The Exchange is now proposing to adopt a rule providing that any registered specialist who fails into the bottom 10% of all registered specialists on his trading floor as determined by the overall evaluation scores received by each specialist in any one quarterly evaluation shall not be eligible for new allocations until such ranking rises above the bottom 10%.[8] However, the proposal also provides that the EAC may make exceptions if there are sufficient mitigating circumstances.[9]

At the PSE's specialist evaluation results and overall rankings are reported in the quarter following the quarter of the evaluation, *e.g.*, the results of the fourth quarter of 1995 are reported in the first quarter of 1996. Accordingly, a specialist who was in the bottom 10% for the fourth quarter of 1995 will not be eligible for new allocations of stocks until, at the earliest, the second quarter of 1996, when the results from the first quarter of 1996 are reported.

The Exchange believes that the restriction on new allocations is an effective tool in encouraging specialists to improve their performance, and thereby to improve their evaluation scores.[10]

The Commission finds that the PSE's proposal to codify its policy that a specialist whose quarterly evaluation score falls in the bottom 10% of registered specialists on his or her trading floor shall not be eligible for any allocations of stock until such specialist is no longer in the bottom 10% is consistent with the requirements of Sections 6 and 11 of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds that the proposed rule change is consistent with the Section 6(b)(5)[11] requirement that the rules of an exchange be 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, and, in general, to protect investors and the public interest. Further, the Commission finds that the proposal is consistent with Section 11(b) of the Act[12] and Rule 11b–1 thereunder[13] which allow national securities exchanges to promulgate rules relating to specialists in order to maintain fair and orderly markets and to remove impediments to and perfect the mechanism of a national market system. For the reasons set forth below, the Commission believes that the proposal should encourage improved specialist performance, consistent with the protection of investors and the public interest.

Specialists play a crucial role in providing stability, liquidity, and continuity to the trading of stocks. Among the obligations imposed upon specialists by the Exchange, and by the Act and the rules promulgated thereunder, is the maintenance of fair and orderly markets in their designated securities.[14] To ensure that specialists fulfill these obligations, the Commission has encouraged the Exchange to have an effective program for evaluating specialists' performance. In this regard, the Commission believes that stocks should be allocated to those specialists who are performing the best. Such stock allocation policies encourage specialists to strive for optimal market making performance.

At present, the only incentive to improved specialist performance found in the PSE specialist performance evaluation program that is applicable beginning with a specialist's first quarter of ranking in the bottom 10% is the restriction on acting as an alternate specialist while the specialist remains ranked in the bottom 10%.[15] The proposed rule change will add another such incentive to the PSE rules by codifying an existing policy of the Exchange that restricts specialists whose ranking falls in the bottom 10% of specialists on his or her floor from eligibility for any allocations (*i.e.*, allocations of new issues, reallocations of existing issues, or swapping of issues with other specialists) until such specialist is no longer in the bottom 10%.

The Commission believes that the codification of this policy into the PSE rules will be an effective and appropriate means by which to encourage improved specialist performance. As a specialist's profitability is directly related to the stocks he or she is allocated, the possibility of a restriction on allocations will provide a strong incentive to PSE specialists to remain out of the bottom 10%. This should translate into improved market making performance by specialists, thereby benefitting investors. Moreover, the imposition of the restriction on allocations to specialists in the bottom 10% should increase the likelihood that stocks are allocated to specialists who will make the best markets.

Finally, the Commission notes that the EAC retains the ability to allow specialists whose scores are in the bottom 10% in any quarterly evaluation to continue receiving allocations if it finds that sufficient ''mitigating circumstances'' are present. While the Exchange has represented that relief from the restriction by mitigation is the exception[16] and the Commission recognizes the need for the EAC to retain the discretion to refrain from imposing this restriction in appropriate instances, the Commission expects that findings by the EAC that ''mitigating circumstances'' are present will not become routine, but will remain the exception and be made only when appropriately warranted.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[17] that the proposed rule change (SR–PSE–96–13) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[18]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–16166 Filed 6–24–96; 8:45 am]

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[8] The PSE has represented that the restriction applies to both initial allocations and allocations available as a result of subsequent reallocations. Furthermore, it also would apply in situations where two specialists desire to ''swap'' issues with each other . *See* Letter from Michael Pierson, Senior Attorney, PSE, to John Kroeper, Attorney, SEC, dated June 7, 1996 (''PSE Letter'').

