the initial primary distribution or in the Sponsors' secondary market, (c) exchanges will be in whole units only, and (d) for certain Trusts, units may be obtained in blocks of certain sizes only. Exercise of the Conversion Offer is subject to the following conditions: (a) The Conversion Offer is open only to unitholders of a Redemption Trust, (b) at the time of the unitholder's election to participate, there must be available units of a Conversion Trust, either under a primary distribution or in the Sponsors' secondary market, (c) exchanges will be in whole units only, and (d) for certain Trusts, units may be obtained in blocks of certain sizes only.

6. Unitholders who wish to exchange units under the Exchange or Rollover Privileges or Conversion Offer within the first five months of purchase will not be eligible for the reduced sales charge. Such unitholders will be charged a sales load equal to the greater of (a) the reduced sales load or (b) an amount which, when added to the sales charge paid by the unitholder upon his or her original purchase of units of the applicable Trust, would equal the sales charge applicable to the direct purchase of the newly acquired units, determined as of the date of purchase.

7. Applicants request that the relief be extended to all subsequently issued series of unit investment trusts sponsored by Reich & Tang or a sponsor controlled by or under common control with Reich & Tang and each unit investment trust registered under the Securities Act of 1933 and the Act (each is also a ''Trust'').

Applicants' Legal Analysis

1. Section 11(a) requires SEC approval of an offer to exchange securities between open-end investment companies if the exchange occurs on any basis other than the relative net asset values of the securities to be exchanged. Section 11(c) makes section 11(a) applicable to any type of exchange offer of securities of registered unit investment trust for the securities of any other investment company, irrespective of the basis of exchange.

2. Applicants state that the Exchange and Rollover Privileges provide investors with a convenient means of transferring their interests at a reduced sales charge into series of the Exchange and Rollover Trusts which suit their current investment objectives. Further, applicants state that the Conversion Offer provides unitholders of a Trust in which there is no active secondary market a means to redeem those units and invest the proceeds at a reduced sales charge into units of the Conversion Trusts which maintain an active secondary market. Applicants state that absent the Exchange and Rollover privilege and the Conversion Offer, unitholders would be required to dispose of their units, either in the secondary market (in the case of the Exchange and Rollover Privileges) or through redemption, and to reinvest, at the then fully applicable sales charge, into the chosen Trusts.

3. Applicants represent that unitholders will not be induced or encouraged to participate in the Exchange or Rollover Privileges or Conversion Offer through an active advertising or sales campaign. The Sponsor recognizes its responsibility to its customers against generating excessive commissions through churning and asserts that the sales charge collected will not be a significant economic incentive to salesmen to promote inappropriately the Exchange or Rollover Privilege or the Conversion Offer. Applicants state that the reduced sales charge will fairly and adequately compensate the Sponsor and the participating underwriters and brokers for their services and expenses in connection with the administration of the programs. Applicants further believe that the Exchange and Rollover Privileges and the Conversion Offer are appropriate in the public interest and consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act.

Applicants' Conditions

Applicants agree, as a condition to the grant of the requested order, to the following conditions:

1. The prospectus for each Trust and any sales literature or advertisement that mentions the existence of the Exchange Privilege, Conversion Offer, or Rollover Privilege will disclose that they are subject to termination and that their terms are subject to change and that such changes or termination may be made in the circumstances specified in condition 2.

2. Whenever the Exchange Privilege, Conversion Offer, or Rollover Privilege are to be terminated or their terms are to be amended materially, any holder of a security subject to the privilege will be given prominent notice of the impending termination or amendment at least 60 days prior to the date of termination or the effective date of the amendment, *provided that*:

(a) No such notice need be given if the only material effect of an amendment is to reduce or eliminate the sales charge payable at the time of an exchange, to add one or more new series or a new Trust, eligible for the Exchange Privilege, Conversion Offer, or Rollover Privilege, or to delete a series or Trust which has terminated, and

(b) No notice need be given if, under extraordinary circumstances, either (i) there is a suspension of the redemption of units of an Exchange Trust, Conversion Trust, or Rollover Trust under section 22(e) of the Act and the rules and regulations thereunder, or (ii) an Exchange Trust, Conversion Trust, or Rollover Trust temporarily delays or ceases the sale of its units because it is unable to invest amounts effectively in accordance with applicable investment objectives, policies, and restrictions.

3. An investor who purchases units under the Exchange Privilege, Conversion Offer, or Rollover Privilege will pay a lower sales charge than that which would be paid for the units by a new investor.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Jonathan G. Katz,

Secretary.

[FR Doc. 96–24079 Filed 9–19–96; 8:45 am]

BILLING CODE 8010–01–M

[Release No. 34–37676; File No. SR–CBOE–96–01]

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Amendment No. 2 Thereto and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change by the Chicago Board Options Exchange, Inc., to, Among Other Things, Increase SPX Position and Exercise Limits, Increase SPX Firm Facilitation, Index Hedge, and Money Manager Exemptions, and Extend Broad-Based Index Hedge Exemption to Broker-Dealers

September 13, 1996.

I. Introduction

On January 8, 1996, 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, among other things, increase the Standard & Poor's 500 index (''SPX'') option position and exercise limits, increase the SPX firm facilitation, index hedge, and money manager exemptions, extend the broad-based index hedge exemption to broker-dealers, and

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4.

expand the types of qualified portfolios for the broad-based index hedge exemption.

Notice of the proposed rule change appeared in the Federal Register on January 25, 1996.[3] One comment letter, representing the views of ten broker-dealers, was received in response to the proposed rule change.[4] The Exchange subsequently filed Amendment No. 1 to the proposed rule change on May 9, 1996,[5] and Amendment No. 2 to the proposed rule change on July 25, 1996.[6] This order approves the CBOE's proposal, as amended.

