial filing" in that the proposed amendments do not significantly affect the protection of investors or the public interest and do not impose any significant burden on competition. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate for 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. 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 Amex. All submissions should refer to File No SR-Amex-96-11 and should be submitted by June 5, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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[Release No. 34-37186; File No. SR-PSE-96-12]

## **Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Stock Exchange, Inc. Relating to Financial Arrangements of Market Makers**

May 9, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on April 5, 1996, the Pacific Stock Exchange Incorporated ("PSE" 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 Organization's Statement of the Terms of Substance of the Proposed Rule Change**

The PSE proposes to amend its rules on the trading restrictions that apply to Options Floor Members with "financial arrangements" as defined in PSE Rule 6.40.

<sup>5</sup> 17 CFR 200.30-3(a)(12) (1994).

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

## 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

PSE Rule 6.40(a) currently provides that two Members have a "financial arrangement" with each other for purposes of Rule 6.40 if: (1) one Member directly finances the other Member's dealings on the Exchange and has a beneficial interest in the other Member's trading account such that the first Member is entitled to at least 10% of the second Member's trading profits; or (2) both Members are trading for the same joint account. Rule 6.40(b) provides that two Members with a financial arrangement may not bid, offer and/or trade in the same trading crowd without a written exemption from two floor officials.<sup>2</sup> Commentary .06 sets forth the circumstances under which the Options Floor Trading Committee ("OFTC") ordinarily may grant an exemption to those trading restrictions, *i.e.*, to provide liquidity in the trading crowd.

The Exchange proposes to redefine the term "financial arrangements" for purposes of Rule 6.40, so that two Members have a financial arrangement with each other if: (1) One Member directly finances the other Member's dealings on the Exchange, the amount financed is \$5,000 or more, and the Member providing the financing is entitled to a share of the other Member's trading profits; or (2) both Members are registered with the Exchange as nominees of the same Member Organization; or (3) both Members are registered with the Exchange to trade on behalf of the same joint account; or (4) both Members' dealings on the Exchange are financed by the same

<sup>2</sup> Under PSE Rule 6.40, Commentary .05, two or more Lead Market Makers ("LMMs") who are trading on behalf of the same Member organization may not trade in the same option series at the same time, but may trade in the same trading crowd at the same time.

source, the amount financed is \$5,000 or more, and the Member providing the financing is entitled to a share of each of the other Members' trading profits. The proposal states that Members with "financial arrangements," as defined, may not bid, offer and/or trade in the same trading crowd at the same time in the absence of an exemption from the OFTC.

The proposal further provides for both long-term and short-term exemptions that can be provided by the OFTC or two Floor Officials, respectively. Proposed Rule 6.40(b)(4) states, more specifically, that the OFTC may grant long-term exemptions to Members on a case-by-case basis if it determines that a fair and orderly market would not be impaired by allowing such Members with financial arrangements to trade in the same trading crowd at the same time. It further states that in making such determinations, the Committee shall consider the following factors; (1) The nature of the financial arrangement; (2) the degree of independence to be maintained by the applicants in making trading decisions; (3) the impact on competition in the trading crowd if an exemption were granted; (4) the applicants' prior patterns of trading if they have traded previously in the same trading crowd at the same time; and (5) any other information relevant to whether the applicants would tend collectively to dominate the market in a particular trading crowd or a particular option series. The proposal further states that the Committee may revoke any long-term exemption granted pursuant to this subsection if it determines that a fair and orderly market otherwise would be impaired by a continuation of the exemption. The Exchange believes that the proposed criteria to be used by the OFTC in granting long-term exemptions will provide for even-handed treatment of Members who apply for a long-term exemption. With respect to short-term exemptions, the proposal states that two Floor Officials may grant short-term exemptions to Members on a case-by-case basis if such Floor Officials determine that a fair and orderly market would not be impaired and that the need for liquidity in the trading crowd warrants such action.