[9] In the PSE Letter the Exchange gave the following, non-definitive, examples of ''mitigating circumstances'' that have been accepted by the EAC in the past two years: i) extensive systems problems existed that clearly were beyond the specialist's control; ii) a specialist was able to show that, of the trades covered in a specialist evaluation, the percentage of trades involving interaction with a broker was very low, and undue weight therefore was placed on the Questionnaire Survey; iii) a specialist's financial backer withdrew mid-quarter, having a negative impact on the specialist's performance during that quarter; and iv) the specialist's overall score on the quarterly evaluation (as opposed to the specialist's ranking) was above 80%. The Exchange further represented that based on past EAC decisions, relief by mitigation is the exception, not the rule. *See* PSE Letter, *supra* note 8.

[10] *Cf.* Securities Exchange Act Release NO. 31539 (November 30, 1992), 57 FR 57851 (December 7, 1992) (File No. SR–PSE–92–32). This order approved, among other things, the addition of Commentary .03 to PSE Rule 5.36(d), which precludes a specialist whose specialist ranking falls in the bottom 10% of his or her Floor from acting as an alternate specialist until his or her ranking raises above the bottom 10%, unless the EAC determines otherwise.

[11] 15 U.S.C. 78f(b)(5).

[12] 15 U.S.C. 78k(b).

[13] 17 CFR 240.11b–1.

[14] Rule 11b–1, 17 CFR 240.11b–1; PSE Rules 5.29(f).

[15] *See* PSE Rule 5.36(d), Commentary .03. As discussed previously, under PSE Rule 5.37 the exchange has the ability to take more significant action against any specialist who is ranked in the bottom 10% in any two out of four consecutive evaluations. *See* PSE Rule 5.37(j).

[16] *See* PSE Letter, *supra* note 8.

[17] 15 U.S.C. 78s(b)(2).

[18] 17 CFR 200.30–3(a)(12).

[Release No. 34–37321; File No. SR–Phlx–96–21]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Index Option Exercise Advices

June 18, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on June 7, 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 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 Exchange Rule 1042A, Exercise of Option Contracts, and Floor Procedure Advice (''Advice'') G–1, to be retitled Index Option Exercise Advice Forms, by requiring an index option exercise advice form for all non-expiration exercises. In this manner, the Exchange will eliminate the rule's current 25 contract threshold.

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

Exchange Rule 1042A and Advice G–1 govern the exercise of index options.[3] Specifically, Exchange Rule 1042A(a)(i) requires that a memorandum to exercise any American-style index option must be received or prepared by the Phlx member organization no later than 4:30 p.m. on the day of exercise.[4] In addition, Exchange Rule 1042A(a)(ii) and Advice G–1 require the submission of an exercise advice form to the Exchange when exercising 25 or more American-style index option contracts.

Pursuant to Exchange Rule 1042A(b), however, these requirements are not applicable on the last business day before expiration.[5] The above requirements are also not applicable to European-style index options which, by definition, cannot be exercised prior to expiration. Lastly, the Exchange notes that the procedures for exercising equity option contracts, contained in Exchange Rule 1042, are not affected by this rule proposal.

As stated above, the Phlx proposes to amend Exchange Rule 1042A and Advice G–1 by requiring the submission of an index option exercise advice form for all non-expiration exercises. In this manner, the Exchange is eliminating the rule's current 25 contract threshold.