II. Background

A. Increase SPX Position and Exercise Limits

The CBOE is proposing to increase the basic SPX position and exercise limits from 45,000 contracts to 100,000 contracts on the same-side of the market.[7] According to the CBOE, member firms have expressed their need for relief from the current SPX position and exercise limits,[8] which have not been increased since 1992.[9] Since 1992, however, volume in the SPX index option class has more than doubled, and open interest has remained consistently high.[10] The CBOE believes that by increasing the existing SPX position and exercise limits of 45,000 contracts to 100,000 contracts the investing public as well as CBOE members and member firms will be afforded greater opportunity and flexibility to use SPX options for their hedging needs. The CBOE does not believe that the higher limits will increase the potential for market disruption.

To enhance its ability to monitor unhedged positions as well as to create a database of non-standard hedge practices, the CBOE will add a reporting requirement (new Interpretation .03 to Exchange Rule 24.4) for accounts having a position in excess of 45,000 a.m.-settled, European-style S&P 500 option contracts on the same-side of the market. According to the CBOE, this reporting requirement will allow the Exchange to gather data on hedging practices that do not fit into the CBOE's definition of a qualified portfolio.[11] Specifically, new Interpretation .03 to Exchange Rule 24.4 states that if a member or member organization, other than an Exchange market-maker,[12] maintains a position in excess of 45,000 a.m.-settled, European-style S&P 500 option contracts on the same-side of the market on behalf of its own account or for the account of a customer, it must report information as to whether those positions are hedged and provide documentation as to how such contracts are hedged, in the manner and form required by the Exchange's Department of Market Regulation. In addition, to address the Commission's concerns with respect to the ability of the Exchange to monitor customer accounts that maintain large unhedged positions, the CBOE will add a margin and clearing firm requirement. Pursuant to new Interpretation .04 to Exchange Rule 24.4, whenever the Exchange determines that additional margin is warranted in light of the risks associated with an under-hedged option position in excess of 45,000 contracts, the Exchange may impose additional margin upon the account maintaining such under-hedged position, or assess capital charges upon the clearing firm carrying the account to the extent of any margin deficiency resulting from the higher margin requirement.

B. Increase SPX Firm Facilitation, SPX Index Hedge, and SPX Money Manager Exemptions

In light of the increased SPX index option contract volume and the interest expressed by the member firm community, the Exchange proposes to increase the SPX firm facilitation exemption [13] from 100,000 contracts to 400,000 contracts, and to increase the SPX index hedge exemption [14] from 150,000 contracts to 250,000 contracts. The Exchange also proposes to increase the SPX money manager exemption to 350,000 exempted same-side of the market contracts, with no more than 235,000 contracts in any single account (from the existing 250,000 and 135,000 contracts permitted, respectively).

C. Expansion of Definition of Qualified Portfolio and extension of Broad-Based Index Hedge Exemption to Broker-Dealers

The CBOE proposes to expand the types of qualified portfolios described in Interpretation .01 to Exchange Rule 24.4, as well as the types of option strategies that qualify for higher position limits. As the investing public and broker-dealers use a broader and more sophisticated range of hedging strategies, the CBOE believes that there is a need to include in a qualified portfolio products that overlay various broad-based indexes, including index futures, options on index futures, index options, and index warrants, where the

[3] See Securities Exchange Act Release No. 36738 (January 19, 1996), 61 FR 2324 (January 25, 1996).

[4] See Letter from Bear Sterns & Co., CS First Boston, Goldman, Sachs & Co., J.P. Morgan Securities, Lehman Brothers Inc., Merrill Lynch & Co. Inc., Morgan Stanley & Co. Incorporated, Smith Barney Inc., Salomon Brothers Inc., and Swiss Bank Corporation to Jonathan G. Katz, Secretary, Commission, dated April 12, 1995 (''Working Group Letter'').

[5] In Amendment No. 1, the CBOE proposed the following revisions to its rule filing: (1) Amend the SPX index hedge exemption limits to 250,000 contracts (from the previously proposed 400,000 contracts); (2) amend the money manager SPX index hedge exemption limits to 350,000 SPX option contracts in the money manager's aggregated accounts and 235,000 SPX option contracts in any single account (from the previously proposed 600,000/325,000 contract levels); and (3) amend the broad-based index hedge exemption so that the Exchange's Department of Market Regulation may grant prospective broad-based index hedge exemptions to broker-dealers who may not yet have established qualified portfolios under Interpretation .01(c) to Exchange Rule 24.4. See letter from Margaret G. Abrams, Senior Attorney, CBOE, to Holly Smith, Associate Director, Division of Market Regulation, Commission, dated May 9, 1996 (''Amendment No. 1'').

[6] See Securities Exchange Act Release No. 37504 (July 31, 1996), 61 FR 40868 (August 6, 1996) (notice of Amendment No. 2 to File No. SR–CBOE–96–01) (''Amendment No. 2'').

[7] These positions do not have to be hedged under CBOE rules.

[8] Position limits impose a ceiling on the aggregate number of option contracts on the same-side of the market that an investor, or group of investors acting in concert, may hold or write. Exercise limits impose a ceiling on the aggregate long positions in option contracts that an investor, or group of investors acting in concert, can or will have exercised within five consecutive business days.

[9] See Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (increase of SPX position and exercise limits from 25,000 contracts to 45,000 contracts) (approval order for File No. SR–CBOE–92–09).

