

Clearing Fund to Excess Losses and Losses Outside of a System, which will provide that if NSCC were to have an unsatisfied loss due to a member's use of the NYW service, the loss may be satisfied from the entire clearing fund.<sup>7</sup>

An additional purpose of the filing is to clarify that members may choose to use only some of the NYW services (e.g., custodial and custodial related services). Members may enter into agreement(s) with NSCC limiting their access to specified NYW services which they desire to access.

## II. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder and particularly with the requirements of Sections 17A(b)(3) (A) and (F).<sup>8</sup> Sections 17A(b)(3) (A) and (F) require that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of securities transactions and to safeguard securities and funds in its custody or control or for which it is responsible.

NSCC's rule change will provide participants with greater access to the NYW service by allowing participants to continue to access the service through their own systems which should facilitate the prompt and accurate clearance and settlement of securities transactions. Furthermore, when participants elect to access the NYW service via NSCC's proprietary system, NSCC will assume greater responsibility for certain losses resulting therefrom. In connection with assuming greater responsibility for certain losses, NSCC will apply its usual procedures to ensure the safeguarding of securities and funds processed through NSCC.

## III. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with Sections 17A(b)(3) (A) and (F) of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-NSCC-96-08) be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

<sup>7</sup> Interpretation of the Board of Directors, Application of Clearing Fund, Addendum K, II, 2.

<sup>8</sup> 15 U.S.C. 78q-1(b)(3) (A) and (F) (1988).

<sup>9</sup> 17 CFR 200.30-3(a)(12) (1996).

Margaret H. McFarland,

*Deputy Secretary.*

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### Self-Regulatory Organizations; the Options Clearing Corporation; Order Approving a Proposed Rule Change Relating to the Clearance and Settlement of Flexibly Structured Equity Options

September 3, 1996.

On April 30, 1996, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change (File No. SR-OCC-96-03) under Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> to enable OCC to clear and settle flexibly structured equity options. Notice of the proposal was published in the Federal Register on June 25, 1996.<sup>2</sup> No comment letters were received. For the reasons discussed below, the Commission is approving the proposed rule change.

#### I. Description

OCC is modifying its existing by-laws and rules to allow for the clearance and settlement of flexibly structured options on individual equity securities as proposed for trading by the American Stock Exchange, Inc. ("AMEX"), the Chicago Board Options Exchange, Incorporated ("CBOE"), the Philadelphia Stock Exchange, Inc. ("PHLX"), and the Pacific Stock Exchange, Inc. ("PSE")— (collectively, "Exchange" or "Exchanges").<sup>3</sup> Flexibly structured equity options will allow the parties to each flexibly structured equity option trade to customize certain terms of the option within specified limits established by the Exchange. Specifically, for each flexibly structured equity option trade the parties may establish the exercise price, the exercise

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

<sup>2</sup> Securities Exchange Act Release No. 37318 (June 18, 1996), 61 FR 32873.

<sup>3</sup> For a complete description of flexibly structured equity options, refer to Securities Exchange Act Release Nos. 36841 (February 14, 1996), 61 FR 6666 [File Nos. SR-CBOE-95-43 and SR-PSE-95-24] (order approving the trading of flexibly structured equity options by the CBOE and PSE) and 37366 (June 19, 1996), 61 FR 33558 [File No. SR-AMEX-95-57] (order approving the trading of flexibly structured equity options by the AMEX). The PHLX filed and subsequently withdrew a proposed rule change regarding the trading of flexibly structured equity options. The Commission anticipates that the PHLX will refile in the near future.

style (i.e., American,<sup>4</sup> European<sup>5</sup> or capped)<sup>6</sup> the cap interval in the case of a capped-style option, the expiration date, and the option type (i.e., put or call).<sup>7</sup> In addition to customization, flexibly structured equity option trades will require a minimum transaction size of 250 contracts in opening trades in currently unopened series and 100 contracts in the case of opening and most closing trades in currently open series. Flexibly structured equity options thus will differ from existing Exchanged-traded equity options both in terms of customization and size.

From a clearance and settlement prospective, flexibility structured equity options will be treated and processed in virtually all respects like any other equity option. While Exchange rules permit a Request for Quotes<sup>8</sup> to specify a quote either as a dollar amount or as a percentage of the underlying stock price, the option premium always will be expressed as a dollar amount when a trade is reported to OCC. Therefore, when a flexibly structured equity option trade is reported to OCC by one of the Exchanges, all of the terms of that option will have been established in the Exchange's report, and the terms will correspond to existing equity options term categories. As a result, on receipt of a matched trade report from an Exchange, OCC will establish long and short flexibility structured equity option positions in clearing member accounts in precisely the same way it does for existing equity options. Furthermore, flexibly structured equity option positions should exhibit virtually the

<sup>4</sup> An American-style equity option may be exercised at any time prior to its expiration date.

<sup>5</sup> A European-style equity option may be exercised only during a specified period before the option expires.

<sup>6</sup> A capped-style equity option will be exercised automatically prior to expiration if the options market on which the option is trading determines that the value of the underlying interest at a specified time on a trading day "hits the cap price" for the option (i.e., when the cap price is less than or equal to the closing price of the underlying security for calls or when the cap price is greater than or equal to the closing price of the underlying security for puts).