According to the Phlx, the purpose of this change is to enhance surveillance efforts in determining compliance with the exercise cut-off time. Currently, the submission of an exercise advice form where 25 or more contracts are exercised creates an audit trail for the Exchange to examine when ascertaining compliance with the exercise cut-off time. Thus, by eliminating the 25 contract threshold, all non-expiration exercises will require the submission of an exercise advice form. By providing a more complete audit trail for smaller exercises, the Phlx believes that its surveillance efforts will be enhanced.

The Exchange also believes that eliminating the 25 contract threshold should prevent the confusion associated with having to calculate the number of index option contracts being exercised for each Phlx index as exercise advices will be required for all non-expiration exercises. In addition, the Exchange notes that the requirement of Exchange Rule 1042A(a)(i) to prepare a memorandum to exercise pertains to all non-expiration exercises, not just to those over 25 contracts. Thus, according to the Phlx, because member organizations are already preparing such memoranda, the additional preparation of an advice form does not impose a substantial burden.

The Phlx notes that because Advice G–1 is based on Exchange Rule 1042A and contains certain pertinent provisions of the rule for easy reference on the trading floor, specific reference to Exchange Rule 1042A is proposed to be added to Advice G–1.

The Phlx, in administering advices such as Advice G–1 as part of its minor rule violation enforcement and reporting plan (''minor rule plan''),[6] understands that infractions cited pursuant to the plan are minor in nature. Thus, in order to bolster the distinction between minor and serious violations, the Phlx proposes that Advice G–1 expressly state that it is only intended to cover minor infractions.[7] At the same time, however, the Exchange notes that it does not believe that including certain provisions of Exchange Rule 1042A into Advice G–1 deems all violations of Advice G–1 as minor. Exchange Rule 1042A was intended to govern exercise memorandum and advice procedures in order to prevent abuses and fraudulent activity; incorporating part of the rule into an advice does not diminish this critical purpose. Rather, as with many other important, substantive provisions in Exchange rules that are codified into Advices,[8] this system merely allows for the efficient handling of minor violations.

2. Statutory Basis

The Phlx believes that the proposed rule change is consistent with Section 6(b) of the Act in general, and with

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[1] 15 U.S.C. § 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4.

[3] The Exchange notes that with respect to index option contracts, clearing members are also required to follow the procedures of the Options Clearing Corporation (''OCC'') for tendering exercise notices. Exercise notices are the exercise instructions required by OCC and are distinct from exercise advices which are required by Exchange rules.

[4] *See* Securities Exchange Act Release No. 37077 (April 5, 1996), 61 FR 16156 (April 11, 1996) (File No. SR–Phlx–95–86). In this regard, the Exchange has attempted to create a level playing field among option investors by maintaining a cut-off time to ensure that all exercise decisions occur promptly after the close of trading. Consequently, to prevent fraud and unfairness, a long option holder is prohibited from exercising index options on non-expiration days based on information obtained after the cut-off.

[5] *See* Securities Exchange Act Release No. 36903 (February 28, 1996), 61 FR 9001 (March 6, 1996) (File No. SR–Phlx–96–01).

[6] *See* Exchange Rule 970.

[7] Advice G–1 states that the fine schedule provides sanctions for infractions of the index option Exercise Advice Form procedures which are minor in nature. Any violation of the procedure which has been deemed serious by the Phlx will be referred directly to the Exchange's Business Conduct Committee where stronger sanctions may result. The Phlx notes, however, that this language does not affect the other floor procedure advices administered pursuant to the plan which do not specifically contain this statement; infractions cited pursuant to the plan are minor in nature regardless of whether this specific language was added to the advice.

[8] *See, e.g.,* Advice F–15 which pertains to the Exchange's position and exercise limits.

Section 6(b)(5) in particular,[9] in that it is designed to prevent fraudulent and manipulative acts and practices, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in, securities as well as to protect investors and the public interest, by bolstering the exercise advice requirement to include all non-expiration exercises, not just exercises of 25 or more contracts. Specifically, the Phlx believes that requiring exercise advices for all American-style index options exercised prior to expiration should enhance surveillance efforts regarding compliance with the exercise cut-off time by providing a more complete audit trail.