[10] The CBOE notes that in September 1992, the average daily SPX index option volume during expiration week was 86,682 contracts and open interest was 1.3 million contracts. In comparison, in March 1995, the average daily SPX index option volume during expiration week was 208,678 contracts and open interest was 1.2 million contracts. In each of the years 1992 through 1994, approximately 300 market-maker exemptions from SPX position limits were granted in accordance with Interpretation .05 to Exchange Rule 4.11. In contrast, from January through November 20, 1995, 455 market-maker exemptions from SPX position limits were granted.

[11] See Interpretation .01 to Exchange Rule 24.4.

[12] According to the Exchange, the SPX reporting requirement of Interpretation .03 to Exchange Rule 24.4 will not apply to market-maker accounts because the Exchange's Department of Financial Compliance routinely monitors market-maker risk. As such, the Exchange believes that it is not necessary for a market-maker to report hedging information to the Exchange as this information is available through other means.

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

[14] Under existing rules, public customers are allowed to apply for a hedge exemption from established position limits of SPX options if those customers hold certain pre-approved stock portfolios. The maximum size of the exempted position, however, cannot exceed the unhedged value of the qualified stock portfolio, and no exempted positions can exceed 150,000 contracts, regardless of the size of the stock portfolio.

As discussed below, the CBOE is also proposing to expand the existing definition of a qualified portfolio as well as to extend the customer index hedge exemption to broker-dealers. See Section II.C. and its discussion *infra.*

indexes are included in the same margin or cross-margin product groups at the Options Clearing Corporation (''OCC'').

In addition, the CBOE proposes to extend the broad-based index hedge exemption to broker-dealers. The existing broad-based index hedge exemption is currently available only to public customers, including money managers. The CBOE notes that the corresponding equity hedge exemption [15] is available to both public customers and broker-dealers. The Exchange believes that it can better meet the needs of securities professionals by making the broad-based index hedge exemption available to them to the same extent that the index hedge exemption is available to public customers.

D. Prospective Broad-Based Index Hedge Exemption for Broker-Dealers

The CBOE also proposes to amend the broad-based index hedge exemption so that the Exchange's Department of Market Regulation may grant prospective broad-based index hedge exemptions to broker-dealers who may not yet have established qualified portfolios under Interpretation .01(c) to Exchange Rule 24.4. The Exchange's Department of Market Regulation anticipates the need for granting prospective hedge exemptions in a situation where an Exchange market-maker or member organization is close to exceeding position limits in a particular broad-based index option class. According to the Exchange, a market-maker or member organization often will trade the option first and then hedge with either a stock basket or futures contract. Thus, a broker-dealer may not have established the qualified portfolio at the exact time it is putting on its options position. Accordingly, the Exchange's Department of Market Regulation may grant the index hedge exemption to a broker-dealer without a qualified portfolio, so long as the broker-dealer establishes the portfolio ''concurrent with or at or about the same time as the execution of the exempt options positions'' and provides to the Exchange's Department of Market Regulation appropriate documentation within two business days. The Exchange expects that the hedge will be established immediately following the execution of the options transaction.

[15] See Interpretation .04 to Exchange Rule 4.11.

E. Treatment of Collar and Debit Put Spread Transaction as One Contract for Hedging and Position Limit Purposes and Neither Side of Collar Transaction Can Be In-the-Money When Established for Broad-Based Index Hedge Exemption Purposes

The CBOE proposes to treat a ''collar'' [16] position as one contract rather than as two contracts in Interpretation .01(f)(5) to Exchange Rule 24.4. [17] According to the Exchange, within a limited range, the collar has less opportunity to benefit from upward and downward price changes than either of the collar's components. If the market climbs, the collar is equivalent to a covered write position. If the market declines, the collar is equivalent to a long put position. Because the strategy requires both the purchase of puts and the sale of calls, the CBOE believes that the position is more appropriately treated as one contract for hedging purposes rather than two separate put and call components. For the same reasons, because a strategy involving a covered write accompanied by a debit put spread requires a collar component, the CBOE similarly believes that the short call and long put should be treated as one contract in Interpretation .01(f)(7) to Exchange Rule 24.4.

The CBOE also proposes that new language in Interpretations .01(f)(5) and .01(f)(7) to Exchange Rule 24.4 will be added to require that neither side of the collar transaction can be in-the-money at the time the position is established. According to the Exchange, this is consistent with the Commission's approval of the National Association of Securities Dealer's (''NASD'') definition of a collar transaction pursuant to its hedge exemption rule,[18] as well as with the Exchange's original intention.[19]

F. Miscellaneous Changes

The CBOE also proposes to make other editorial changes to Exchange Rule 24.4 that are designed to streamline the rule and to eliminate confusing provisions. The CBOE notes that some of the changes include the following: (1) Allowing a hedge exemption account to be carried by any member of a self-regulatory organization (''SRO'') participating in the Intermarket Surveillance Group (''ISG''); [20] confirming Exchange Rule 24.11A concerning debit put spread cash account transactions to Exchange Rule 24.4; and (3) consolidating the treatment of Quarterly Index Expiration (''QIXs'') and Quarterly Index Expiration, Capped-Style (''Q–CAPS'') options from three paragraphs to one.

[16] In existing Interpretation .02(a)(5) to Exchange Rule 24.4, a collar position is referred to as a ''hedgewrap.''

[17] A collar is a short call/long put option combination that is designed to protect the value of a related stock position.

[18] *See* Securities Exchange Act Release No. 35874 (June 21, 1995), 60 FR 33440 (June 28, 1995) (approval order for File No. SR–NASD–94–60).