The Exchange believes that the proposed definition improves upon the current definition by expanding, to an appropriate extent, the scope of persons who are covered by its terms. Specifically, the current rule allows two or more Members who are backed financially by the same source (*i.e.*, Members with "indirect" financial arrangements), to trade in the same

crowd or same series as long as they are not receiving trading profits from each other and are not trading for the same joint account. This however, allow for certain situations where the spirit (*i.e.*, to prevent one source from dominating the market in a particular option issue or dominating a particular trading crowd), but not the letter, of Rule 6.40 might be violated. The Exchange believes that the proposed rule would better assure that such situations do not occur and that competition will continue to be maintained in each trading crowd.<sup>3</sup>

The Exchange also proposed to remove a provision in the current rule that states that the primary appointment of a market maker may not include trading posts that constitute the primary appointment of any market maker with whom the first market maker has an existing financial arrangement.<sup>4</sup> The Exchange believes that that rule is superfluous in light of the trading restrictions set forth in Rule 6.40. Moreover, the Exchange believes that Members trading for joint accounts should be permitted to establish overlapping primary appointment zones to allow for coverage on the floor when members who trade for those accounts are temporarily absent from the floor. In this regard, the Exchange notes that the Commission recently approved a PSE rule change to increase from two to six the maximum number of trading posts that may be included within a market maker's primary appointment zone.<sup>5</sup>

Finally, the PSE proposes to add violations of Rule 6.40(b) to the Exchange's Minor Rule Plan<sup>6</sup> with recommended fines of \$500, \$1,000 and \$1,500 for first-, second- and third-time violations, respectively. The Exchange believes that violations of Rule 6.40(b) are easily ascertainable and easily verifiable, and, therefore, are appropriate for inclusion in the Minor Rule Plan.

The Exchange believes that the proposal is consistent with Section 6(b) of the Act, in general, and Section 6(b)(5), in particular, in that it is designed to promote just and equitable principles of trade, and to protect investors and the public interest.

<sup>3</sup> Current Commentary .04 to Rule 6.40 attempts to address the problem of market domination by multiple traders with "indirect" financial arrangements by expressly prohibiting unfair domination of markets. In this regard, the Exchange believes that the proposed rule improves upon the current rule by relying more on the nature of the financial arrangement and less on patterns of trading.

<sup>4</sup> See PSE Rule 6.35, Commentary .05.

<sup>5</sup> See Exchange Act Release No. 36370 (October 13, 1995), 60 FR 54273.

<sup>6</sup> PSE Rule 10.13.

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

The Exchange 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**

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, N.W., 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-PSE-96-12 and should be submitted by June 5, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

Margaret H. McFarland,  
*Deputy Secretary.*

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[Release No. 34-37178; File No. SR-PSE-96-10]

**Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Pacific Stock Exchange, Inc., To Establish a Firm Facilitation Exemption**

May 8, 1996.

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> notice is hereby given that on April 4, 1996, the Pacific Stock Exchange, Inc. ("PSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization. The PSE subsequently filed Amendment No. 1 to the proposed rule change on May 2, 1996.<sup>3</sup> The PSE has requested accelerated approval for the proposal. This order approves the PSE's proposal, as amended, on an accelerated basis and solicits comments from interested persons.

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

The PSE is proposing to amend its rules on option position limits in order to establish a firm facilitation exemption to such limits.

**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 PSE 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 III below. The PSE 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 PSE is proposing to establish a firm facilitation exemption<sup>4</sup> for all non-multiply-listed Exchange option issues by adding new Commentary .08 to Exchange Rule 6.8, the general options position limit rule.<sup>5</sup> The exemption would be available to equity, broad-based index, narrow-based index, Flexible Exchange ("FLEX"), interest rate, and government securities option issues to the extent and at the levels specified therein.

Under the proposal, the procedures in Exchange Rule 6.47(b) and Options Floor Procedure Advice A-6 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 a 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 an interest rate firm facilitation exemption, which is set at a higher level, the firm facilitation exemption will be twice the standard limit.

The PSE 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 issue, which is assumed not to be multiply-listed and also assumed to have 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

<sup>4</sup> The Commission notes that a facilitation trade is defined 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.

<sup>5</sup> The PSE's exercise limit provisions will correspond to the increase in position limit levels permitted by the firm facilitation exemption.

<sup>7</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> On May 2, 1996, the PSE filed Amendment No. 1 to the proposed rule change to include within the rule text the requirement that if the Exchange grants a facilitation exemption on the basis of oral representations, the member organization must file the appropriate forms and documentation substantiating the basis for the exemption within either two business days or a period of time to be designated by the Exchange ("Amendment No. 1"). See Letter from Michael D. Pierson, Senior Attorney, Market Regulation, PSE, to Matthew S. Morris, Attorney, Office of Market Supervision, Division of Market Regulation, Commission, dated May 2, 1996.