supports these goals by promoting the efficient, undisrupted conduct of business on the Floor.

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

The Exchange believes the proposed rule change will not impose 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

Comments were neither solicited nor received.

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

The proposed rule change is concerned solely with the administration of the Exchange, and as such, takes effect upon filing with the Commission pursuant to Section 19(b)(3)(A)(iii) of the Act[6] and Rule 19b–4(f)(3) thereunder.[7] At any time within 60 days of the filing of the 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.[8]

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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 20549–0609. 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 NYSE. All submissions should refer to file number SR–NYSE–99–16, and should be submitted by June 1, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[9]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–11598 Filed 5–7–99; 8:45 am]

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[6] 15 U.S.C. 78s(b)(3)(A)(iii).

[7] 17 CFR 240.19b–4(f)(3).

[8] In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[9] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41353; File No. SR–PCX–98–62]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Exchange, Inc. Relating to Differential Index Options

April 30, 1999.

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 December 18, 1998, the Pacific Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Exchange filed with the Commission Amendments No. 1[3] and 2[4] to the proposed rule change on April 8, 1999. The Commission is publishing this notice to solicit comments on the proposed rule change as amended from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to trade a standardized index option, the Differential Index Option, whose value at expiration will be based on the relative performance of either a designated index versus a benchmark index, a designated stock versus a benchmark index, or a designated stock versus a benchmark stock.

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

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

Proposal. The Exchange is proposing to trade a new type of standardized index option, the Differential Index Option, that will offer new investment and hedging opportunities.[5] Differential Index Options will have a value at expiration based on an index, called the ''differential index,'' that measures the relative performance of (1) A designated index versus a benchmark index over a specific time period (''Index Differential Option''); (2) a designated stock versus a benchmark index over a specific time period (''Equity Differential Option''); or (3) a designated stock versus a benchmark stock over a specific period of time (''Paired Stock Differential Option''). If the percent gain in the level

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

[2] 17 CFR 240.19b–4.

[3] *See* Letter to Michael A. Walinskas, Division of Market Regulation, Commission, from Robert P. Pacileo, PCX, dated April 7, 1999 (''Amendment No. 1''). Amendment No. 1 makes certain technical changes to the proposed rule change. Amendment No. 1 also specifies the procedures the Exchange will follow if an underlying differential index previously approved for options trading does not meet the Exchange's requirements for continued approval. In addition, Amendment No. 1 clarifies the conditions under which Exchange Rule 6.11, relating to restrictions on Exchange options transactions and exercises, will be applicable to Differential Index Options.

[4] *See* Letter to Michael A. Walinskas, Division of Market Regulation, Commission, from Robert P. Pacileo, PCX, dated April 7, 1999 (''Amendment No. 2''). Amendment No. 2 provides information as to what the Exchange will do to make adjustments in value for differential index options contracts when certain corporate events take place in the case of Equity Differential and Paired Stock Differential options, or when significant action has been taken by the publisher of an index in the case of Index Differential options. Amendment No. 2 also specifies that if the Exchange chooses as either a designated or benchmark index an index that has been approved for index warrant trading only, to establish the appropriate position limit the Exchange will (i) use the procedures set forth in its narrow-based index options rules with respect to differential options using a narrow-based index warrant and (ii) consult with the Commission with respect to differential options using a broad-based index warrant. Furthermore, Amendment No. 2 indicates the Exchange's intent to trade flexible exchange-traded options on Differential index options and provides the proposed rule language governing these options.

[5] The proposal is similar to filings of the American Stock Exchange and the Chicago Board Options Exchange, Inc. *See* Exchange Act Release No. 40537 (October 8, 1998), 63 FR 56052 (October 20, 1998); SR–CBOE–98–50.

of the designated index or stock during the period is greater than the percent gain in the underlying benchmark index or stock, then a Differential Call Option originally struck at the money will have a positive value at expiration and a Differential Put Option originally struck at the money will expire worthless. If the percentage gain in the level of the designated index or stock during the period is less than the percent gain in the underlying benchmark, then a Differential Put Option originally struck at the money will have a positive value at expiration and a Differential Call Option originally struck at the money will expire worthless. Thus, a Differential Index Option affords an investor the opportunity, through a single investment, to participate in the relative out-performance of a designated index or stock versus a benchmark index or stock (a Differential Call Option) or the relative under-performance of a designated index or stock versus a benchmark index or stock (a Differential Put Option) over the life of the option, regardless of the absolute performance of the designated index or stock.