[19] The Exchange is also proposing to replace the references to ''a.m. settled'' contracts in Interpretations .01(f)(5), .01(f)(6), and .01(f)(7) to Exchange Rule 24.4 with ''non-p.m. settled'' contracts.

III. Summary of Comments

The Commission received one comment letter on the proposed rule changes.[21] The commenters, in general, expressed support for the proposed changes, noting that there is a demonstrated need for the higher position limits and that the increased and expanded facilitation and hedge exemptions will not increase market disruptions. In support of this, the commenters believe that the size of the market for index options has lessened the possibility that market participants could successfully engage in manipulation and that the SROs' surveillance systems have developed into highly sophisticated mechanisms that would make any effort to manipulate securities underlying indices easily transparent. Although believing that the proposals are a ''good first step'' in reducing the constraints imposed by position limits, the commenters state that further expansion of position limits is required. For example, the commenters argue that because hedged positions are market neutral, there should be no position or exercise limits on these positions. In addition, the commenters state that any limitation on the ability of market participants to use options to hedge their positions exposes participants to unnecessary risk on the unhedged portion of their portfolios. In this regard, the commenters believe that the adoption of an uncapped hedge exemption (*i.e.*, the ability to accumulate an unlimited number of options contracts provided that such contracts are properly hedged) is appropriate.

Similarly, the commenters support the CBOE's proposal to expand the types of hedges that qualify under the rule. By opening the discussion of how to take into account more sophisticated hedging techniques, the commenters believe that the CBOE is taking the ''first step'' toward recognizing delta hedging

[20] See new Interpretation .01(b) to Exchange Rule 24.4. Previously, such an account was restricted to being carried by a CBOE clearing member.

[21] See *supra* note 4.

as a valid hedging mechanism for position limit purposes.

In addition, by increasing SPX limits, the commenters believe that the proposal provides much needed relief for market participants who have increasingly found their ability to enter into legitimate market transactions unnecessarily constrained or who have turned to the futures market for the liquidity they require. Similarly, as the number of institutional clients who have the capacity and the need to hedge multi-billion dollar portfolios has grown, the increased customer facilitation limits will provide market participants with the ability to address both their current and potential clients' liquidity needs.

IV. Discussion

The Commission finds that the proposed rule changes are 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).[22] Specifically, the Commission believes that the proposed increase in the SPX position limits and the SPX exemptions, together with the expansion of the index hedge exemption and the qualified portfolio provisions, will enhance the depth and liquidity of the market for both members and investors. Accordingly, the Commission believes that these rule changes are consistent with, and further the objectives of, Section 6(b)(5) of the Act in that they would remove impediments to and perfect the mechanism of a free and open market in a manner consistent with the protection of investors and the public interest.

A. *Increase SPX Position and Exercise Limits*

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member or customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations [23] and for corners or squeezes of the underlying market. In addition, they serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.

The Commission has been careful to balance two competing concerns when considering an SRO's position and exercise limits. First, the Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market for the underlying security by acquiring and exercising a number of options contracts disproportionate to the deliverable supply and average trading volume of the underlying security. At the same time, the Commission has realized that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market.[24]

The Commission believes that the proposed increase in SPX position and exercise limits to 100,000 contracts will expand the depth and liquidity of the SPX market without significantly increasing concerns regarding intermarket manipulations or disruptions of the options or the underlying securities.[25] As previously noted by the Commission, markets with active and deep trading interest, as well as with broad public ownership, are more difficult to manipulate or disrupt than less active and deep markets with smaller public floats. In this regard, the SPX is a broad-based, capitalization-weighted index consisting of 500 of the most actively-traded and liquid stocks in the U.S.

Moreover, the CBOE has adopted important safeguards that will allow it to monitor large unhedged positions (those in excess of 45,000 contracts) in order to identify instances of potential risk [26] and to assess additional margin or capital charges against the clearing firm, if necessary.[27] In this regard, the CBOE states that in the event of a large unhedged, potentially risky position, the Exchange will notify the clearing firm and assess the circumstances of the transactions, along with the firm's view of the exposure of the account, whether the account is approved and suitable for the strategies used, and whether additional margin has been collected.[28] The monitoring of unhedged accounts in excess of 45,000 contracts in this manner should provide the CBOE with the information necessary to determine whether additional margin or capital charges should be imposed in light of the risks associated with the under-hedged SPX option position in accordance with Interpretation .04 to Exchange Rule 24.4.

Accordingly, given the size and breadth of the SPX, along with the new SPX reporting requirement set forth in Interpretation .03 to Exchange 24.4 and the new margin and clearing firm requirements set forth in Interpretation .04 to Exchange Rule 24.4, the Commission believes that increasing the SPX position and exercise limits to 100,000 contracts should not increase any manipulative concerns. Finally, the Exchange's surveillance program will continue to be applicable to the trading of SPX options and should detect and deter trading abuses arising from the increased position and exercise limits.[29]

B. *Increase SPX Firm Facilitation Exemption*

The Commission believes that the proposed increase of the SPX firm facilitation exemption from 100,000 contracts to 400,000 contracts will accommodate the needs of investors as well as market participants without substantially increasing concerns regarding the potential for manipulation and other trading abuses.[30] The Commission also believes that the proposed rule change will further enhance the potential depth and liquidity of the options market as well

[22] 15 U.S.C. 78f(b)(5) (1988).

[23] Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established derivatives position.

[24] See H.R. Rep. No. IFC–3, 96th Cong., 1st Sess. at 189–91 (Comm. Print 1978) (''Options Study'').

[25] See Exchange Rule 24.4(a).