<sup>7</sup> Although the rules of the Exchanges provide for capped-style flexibly structured equity options, the Exchanges advised OCC that they do not intend to provide a market in capped-style equity options at the outset. Accordingly, this proposed rule change does not include the rules that would be required for the clearance and settlement of such options. The commencement of trading in capped-style flexibly structured equity options will require that OCC file and that the Commission approve another proposed rule change filed by OCC under Section 19(b)(1) of the Act.

<sup>8</sup> A Request for Quotes is the initial request by an exchange member to initiate flexibly structured option bidding and offering.

same characteristics as existing equity options.

Because of the similarities between existing equity options and flexibly structured equity options, only a few of OCC's by-laws and rules need adjustment to accommodate flexibly structured equity options.<sup>9</sup> OCC is amending Section 1 of Article I to add an all-purpose definition of "flexibly structured option." Thus, the definition of flexibly structured option set forth in Articles XV, XVII, and XXIII will be deleted. The definition of "expiration date" is being amended to make clear that flexibly structured equity options may expire on dates other than the Saturday following the third Friday of the expiration month. The expiration date of any such option will be the date reported to OCC by the Exchange, subject to such constraints on the range of possible expiration dates as set forth in the rules of the Exchanges.

Section 11 of Article VI regarding adjustments to equity and index options also will apply to the adjustment of flexibly structured equity and index options.<sup>10</sup> However, paragraph (j) has been amended to reserve to the Securities Committee<sup>11</sup> the power to make special exceptions for flexibly structured options whenever it determines that such exceptions are appropriate. This is intended to give the Securities Committee the flexibility to deal with situations where a different adjustment for flexibly structured options is warranted.

OCC also is adding Interpretation and Policy .08 to Section 11. The interpretation provides that when a flexibly structured option with a European style exercise is adjusted to require the delivery upon exercise of a fixed amount of cash, such as would ordinarily occur in a merger where the

<sup>9</sup>The specific changes to OCC's by-laws and rules are set forth in OCC's proposed rule change, which is available for review at the principal office of OCC and at the Commission's Public Reference Room.

<sup>10</sup>Adjustments may be made to the number of option contracts, the unit of trading, the exercise price, and the underlying security with respect to all outstanding option contracts open for trading on an underlying security which is the subject of a dividend, stock dividend, stock distribution, stock split, reverse stock split, rights offering, distribution, reorganization, recapitalization, reclassification or similar event, or the merger, consolidation, dissolution, or liquidation of the issuer of the underlying security.

<sup>11</sup>The Securities Committee consists of one designated representative of each exchange and the Chairman of OCC.

underlying security is converted into a right to receive a fixed amount of cash, the expiration date of the option will ordinarily be accelerated so that the option will expire on or shortly after the date when the underlying stock is converted into the right to receive cash. Without this adjustment, the option position would have to be maintained until it could be exercised at its regular expiration even though the amount to be received on exercise had already been fixed. This special adjustment is being made to accommodate flexibly structured equity options because, unlike existing equity options, flexibly structured equity options may have European-style exercise features.

The only change being made to OCC's rules is the addition of Interpretation and Policy .03 to Rule 805 which clarifies that OCC's exercise procedures as set forth in Rule 805 shall apply to the exercise of flexibly structured equity options. The new interpretation also gives OCC the flexibility, if necessary, to depart from regular expiration date procedures and deadlines in the case of flexibly structured options. Such departures are not currently anticipated and adequate notice will be given to all clearing members prior to such departures being made.

## II. Discussion

Sections 17A(b)(3) (A) and (F)<sup>12</sup> of the Act require that a clearing agency be structured and its rules designed to facilitate the prompt and accurate clearance and settlement of securities transactions and to safeguard securities and funds in its custody or control or for which it is responsible. Because from a clearance and settlement perspective, OCC will process flexibly structured equity options like any other equity option, the Commission believes that OCC's proposed change is consistent with Sections 17A(b)(3) (A) and (F) of the Act because the proposed rule change establishes a framework in which existing, reliable OCC systems, rules, and procedures are extended to the processing of flexibly structured equity options. As a result, the proposed rule change should promote the prompt and accurate clearance and settlement of such options and should provide for the safeguarding of related securities and funds.

<sup>12</sup> 15 U.S.C. 78q-1(b)(3) (A) and (F) (1988).

## III. Conclusion

The Commission finds that OCC's proposal is consistent with the requirements of the Act and particularly with Section 17A and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (File No. SR-OCC-96-03) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Margaret H. McFarland,

*Deputy Secretary.*

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### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Stock Exchange Incorporated**

September 3, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 11, 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 Exchange hereby amends its Schedule of Rates for Exchange Services by reducing the current cap on transaction charges for equity block trades and by adopting a transaction fee cap per 100 shares for equity securities. The text of the proposed rule change is set forth below [new text is italicized; deleted text is bracketed]:

<sup>13</sup> 17 CFR 200.30-3(a)(12) (1996).

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