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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40015; File No. SR-CBOE-98-11]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Adjustments in Market Maker Equity

May 20, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on March 31, 1998, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE.² 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 CBOE proposes to amend CBOE Rule 12.3, "Margin Requirements" by adopting Interpretation and Policy .06, which will allow clearing firms to adjust a market maker's equity under certain limited circumstances so that the clearing firm may extend credit for opening trades. Specifically, proposed Interpretation and Policy .06 will allow a clearing firm to adjust the equity in a market maker's account when the underlying stock price is disseminated after the options close at 3:02 p.m.³ at

¹ 15 U.S.C. 78s(b)(1).

² On May 7, 1998, the CBOE filed Amendment No. 1 to the proposal. See Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Yvonne Fraticelli, Division of Market Regulation, Commission, dated May 6, 1998 ("Amendment No. 1"). In Amendment No. 1, the CBOE revised its proposal to: (1) indicate that CBOE Rule 12.3(f)(3)(C)(3), rather than Regulation X of the Board of Governors of the Federal Reserve System, prohibits a clearing firm from extending credit to a market maker when the market maker's account is in deficit; (2) replace a reference in proposed Interpretation and Policy .06 to CBOE Rule 12.3(b)(1)(D) with a reference to CBOE Rule 12.3(f)(1)(F) to define net liquidating equity; and (3) revise proposed Interpretation and Policy .06 to indicate that clearing firms will be allowed to extend credit for opening trades, rather than to permit opening trades.

³ All time references are in Central Time.

a price that is inconsistent with the options closing price.

Copies of the proposed rule change are available at the Office of the Secretary, CBOE, 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 CBOE 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 CBOE 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

CBOE Rule 12.3(f)(3)(C)(3)⁴ prohibits clearing firms from extending credit to a market maker for opening transactions when the market maker's account is in deficit. The CBOE proposes to add Interpretation and Policy .06 to CBOE Rule 12.3 to permit a clearing firm to adjust the equity in a market maker's account under certain limited circumstances in order to allow the clearing firm to extend credit for opening trades. Specifically, proposed Interpretation and Policy .06 will permit a clearing firm to adjust the equity in market maker's account when the underlying stock price is disseminated after the options close at 3:02 p.m. at a price that is inconsistent with the options closing price.

In 1997, the CBOE and the other options exchanges changed the closing time for trading equity options and certain narrow-based index options from 3:10 p.m. to 3:02 p.m.⁵ Since then, the CBOE has discovered that the equity of market maker's account at a clearing firm can be severely affected when news of a stock underlying a CBOE option is disseminated near the close, resulting in heavy trading and a late trade tape. In these situations, the last sale of the underlying stock could be disseminated well after the overlying options stop trading at 3:02 p.m.,⁶ and closing price

⁴ See Amendment No. 1, *supra* note 2.

⁵ See e.g., Securities Exchange Act Release No. 38543 (May 14, 1997), 62 FR 28082 (May 22, 1997) (order approving File No. SR-CBOE-96-71).

⁶ When the options markets closed at 3:10 p.m., this situation would rarely arise because the final

of the underlying stock may be out of line with the closing quotes and the last sale of the options series. The CBOE notes that while this situation would almost assuredly realign itself at the opening of trading on the next day, the discrepancy in closing prices may cause a market maker's account to have deficit equity. This is true even though from a market risk standpoint the market maker may be hedged.

Proposed Interpretation and Policy .06 would allow a clearing firm to appropriately adjust a market maker's account equity to eliminate a pricing disparity for a trader whose account is in deficit as a result of such a situation. The clearing firm will be required to provide documentation to the CBOE for such adjustments before the opening of trading the next day (or before the firm may extend credit for opening transactions). These adjustments will be made on a case-by-case basis. In situations where the deficit is eliminated by the adjustment and the adjustment is approved by the CBOE's Department of Financial and Sales Practice Compliance, the trader would be permitted to continue trading the next business day.

2. Statutory Basis

The CBOE 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, by allowing for an adjustment in a market maker's account equity in situations where the stock and the overlying options close at anomalous prices, the proposal is designed to promote just and equitable principles of trade and to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change will impose any 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**

stock prices were almost always disseminated by the time the options markets closed, thereby allowing options market makers to adjust their quotes accordingly.

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 by order approve such proposed rule change, or 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, including whether the proposed rule change is consistent with the Act. 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 CBOE. All submissions should refer to File No. SR-CBOE-98-11 and should be submitted by June 18, 1998.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40021; File No. SR-CBOE-98-12]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Exchange Mandated Education Training

May 21, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,¹ notice is hereby given that on April 20, 1998, the Chicago Board Options Exchange, Incorporated ("CBOE" 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 CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to grant accelerated approval on the proposed rule change.

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

The CBOE proposes to add a provision of Exchange Rule 6.20 Admission to and Conduct on the Trading Floor, Member Education, to require that Exchange members and persons associated with Exchange members attend mandatory continuing education classes as directed by the Exchange. Proposed new language is in italics.

Chicago Board Options Exchange, Inc. Rules

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CHAPTER VI

Doing Business on the Exchange Floor

Section B: Member Activities on the Floor

Admission to and Conduct on the Trading Floor: *Member Education*
Rule 6.20(a)—(c) No change.

(d) *Education Classes. Members and persons associated with members are required to attend such educational classes as the Exchange may require from time to time. Failure to attend Exchange mandated continuing educational classes may subject members and persons associated with members to sanctions pursuant to the Exchange's Minor Rule Violation provided in Exchange Rule 17.50. Any*

action taken by Floor Officials thereunder shall not preclude further disciplinary action by the Business Conduct Committee under Chapter XVII of the Rules, except as otherwise provided in Rule 17.50.

. . . Interpretations and Policies:
.01-.09 No change.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, CBOE included statements concerning the purpose of, and statutory 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 CBOE 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 Exchange is proposing to add a provision to Exchange Rule 6.20, Admission to and Conduct on the Trading Floor; Member Education, to require that Exchange members and persons associated with Exchange members attend mandatory continuing education classes as directed by the Exchange. The Exchange believes it is necessary from time to time to require mandatory participation in certain educational training classes by its members and persons associated with its members for a variety of reasons, including to promote professional behavior and decorum on the trading floor, or to explain the operation of new technology. For example, the Exchange intends to implement a harassment awareness training and ethics program for its members and persons associated with its members who are present on the trading floor.

Without this rule change, the Exchange would not have the ability to mandate attendance. The Exchange is also proposing to amend its Minor Rule Violation fine schedule pursuant to Exchange Rule 17.50(g)(6). Floor Officials are allowed, pursuant to Rule 17.50(g)(6), to fine members and associated persons for violations of trading conduct and decorum policies. For failure to attend an Exchange mandated continuing educational class, the Exchange proposes a fine of \$500 for a first offense, \$750 for a second offense

⁷ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).