[26] Under new Interpretation .03 to Exchange Rule 24.4, each member or member organization, other than an Exchange marketmaker, that maintains a position in excess of 45,000 a.m.—settled, European-style S&P 500 option contracts on the sameside of the market on behalf of its own account or for the account of a customer will report information as to whether those positions are hedged and provide documentation as to how such contracts are hedged, in the manner and form required by the Exchange's Department of Market Regulation.

[27] Under new Interpretation .04 to Exchange Rule 24.4, whenever the Exchange determines that additional margin is warranted in light of the risks associated with an under-hedged SPX option position in excess of 45,000 contracts, the Exchange may impose additional margin upon the account maintaining such under-hedged position, or assess capital charges upon the clearing firm carrying the account to the extent of any margin deficiency resulting from the higher margin requirement.

[28] See Amendment No. 2, *supra* note 6.

[29] The Exchange has represented that it intends to implement increased surveillance and reporting procedures to ensure a thorough understanding of the uses and risks of the underlying strategies supported by the increased position limits. The Exchange has also represented that it intends to provide reports regarding position limits to the Commission's Division of Market Regulation on a periodic basis and at appropriate thresholds of activity. See Amendment No. 1, *supra* note 5.

[30] The Commission notes that the SPX firm facilitation exemption is in addition to the standard limit and other exemptions available under Exchange rules, interpretations, and policies.

as the underlying markets by providing Exchange members greater flexibility in executing large customer orders.[31]

The CBOE's existing safeguards that apply to the current facilitation exemption will continue to serve to minimize any potential disruption or manipulation concerns. First, the facilitation firm must receive approval from the Exchange's Exemption Committee prior to executing facilitation trades.[32] 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.[33] 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.[34] In addition, a facilitation firm is not permitted to use the facilitation exemption for the purpose of engaging in index arbitrage.[35] 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 on any underlying stock positions.

Third, 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.[36]

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) (crossing order) procedures have been satisfied and crowd members have been given a reasonable time to participate in the trade.[37]

Fifth, the facilitation firm may not increase the exempted option position once it is closed, unless approve from the CBOE is again received pursuant to a reapplication.[38]

Lastly, violation of any of these provisions, absent reasonable justification or excuse, will result in the withdrawal of the facilitation exemption and may form the basis for subsequent denial of an application for a facilitation exemption.[39]

In summary, the Commission continues to believe that the safeguards built into the facilitation exemptive process will 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. The Commission also believes that the CBOE has adequate surveillance procedures to surveil for compliance with the rule's requirements. Based on these reasons, the Commission believes that it is appropriate to increase the SPX firm facilitation exemption to 400,000 contracts.

C. Increase SPX Index Hedge Exemption

The Commission believes that the proposed increase of the SPX index hedge exemption from 150,000 contracts to 250,000 contracts is consistent with the Commission's approach to position and exercise limits and adequately balances the benefits derived from increased limits against concerns regarding the potential for market disruptions and manipulations.[40] Specifically, because any SPX options position in excess of the outstanding SPX position limit must be fully hedged in conformity with one of the enumerated hedge positions,[41] market disruption concerns are reduced. Moreover, to the extent that an SPX options position is hedged with a qualified stock portfolio,[42] it should be more difficult to profit from any intermarket manipulation. The Commission also notes that the rule will continue to require that the underlying options positions cannot exceed the unhedged value of the qualified portfolio. Accordingly, the Commission does not believe that the proposed increase of the index hedge exemption for SPX options will disrupt the options or equity markets or materially increase the possibility of manipulation in the underlying securities or options.

The CBOE's existing safeguards that apply to the current SPX index hedge exemption will continue to serve to minimize any potential disruption or manipulation concerns. The Commission notes that these safeguards and procedures will apply to the SPX index hedge exemption as well as to all other broad-based index hedge exemptions permitted under CBOE rules. First, the account in which exempted option positions are held must receive prior Exchange approval for the hedge exemption as well as specify the maximum number of contracts which may be exempt.[43] In addition, the hedge exemption account must promptly provide to the CBOE any information requested concerning the qualified portfolio, as well as promptly notify the Exchange of any material change in the qualified portfolio which materially affects the unhedged value of the qualified portfolio.[44]

Second, positions included in a qualified portfolio which serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange, any other SRO, or any futures contract market.[45]

Third, any member or member organization that maintains a broad-based index option position in such member's or member organization's own account or in a customer account, and has reason to believe that such position is in excess of the applicable limit, must promptly take the action necessary to bring the position into compliance.[46] Failure to abide by this provision will be deemed to be a violation of Exchange Rules 4.11 and 24.4.[47]

Lastly, violation of any of the provisions of Exchange Rule 24.4 and the interpretations and policies thereunder, absent reasonable justification or excuse, will result in the

[31] When initially approving the firm facilitation exemption for SPX options, the Commission expressed its opinion that providing member organizations with an exemption 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. The Commission currently believes that these same benefits and assurances are also applicable with respect to the increased firm facilitation exemption. *See* Securities Exchange Act Release No. 20944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (approval order for File No. SR–CBOE–92–09).

[32] See Interpretation .06(a) to Exchange Rule 4.11.

[33] See Interpretation .06(d) to Exchange Rule 4.11.

[34] See Interpretation .06(e)(1) to Exchange Rule 4.11.

[35] *Id.*

[36] See Interpretations .06(b) and .06(e)(2) to Exchange Rule 4.11.

[37] See Interpretations .06(c)(1) and .06(c)(2) to Exchange Rule 4.11.

[38] See Interpretation .06(e)(3) to Exchange Rule 4.11.

[39] See Interpretation.06(f) to Exchange Rule 4.11.

[40] See Interpretation .01 to Exchange Rule 24.4.

