

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

The CBOE does not believe that the proposed rule change will impose any burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (a) By order approve such proposed rule change, or
- (b) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-98-33 and should be submitted by December 7, 1998.

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

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[(Release No. 34-40652; File No. SR-NASD-98-78)]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Equity Option Hedge Exemption

November 9, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act" or "Act"),¹ notice is hereby given that on October 15, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, NASD Regulation ("NASD Regulation"), 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 NASD Regulation. 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

NASD Regulation proposes to amend Rule 2860(B)(3)(A)(vii) of the NASD, to make permanent the Equity Option Hedge Exemption, which has been operating as a pilot program since 1990. Below is the text of the proposed rule change. Deletions are bracketed.

Rule 2860. Options.

* * * * *

(b)(3)(A)(vii) Equity Option Hedge Exemption

a. The following positions, where each option contract is "hedged" by 100 shares of stock or securities readily convertible into or economically equivalent to such stock, or, in the case of an adjusted option contract, the same number of shares represented by the adjusted contract, shall be exempted from established limits contained in (i) through (vi) above:

- 1. long call and short stock;

- 2. short call and long stock;
- 3. long put and long stock;
- 4. short put and short stock.

b. Except as provided under the OTC Collar Exemption contained in paragraph (b)(3)(A)(viii), in no event may the maximum allowable position, inclusive of options contracts hedged pursuant to the equity option position limit hedge exemption in subparagraph a. above, exceed three times the applicable position limit established in subparagraph (b)(3)(A)(i) through (v) with respect to standardized equity options, or subparagraph (b)(3)(A)(ix) with respect to conventional equity options.

[c. The Equity Option Hedge Exemption is a pilot program authorized by the Commission through December 31, 1998.]

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

In its filing with the Commission, NASD Regulation 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. NASD Regulation 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

Position limits impose a ceiling on the number of options contracts of each options class on the same side of the market that can be held or written by a member, an investor, or a group of investors acting in concert. NASD Rule 2860(b)(3) provides that the position limits for equity options are determined according to a five-tiered system in which more actively traded stocks with larger public floats are subject to higher position limits. Currently, the five tiers for standardized equity options² are 4,500, 7,500, 10,500, 20,000 and 25,000 contracts. The position limits for conventional equity options³ are three times the limits for standardized equity

² Standardized equity options are exchange-traded options issued by the Options Clearing Corporation ("OCC") that have standard terms with respect to strike prices, expiration dates and the amount of the underlying security.

³ A conventional option is any option contract not issued, or subject to issuance by, the OCC.

¹⁰ 17 CFR 200.30-3(a)(12).

¹¹ 15 U.S.C. 78s(b)(1).

options.⁴ NASD rules do not specifically govern how a particular equity option falls within one of the five position limit tiers. Rather, the NASD's position limit rule provides that the position limit established by an options exchange for a particular equity option is the applicable position limit for purposes of the NASD's rule.⁵

The NASD's Equity Option Hedge Exemption ("Hedge Exemption") provides for an automatic, limited exemption from position limits for equity options that are hedged using one of the four most commonly used hedge positions: (1) long stock and short calls; (2) long stock and long puts; (3) short stock and long calls; and (4) short stock and short puts. The Hedge Exemption applies to accounts in which the option contract is either (i) hedged by 100 shares of stock, (ii) hedged by securities that are readily convertible into, or economically equivalent to, such stock, or (iii) in the case of an adjusted options contract, hedged by the number of shares represented by the adjusted contract.

Under the Hedge Exemption, the largest standardized equity options position (combining hedged and unhedged positions) that may be established may not exceed three times the basic position limits, *i.e.*, 13,500, 22,500, 31,500, 60,000, or 75,000 contracts, depending on the basic position limits of the underlying security. Likewise, the largest conventional equity options position (combining hedged and unhedged positions) that may be established may not exceed three times the basic position limits on conventional equity options, *i.e.*, 40,500, 67,500, 94,500, 180,000, or 225,000 contracts.

The Hedge Exemption has been operating as pilot program since its inception in 1990.⁶ The Commission recently extended the deadline of the pilot program until December 31, 1998, to give the NASD time to adopt it on a permanent basis.⁷

NASD Regulation believes that the Hedge Exemption is an important component of the options position limit

rules and should be continued on a permanent basis. NASD Regulation staff has over eight years experience administering the Hedge Exception and has concluded that it is both an important and necessary tool for market participants to manage their market exposure by allowing them the flexibility to hold larger options positions in cases where such positions are hedged. In addition, NASD Regulation believes that the Hedge Exemption should be made permanent to achieve parity with the other options self-regulatory organizations which have in effect a permanent, substantively identical equity option hedge exemption.⁸

Finally, NASD Regulation believes that continuing the Hedge Exemption on a permanent basis will not pose any risk to the options or underlying equity market. NASD rules require each member to report options positions of any account which has established an aggregate position of 200 or more option contracts of the put class and the call class on the same side of the market covering the same underlying security.⁹

2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,¹⁰ which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASD believes that making the Hedge Exemption permanent will maintain the depth and liquidity of the options markets by permitting investors to hedge greater amounts of stock than would otherwise be permitted under NASD rules. Making the Hedge Exemption permanent also will promote consistency among the rules of the NASD and the other options self-regulatory organizations. NASD Regulation notes that the higher position limits currently available under the Hedge Exemption have not resulted in disruptions of the underlying equities market, and it will continue monitoring the market effects, if any, from the Hedge Exemption. Lastly, NASD Regulation will continue to monitor use of the Hedge Exemption to ensure that

members are complying with all applicable requirements.