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

The self-regulatory organization 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 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 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 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, 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 self-regulatory organization. All submissions should refer to File No. SR–Phlx–96–21 and should be submitted by July 16, 1996.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96–16063 Filed 6–24–96; 8:45 am]

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[9] 15 U.S.C. § 78f(b)(5)(1988).

[10] 17 CFR 200.30–3(a)(12).

[Release No. 34–37320; File No. SR–Phlx–96–07]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the Philadelphia Stock Exchange, Inc., to Adopt a Market Index Option Hedge Exemption

June 18, 1996.

I. Introduction

On February 13, 1996, the Philadelphia Stock Exchange, Inc. (''Phlox'' 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 amend Commentary .01 to Phlx Rule 1001A to establish a hedge exemption from broad-based (Market) index option position and exercise limits.[3]

The proposed rule change appeared in the Federal Register on March 21, 1996.[4] No comments were received on the proposed rule change. This order approves the Phlx's proposal.

II. Background and Description

The Phlx proposes to adopt a market index option hedge exemption under which broad-based index option positions hedged in accordance with the proposal would be entitled to exceed existing position and exercise limits by up to two-times about the limit.[5] According to the Phlx, the purpose of the proposal is to establish a provision parallel to the hedge exemption of equity options[6] as well as the broad-based index option hedge exemptions that are in place at other option exchanges.[7]

In order to qualify for the exemption, the market index option position must be hedged by share positions in at lease 20 stocks, or securities immediately or readily convertible into such stock,[8] in four industry groups comprising the index, of which no one component security accounts for more than 15% for the value of the portfolio hedging the index option position. Under the proposal, no position in a market index option may exceed two-times the broad-based index option position specified in Phlx Rule 1001A(a).[9] In addition, the underlying value of the option position may not exceed the value of the

[1] 15 .S.C. § 78s(b)(1) (1988).

[2] 17 CFR 240.19b-4 (1994).

[3] 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). Exercise limits prohibit an investor or group of investors acting in concern from exercising more than a specified number of puts or calls in a particular class of options within five consecutive business days.

[4] See Securities Exchange Act Release No. 36976 (March 14, 1996), 61 FR 11668 (March 21, 1996).

[5] The Exchange notes that is adopting the language ''two times above the limit'' to signify ''in addition to'' the current position limit. For instance, if the position limit for a market index option is 25,000 contracts, an additional 50,000 contracts under this proposal would be permitted, for a total of 75,000 contracts. This language parallels a recent change by another exchange. *See* Securities Exchange Act Release No. 36609 (December 20, 1995), 60 FR 67002 (December 27, 1995) (notice of File No. SR–CBOE–95–68).

[6] *See* Phlx Rule 1001, Commentary .07. *See also* Securities Exchange Act Release No. 35738 (May 18, 1995), 60 FR 27573 (May 24, 1995) (order approving permanent hedge exemption pilot programs) (File Nos. SR–Phlx–95–10, SR–Amex–95–13, SR–CBOE–95–13, SR–NYSE–95–04, and SR–PSE–95–05).

[7] *See, e.g.*, CBOE Rule 24.4 and the Interpretations and Policies thereunder, and Commentary .01 to Amex Rule 904C.

[8] The Exchange permits the use of convertible securities in its equity option hedge exemption as long as such securities are immediately or readily convertible into the underlying stock. *See* Securities Exchange Act Release No. 32174 (April 20, 1993), 58 FR 25687 (April 27, 1993) (order approving file No. SR–Phlx-92–22). Similarly, other options exchange permit the use of convertible securities with respect to broad-based index option hedge exemptions.

[9] Under Phlx Rule 1001A(a), the Value Line Composite Index (''VLE'') the U.S. Top 100 Index (''TPX''), and the National Over-the-Counter Index (''XOC'') each have a position limit of 25,000 contracts, of which no more than 15,000 contracts can be in the nearest expiration month. The Phlx notes that the Big Cap Index (''MKT'') is no longer listed on the Exchange.