[41] See Interpretation .01(f) to Exchange Rule 24.4.

[42] As discussed below, the CBOE is also proposing to expand the definition of a qualified portfolio as well as to extend the customer index hedge exemption to broker-dealers. See Section IV.D. and its discussion *infra.*

[43] See new Interpretation .01(a) to Exchange Rule 24.4.

[44] See new Interpretation .02(a) and .01(g)(3) to Exchange Rule 24.4.

[45] See new Interpretation .02(b) to Exchange Rule 24.4.

[46] See new Interpretation .02(c) to Exchange Rule 24.4.

[47] *Id.*

withdrawal of the index hedge exemption and may form the basis for subsequent denial of an application for an index hedge exemption.[48]

Accordingly, the Commission continues to believe that the safeguards built into the index hedge exemptive process will serve to minimize the potential for disruption and manipulation, while at the same time benefitting market participants. The Commission also believes that the CBOE's surveillance procedures are sufficient to detect and deter trading abuses arising from the increased position and exercise limits associated with the increased index hedge exemption. Based on these reasons, the Commission believes that it is appropriate to increase the SPX index hedge exemption to 250,000 contracts.[49]

D. Expansion of Definition of Qualified Portfolio and Extension of Broad-Based Index Hedge Exemption to Broker-Dealers

As noted above, the CBOE's broad-based index hedge exemption may be granted for positions in broad-based index options that are hedged with Exchange-approved qualified portfolios. The CBOE is proposing to expand current definition of a qualified portfolio to take into account the broader range of hedging strategies currently used by market participants. Specifically, the CBOE has proposed to include within the definition of a qualified portfolio products that overlay various broad-based indexes, including index futures, options on index futures, index options, and index warrants, where the indexes are represented in margin or cross-margin product groups at the OCC. Specifically, under the new index hedge exemption's requirements, a qualified portfolio may consist of: (i) Net long or short positions in common stocks, or securities readily convertible into common stocks, in at least four industry groups, where the portfolio contains at least twenty stocks, none of which accounts for more than fifteen percent of the value of the portfolio; and/or (ii) net long or short positions in index futures contracts or in options on index futures contracts, or long or short positions in index options or index warrants, for which the underlying index is included in the same margin or cross-margin product group cleared at the OCC as the index option class to which the hedge exemption applies.[50] To remain qualified, a portfolio must at all times meet these standards, notwithstanding trading activity.[51] In addition, the index hedge exemption applies to positions in broad-based index options and is applicable to the unhedged value of the qualified portfolio.[52] the Exchange also proposes to extend the broad-based index hedge exemption to broker-dealers.

The Commission believes, as it did when originally approving the CBOE's index hedge exemption, that providing for increased position and exercise limits for broad-based index options in circumstances where those excess positions are effectively hedged with offsetting positions will provide greater depth and liquidity to the market and will allow investors to hedge their portfolios more effectively, without significantly increasing concerns regarding intermarket manipulations or disruptions of either the options market or the underlying stock market. The Commission believes that through the expanded definition of a qualified portfolio, an increased number of public customers and broker-dealers with long or short portfolios will be able to utilize the broad-based index hedge exemption, thereby making an alternative hedging technique more available.

In addition, the Commission believes that it is reasonable for the CBOE to allow broker-dealers as well as public customers to utilize the broad-based index hedge exemption. The Commission believes that extending the exemption to broker-dealers may help to increase the depth and liquidity of the market for broad-based index options and may help to ensure that public customers receive the full benefit of the exemption. Moreover, the Commission is relying on the absence of discernible manipulation problems under the corresponding equity hedge exemption,[53] which is available to both public customers and broker-dealers, as an indicator that the proposed extension of the broad-based index hedge exemption is appropriate. Lastly, the Commission notes that the broad-based index hedge exemption will continue to include safeguards designed to lessen the possibility that the exempted positions could be used to disrupt or manipulate the market.[54]

E. Increase SPX Money Manager Exemption

The Commission believes that the proposed increase of the SPX position limit exemption for money managers is both reasonable and consistent with the Act because it provides further flexibility to money managers in managing their accounts, without raising the potential for market disruption or manipulation.[55] First, the Commission notes that no single account can hold more than 235,000 exempted same-side of the market SPX option contracts.[56] Second, the exempted options position must be associated with one of the enumerated hedged positions.[57] Thus, all of the safeguards to minimize any potential disruption or manipulation that were discussed above in relation to the SPX index hedge exemption, are also applicable to the money manager SPX exemption.[58]

F. Prospective Broad-Based Index Hedge Exemption for Broker-Dealers

The CBOE proposes to amend the broad-based index hedge exemption so that the Exchange's Department of Market Regulation may grant prospective broad-based index hedge exemptions to broker-dealers who may

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[48] See new Interpretation .02(d) to Exchange Rule 24.4. The hedge exemption account also must: (i) Liquidate and establish options, stock positions or their equivalent, or other qualified portfolio products in an orderly fashion; (ii) not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; (iii) not initiate or liquidate a stock position or its equivalent with an equivalent index option position with a view toward taking advantage of any differential in price between a group of securities and an overlying stock index; and (iv) liquidate any options prior to, or contemporaneously with, a decrease in the hedged value of the qualified portfolio, which options would thereby be rendered excessive. See new Interpretations .01(g)(1) and .01(g)(2) to Exchange Rule 24.4.

[49] The Commission notes that the SPX index hedge exemption is in addition to the standard limit and other exemptions available under Exchange rules, interpretations, and policies.

[50] See new Interpretations .01(c)(i) and .01(c)(ii) to Exchange Rule 24.4.