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

NASD Regulation does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

Written comments were neither solicited nor received.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies there with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-98-78 and should be submitted by December 7, 1998.

⁴ See Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998).

⁵ For equity options that do not trade on an options exchange, the NASD's position limit rule provides that the limit for conventional equity options shall be three times the basic limit of 4,500 contracts, such as 13,500 contracts, unless the member can demonstrate to the Association that the underlying security meets the standards for higher limits and the initial listing standards for standardized options trading.

⁶ See Exchange Act Release No. 27697 (February 9, 1990), 55 FR 5535 (February 15, 1990).

⁷ See Exchange Act Release No. 39865 (April 14, 1998), 63 FR 19992 (April 22, 1998).

⁸ See American Stock Exchange Rule 904; Chicago Board Options Exchange Rule 4.11; Philadelphia Stock Exchange Rule 1001; Pacific Exchange Rule 6.8.

⁹ See Rule 2860(b)(5).

¹⁰ 15 U.S.C. 78o(b)(6).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40644; File No. SR-PCX-98-44]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Pacific Exchange, Inc. Relating to Fees for the Use of Exchange-Sponsored Hand Held Terminals for Options Floor Brokers

November 5, 1998.

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 September 11, 1998, the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On October 29, 1998, the Exchange filed Amendment No. 1 to the proposal.³ 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 is proposing to change its Schedule of Fees and Charges for Exchange Services by adding charges for the use of exchange-sponsored hand held terminals for options floor brokers.

The text of the proposed rule change is available at the Office of the Secretary, PCX and at the Commission.

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

In its filing with the Commission, the Exchange 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 PCX 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

Background. With the use of hand held terminals, PCX Member Firms have the advantage of sending their orders electronically to either (1) a floor broker's exchange-sponsored terminal located in the trading crowd;⁴ (2) a Member Firm booth located on the trading floor; or (3) to POETS,⁵ where they will be automatically executed by Auto-Ex⁶ or maintained in Auto-Book.⁷

Proposal. The Exchange proposes to charge a monthly equipment fee of \$200 for each exchange-sponsored hand held terminal to be billed to the Floor Broker registered to use it. In addition, the Exchange proposes to charge \$0.03 per contract for orders of 10 contracts or less which are not directed to POETS through a Member Firm Interface ("MFI"),⁸ and are executed via the exchange-sponsored hand held terminal. This per contract charge will be billed to the order flow provider.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b)⁹ of the Act, in general, and furthers the objectives of Section 6(b)(4),¹⁰ in particular, because it provides for the equitable allocation of reasonable dues, fees, and other charges among its

members and issuers and other persons using its facilities.

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

The Exchange 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

The Exchange has neither solicited nor received written comments on the proposed rule change.

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

The foregoing rule change establishes or changes a due, fee, or other charge and, therefore, has become effective pursuant to Section 19(b)(3)(A) of the Act¹¹ and subparagraph (e)(2) of Rule 19b-4 thereunder.¹²

At any time within 60 days of the filing of the amended proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing; including whether the proposed rule change and Amendment No. 1 are consistent with the Act. 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange.

¹¹ 15 U.S.C. 78s(b)(3)(A).

¹² 17 CFR 240.19b-4(e)(2).

¹¹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Robert Pacileo, Staff Attorney, Regulatory Policy, PCX, to David Sieradzki, Attorney, Division of Market Regulation, SEC dated October 27, 1998 ("Amendment No. 1"). In Amendment No. 1, the Exchange clarifies the proposal to indicate that these fees are for exchange-sponsored hand held terminals only.

⁴ See Securities Exchange Act Release No. 39970 (May 7, 1998), 63 FR 26662 (May 13, 1998) (Order approving File No. SR-PCX-97-28).

⁵ The Pacific Option Exchange Trading System ("POETS") is the Exchange's automated options trading system. See generally Securities Exchange Act Release No. 27633 (Jan. 18, 1990), 55 FR 2466 (Jan. 24, 1990) (Order approving File No. SR-PSE-89-26).

⁶ Orders executed by Auto-Ex may be automatically executed at the disseminated bid or offering price. *Id.*

⁷ Auto-Book maintains non-marketable limit orders based on limit price and time of receipt. *Id.*

⁸ The MFI is an electronic order delivery and reporting system that allows member firms to route orders for execution by the automatic execution feature of POETS as well as to route limit orders to the Options Public Limit Order Book. Orders that do not reach those two destinations are defaulted to a member firm booth. MFI also provides member firms with instant confirmation of transactions to their systems.

⁹ 15 U.S.C. 78f(b).

¹⁰ 15 U.S.C. 78f(b)(4).