

[Release No. 34-35177; International Series Release No. 765; File No. SR-Phlx-94-42]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 to the Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to an Enhanced Parity Split for the Specialist in the Cash/Spot German Mark Foreign Currency Options

On August 15, 1994, the Philadelphia Stock Exchange, Inc., ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1994 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to provide an enhanced parity participation ("Enhanced Parity Split") for the specialist trading cash/spot German mark ("3D") foreign currency options ("FCOs").³ Notice of the Proposed rule change appeared in the **Federal Register** on October 17, 1994.⁴ No comment letters were received on the proposed rule change. The Exchange subsequently filed Amendment No. 1 to the proposal on December 9, 1994,⁵ and Amendment No. 2 on December 23, 1994.⁶ This order approves the Exchange's proposal, as amended.

I. Description of the Proposal

The Exchange proposes to amend Exchange Rule 1014(h) to adopt an

Enhanced Parity Split for the 3D FCO specialist. Specifically, the 3D FCO specialist will be entitled to receive 50% of the first 500 contracts in any trade in which the 3d FCO specialist and one or more crowd participants are on parity, as defined in Exchange Rule 1014(h), with the remaining 250 contracts allocated on a pro rata basis to the other crowd participants on parity. All contracts in excess of 500 will be allocated on a pro rata basis among the specialist and the other crowd participants on parity.⁷

The Exchange represents that customers with orders for less than 100 contracts will not be disadvantaged by this proposal. Specifically, Rule 1014(h)(i) provides that all bids/offers of customer accounts for under 100 contracts have time priority over non-customer accounts and, therefore, the Enhanced Parity Split will not apply to customer bids/offers for fewer than 100 contracts.⁸

The purpose of the proposed Enhanced Parity Split, according to the Phlx, is to encourage the 3D FCO specialist to make deeper markets in order to attract order flow to the Exchange. At the end of the first year, the Foreign Currency Option Committee ("Committee") will conduct a review of the performance of the 3D FCO specialist and additional reviews will be conducted by the Committee every six months thereafter. If the Committee elects to terminate the Enhanced Parity Split for the 3D FCO specialist as result of one of these regular reviews, the specialist will be afforded the ability to appeal that decision to the Board of Governors of the Exchange pursuant to the procedures in Article XI, Section 11-1 of the Exchange's by-laws.⁹

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5)¹⁰ in that the proposal is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and practices, and to protect investors and the public interest.

Specifically, the Commission finds that the proposal may serve to remove impediments to and perfect the mechanism of a free and open market by encouraging the 3D FCO specialist to maintain tight markets in order to attract order flow to the Exchange. Further, the proposed rule change provides that the Enhanced Parity Split will not disadvantage customer orders for fewer than 100 contracts that are on parity with the 3d FCO specialist.¹¹

The Commission notes that several Exchange proposals implementing enhanced parity splits for equity and index option specialist have recently been approved by the Commission.¹² As discussed in connection with those approval orders, specialists, including the 3D FCO specialist, have responsibilities that other crowd participants do not share, such as the staff costs associated with continually updating and disseminating quotes.¹³ As a result, the Commission believes it is reasonable for the Exchange to grant certain advantages to specialists, such as the Enhanced Parity Split proposed herein, in order to attract and retain well capitalized specialists at the Exchange. As a result, as long as these advantages do not unreasonably restrain competition and do not harm investors, the Commission believes that the granting of such benefits to specialists, in general, is within the business judgment of the Exchange. Therefore, even though the proposed rule change could arguably have some negative impact on other crowd participants, other than customers with orders for less than 100 contracts, for the reasons stated above, the Commission believes the proposal is consistent with the Act.

Furthermore, the Commission believes that: (1) The review procedures proposed by the Exchange, as discussed above, adequately ensure that the 3D FCO specialist will receive the benefit of the Enhanced Parity Split only if the specialist satisfies its obligations and responsibilities pursuant to Exchange rules; and (2) in cases where the 3D FCO specialist is found to no longer be

¹ 15 U.S.C. 78s(b)(1) (1988).

² 17 CFR 240.19b-4 (1992).

³ 3D FCOs are cash-settled, European-style, cash/spot FCO contracts on the German mark that trade in one-week and two-week expirations. See Securities Exchange Act Release No. 33732 (March 8, 1994), 59 FR 52337 (March 15, 1994).

⁴ See Securities Exchange Act Release No. 34814 (October 7, 1994), 59 FR 52337 (October 17, 1994).

⁵ Amendment No. 1 provides that if the 3D FCO specialist is denied the Enhanced Parity Split provided herein as a result of the periodic reviews of specialist performance by the Foreign Currency Option Committee, the specialist will be afforded the ability to appeal that decision to the Exchange's Board of Governors pursuant to the procedures in Article XI, Section 11-1 of the Exchange's by-laws. Amendment No. 1 also amends Rule 509(a) in order to make that rule consistent with Rule 1014, which was recently amended to expand the enhanced parity split applicable to equity option specialists to also include index option specialists. See Letter from Michele Weisbaum, Associate General Counsel, Phlx, to Brad Ritter, Senior Counsel, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated December 9, 1994 ("Amendment No. 1").

⁶ In Amendment No. 2, the Exchange proposes to amend the proposed language in Rule 1014(h), as described herein, to clarify the manner in which Enhanced Parity Split will be applied. See Letter from Michele Weisbaum, Associate General Counsel, Phlx, to Brad Ritter, Senior Counsel, OMS, Division, Commission, dated December 23, 1994 ("Amendment No. 2").

⁷ *Id.*

⁸ Phlx Rule 1014(h) does not confer time priority on customer orders (as compared to non-customer orders) for 100 or more FCO contracts. Consistent with this, the 3D FCO specialist will be entitled to receive the full Enhanced Parity Split on parity trades with customer orders for 100 or more FCO contracts. Telephone conversation between Michele Weisbaum, Associate General Counsel, Phlx, and Brad Ritter, Senior Counsel, OMS, Division, Commission, on December 8, 1994.

⁹ See Amendment No. 1, *supra* note 5.

¹⁰ 15 U.S.C. 78f(b)(5Z) (1988).

¹¹ See *supra* note 8.

¹² See Securities Exchange Act Release Nos. 34109 (May 25, 1994), 59 FR 28570 (June 2, 1994) (providing an enhanced parity split for new equity option specialist units trading newly listed option classes) ("Exchange Act Release No. 34109"), 34606 (August 26, 1994), 59 FR 45741 (September 2, 1994) (providing an enhanced parity split applying to equity option specialists, other than new specialist units, for certain assigned option classes), and 35028 (November 30, 1994), 59 FR 63151 (December 7, 1994) (expanding the enhanced parity split in the foregoing orders to include index option specialists as well as equity option specialists) ("Exchange Act Release No. 35028").

¹³ See Exchange Act Release No. 34109, *supra* note 12.