[51] *Id.*

[52] See new Interpretation .01(d) to Exchange Rule 24.4. Under this provision, the unhedged value is determined as follows: (1) The values of the net long or short positions of all qualifying products in the portfolio are totalled; (2) for positions in excess of the standard limit, the underlying market value of (a) any economically equivalent opposite side of the market calls and puts in broad-based index options, and (b) any opposite side of the market positions in stock index futures, options on stock index futures, and any economically equivalent opposite side of the market positions, assuming no other hedges for these contracts exist, is subtracted from the qualified portfolio; and (3) the market value of the resulting unhedged portfolio is equated to the appropriate number of exempt contracts as follows: the unhedged qualified portfolio is divided by the correspondent closing index value and the quotient is then divided by the index multiplier or 100.

In order to show how the CBOE would determine the number of contracts that qualify for an index hedge exemption, the CBOE has included in its rules both a definition of the unhedged value of a qualified portfolio as well as an example. *See* Interpretation .01(d) to Exchange Rule 24.4.

[53] See Interpretation .04 to Exchange Rule 4.11.

[54] See supra notes 43–48 and accompanying text.

[55] See Interpretation .01(e) to Exchange Rule 24.4.

[56] *Id.*

[57] See Interpretation .01(f) to Exchange Rule 24.4.

[58] See *supra* notes 43–48 and accompanying text.

not yet have established qualified portfolios under Interpretation .01(c) to Exchange Rule 24.4. The Exchange's Department of Market Regulation anticipates the need for granting prospective hedge exemptions in a situation where an Exchange market-maker or member organization is close to exceeding position limits in a particular broad-based index option class. According to the Exchange, a market-maker or member organization often will trade the option first and then hedge with either a stock basket or futures contract. Thus, a broker-dealer may not have established the qualified portfolio at the time it is hedging with the options. Accordingly, the Exchange's Department of Market Regulation may grant the index hedge exemption to a broker-dealer without a qualified portfolio.

The Commission does not believe that trading abuses are likely to result from the prospective hedge exemption for the following reasons. First, the exemption is limited to registered broker-dealers, and second these broker-dealers must effect the transaction(s) necessary to obtain a qualified portfolio ''concurrent with or at or about the same time as the execution of the exempt options positions.'' The CBOE has stated to the Commission that it expects the hedge to be established immediately following the execution of the options transaction. Moreover, broker-dealers must provide to the Exchange's Department of Market Regulation appropriate documentation related to the portfolio within two business days. The Commission believes that the CBOE's surveillance procedures are sufficient to detect and deter trading abuses arising from the prospective hedge exemption and, in the event a broker-dealer is found to have violated the exemption, the CBOE is authorized to take all necessary and appropriate disciplinary actions. Accordingly, the Commission believes that it is appropriate for the Exchange to adopt a limited prospective broad-based index hedge exemption for broker-dealers.

G. Treatment of Collar and Debit Put Spread Transaction as One Contract for Hedging and Position Limit Purposes and Neither Side of Collar Transaction Can Be In-the-Money When Established for Broad-Based Index Hedge Exemption Purposes

The CBOE proposes to treat a collar position as one contract rather than as two contracts in Interpretation .01(f)(5) to Exchange Rule 24.4. Under the CBOE's rules, a collar is defined as a short call position accompanied by long put(s), where the short call(s) expires with the long put(s), and the strike price of the short call(s) equals or exceeds the strike price of the long put(s). According to the Exchange, within a limited range, the collar has less opportunity to benefit from upward and downward price changes than either of the collar's components. If the market climbs, the collar is equivalent to a covered write position. If the market declines, the collar is equivalent to a long put position. Because the strategy requires both the purchase of puts and the sale of calls, the CBOE believes that the position is more appropriately treated as one contract for hedging purposes rather than two separate put and call components. In adopting this interpretation of a collar, the CBOE is also proposing that new language in Interpretations .01(f)(5) and .01(f)(7) to Exchange Rule 24.4 will be added to require that neither side of the collar transaction (or the short call, long put transaction) can be in-the-money at the time the position is established. According to the Exchange, this is consistent with the Commission's approval of the NASD's definition of a collar transaction pursuant to its hedge exemption rule, as well as with the Exchange's original intention. For the same reasons, because a strategy involving a covered write accompanied by a debit put spread requires a collar component, the CBOE similarly believes that the short call and long put should be treated as one contract in Interpretation .01(f)(7) to Exchange Rule 24.4.[59]

The Commission believes that the increased number of options positions available by virtue of the Exchange's proposal will not result in disruptions to either the options or underlying stock market due to the conditions and limitations that must be met to be eligible for the exemption.[60] For example, the broad-based index hedge exemption collar strategy can only be effected in conjunction with a qualified stock portfolio; the exemption is available only for non-p.m. settled, European-style index options; the short call(s) must expire with the long put(s); the strike price of the short call(s) must equal or exceed the strike price of the long put(s); and neither side of the collar transaction can be in-the-money at the time the position is established. The Commission also believes that the Exchange's surveillance program is adequately equipped to ensure that Exchange members comply with the exemption's requirements.

In addition, by approving the Exchange's proposal that neither side of the collar transaction can be in-the-money at the time the position is established, the Commission believes that the desired uniformity between the CBOE's and the NASD's definition of a collar transaction pursuant to their hedge exemption rules will be achieved.

H. Miscellaneous Changes

The CBOE is also proposing several other changes to its rules, including a requirement in new Interpretation .01(b) to Exchange Rule 24.4 that a hedge exemption account can be carried by a member of a SRO participating in the ISG.[61] The Commission believes that through the Exchange's ISG information sharing arrangements,[62] the hedge exemption account will continue to be adequately monitored. Other changes to the Exchange's rules include: (1) conforming Exchange Rule 24.11A concerning debit put spread cash account transactions to Exchange Rule 24.4; (2) consolidating the treatment of QIXs and Q–CAPS options from three paragraphs to one;[63] and (3) replacing the references to ''a.m. settled'' contracts in Interpretations .01(f)(5), .01(f)(6), and .01(f)(7) to Exchange Rule 24.4 with ''non-p.m. settled'' contracts. Because these changes are non-substantive or technical in nature or raise no additional regulatory issues, the Commission believes that they are consistent with Section 6(b)(5) of the Act.

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. Specifically, the increased position limits for the SPX index hedge exemption and the SPX money manager exemption that are contained in Amendment No. 1 to the proposed rule change are more restrictive than the CBOE's original proposal, which was published for the entire twenty-one day comment period and generated no negative responses. In addition, with regard to the prospective broad-based index hedge exemption for broker-dealers, the Commission believes that the Exchange has established sufficient safeguards to address concerns regarding manipulation or

[59] The CBOE defines a debit put spread position as a long put position coupled with a short put position overlying the same broad-based index and having an equivalent underlying aggregate index value, where the short put(s) expires with the long put(s), and the strike price of the long put(s) exceeds the strike price of the short put(s).

[60] See interpretations .01(f)(5) and .01(f)(7) to Exchange Rule 24.4.

[61] Previously, such an account was restricted to being carried by a CBOE clearing member.

[62] See Exchange Rule 15.9.

[63] See Exchange Rule 24.4(b).

other market disruptions. Accordingly, the Commission believes that it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 1 to the proposed rule change on an accelerated basis.

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–96–01 and should be submitted by October 11, 1996.

V. Conclusion

Based on the above, the Commission believes that the proposed rule changes will serve to provide market participants with greater flexibility without significantly increasing concerns regarding intermarket manipulations or disruptions of either the options market or the underlying stock market.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[64] that the proposed rule change (SR–CBOE–96–01), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[65]

Jonathan G. Katz,

Secretary.

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[64] 15 U.S.C. 78s(b)(2) (1988).

[65] 17 CFR 200.30–3(a)(12).

[Release No. 34–37680); File No. SR–CBOE–96–48]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Relating to the Consolidation of Minor Rule Violation Cases Involving the Same or a Related Transaction or Occurrence

September 13, 1996.

On July 10, 1996, the Chicago Board Options Exchange, Incorporated (''CBOE'') submitted a proposed rule change to the Securities and Exchange Commission (''Commission'') pursuant to Section 19(b) of the Securities Exchange Act of 1934 (the ''Act'') [1] and Rule 19b–4 thereunder,[2] to permit the consolidation of, into one hearing, the review of certain conduct involving trading conduct or decorum fines levied against different members of CBOE and involving the same or related transaction or occurrence.

Notice of the proposal together with its terms of substance was given by the issuance of a Commission release [3] and by publication in the Federal Register.[4] No comments were received regarding the proposal. The rule change will save CBOE time and staff resources. Additionally, it will be less burdensome on the individuals involved, who under the previous rules often had to appear at multiple hearings, either as a subject or as a witness. The Commission finds that the proposal rule change is consistent with the requirements of the Act and the rules thereunder applicable and, in particular, the requirements of Section 6 [5] and the rules thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change be, and hereby is approved.

For the Commission, by the Division of Market Regulation pursuant to delegated authority, 17 CFR 200.30–3(a)(12).

Jonathan G. Katz,

Secretary.

[FR Doc. 96–24170 Filed 9–19–96; 8:45 am]

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[1] 15 U.S.C. § 78s(b).

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 37456 (July 19, 1996).

[4] 61 FR 40053 (July 31, 1996).

[5] 15 U.S.C. § 78.

[Release No. 34–37688; File No. SR–Phlx–96–39]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to the Selective Quoting Facility for Foreign Currency Options

September 16, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''), 15 U.S.C. 78s(b)(1), notice is hereby given that on August 20, 1996, the Philadelphia Stock Exchange, Inc. (''Phlx'' or ''Exchange'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') the proposed rule as described in Item 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 the foreign currency option (''FCO'') Selective Quoting Facility (''SQF''), embodied in Rule 1012, Commentary .04 and Floor Procedure Advice (''Advice'') F–18, FCO Expiration Months and Strike Prices—Selective Quoting Facility, to designate two in-the-money strikes and six out-of-the-money strikes for both puts and calls as active.

The SQF establishes criteria to determine whether the bid/ask quotation for each FCO series is eligible for transmission to the Options Price Reporting Authority (''OPRA'') for off-floor dissemination to securities data vendors. Currently, the SQF, a feature of the Exchange's Auto-Quote system, categorizes certain FCO strikes as ''non-update'' or ''inactive'' strikes, which are disseminated with the OPRA indicator ''I'' and zeroes (*e.g.*, 000–000), in lieu of a market. In contrast, ''update'' or ''active'' strikes include, at minimum: (1) Around-the-money strikes in near-term American style options, and (2) strikes with open interest that have traded within the previous five days. Around-the-money strikes were recently [1] defined as those with an approximate 10, 20, 30, 40 and 50 delta.[2] Active strikes may also be added at the initiative of the Exchange or in

[1] Securities Exchange Act Release No. 36636 (December 26, 1995) (File No. SR–Phlx–95–62).

[2] ''Delta'' is a measure of how much an option premium changes in relation to changes in the underlying. For example, a 50 delta represents that for every one point move in the spot price of an underlying foreign currency, the option moves ½.