For example, an investor may feel that Microsoft will out-perform the technology sector for the next few months, but is unsure whether the overall technology sector will move higher or lower. If the investor were to buy an at-the-money standardized Microsoft call option, and the stock declined, the option would expire worthless, even if the stock declined by a much smaller percentage than the technology sector. On the other hand, if the investor were to purchase an at-the-money Equity Differential Call Option on the relative performance of Microsoft versus the PSE Technology 100 Index (''Tech 100''), a benchmark measure of the technology sector, and Microsoft declined by a smaller percentage than the Tech 100, the Equity Differential Call Option would have a positive value at expiration. Conversely, an investor who believes that Microsoft will under-perform the Tech 100 may purchase at-the-money Equity Differential Put Options. If Microsoft under-performs the Tech 100, the Differential Put Options will have a positive value at expiration, regardless of whether Microsoft itself has increased or decreased on an absolute basis. This example can be applied to the other types of Differential Options; the different in the relative performance of a designated stock versus a benchmark stock, such as Microsoft versus Compaq (''Paired Differential Stock Option''), or the relative performance between two indexes, such as the PSE Technology 100 and the Wilshire Small Cap Index (''Differential Index Option'').

a. Differential Calculation. The underlying security for a Differential Index Option is an index (called the ''differential index'') of the performance of the designated stock or index relative to the benchmark stock or index. The differential index is calculated as follows: on December 31 of each year, prior to the listing of a Differential Index Option series, base reference prices are established for the designated index or stock and the benchmark index or stock (typically, the closing levels on a designated business day). Thereafter, percent changes from the base values of both the designated index or stock and the benchmark index or stock are continuously calculated and the percent change in the benchmark is subtracted from the percent change in the designated index or stock, providing a positive number if the designated index or stock has either out-gained or suffered a lesser percentage decline than the benchmark, and a negative number if the benchmark has out-gained the designated index or stock or suffered a lesser percent loss.

The percentage differential in the relative gain or loss is then multiplied by 100 and added to a fixed base index value (typically 100) to yield the differential index that will underlie the Differential Index Options:

$$Dt=((I_t/I_0)-(B_t/B_0))\times 100+f$$

Where:

D=differential index;
I=designated index or security;
B=benchmark index or security;
t=current or settlement value of index or security;
0=base reference value of index or security;
f=a fixed base index value, typically 100.

Thus, if the designated index or security has out-performed the benchmark by 7%, and the fixed value, f, is set at 100, the differential index value would be 107; if it has under-performed by 7%, the differential index value would be 93. The base reference values will remain in effect for a predetermined, fixed period (expected to be between six months and two years). Similar to other index values published by the Exchange, the value of each differential index will be calculated continuously and disseminated under a separate symbol every 15 seconds over the Consolidated Tape Association's Network B.

b. Designated Indexes, Designated stocks, Benchmark Indexes and Benchmark Stocks. Only stocks that meet the current Exchange Rules for listing standardized equity options will be eligible designated stocks in Equity Differential Options. Only stocks that meet the current Exchange Rules for listing standardized equity options will be eligible designated stocks or benchmark stocks in Paired Stock Differential Options. In this way, only the most liquid, actively traded stocks will be considered.

Similarly, only indexes that meet the current Exchange Rules for listing standardized index options and have been approved for options or warrant trading by the Commission will be eligible for designation either as designated indexes or benchmark indexes in Equity and Index Differential Options. In this way, only those indexes already deemed by the Commission to be suitable for options trading will be considered.

c. Expiration and Settlement. The proposed Differential Index Options will be European style (*i.e.*, exercises permitted at expiration only) and cash settled. Index Differential Options in which both the designated or benchmark indexes are broad-based will trade between the hours of 7:00 a.m. and 1:15 p.m., Pacific Time. All other Differential Index Options will trade between 7:00 a.m. and 1:02 p.m., Pacific Time. Differential Index Options will expire on the Saturday following the third Friday of the expiration month (''Expiration Friday''). The last trading day in an expiring option series will normally be the second to last business day preceding the Saturday following the third Friday of the expiration month (normally a Thursday). Trading in expiring options will cease at the close of trading on the last trading day.

While the Exchange seeks approval to list series of Differential Index Options as set forth in proposed PCX Rules 7.20 through 7.31 and Rule 8.102, the Exchange anticipates that it will initially list only five series with expirations corresponding to the four calendar months in the March cycle in the current calendar year, and a fifth series expiring in March of the following calendar year.

The exercise settlement value for Differential Index Options will be calculated based on the respective exercise settlement values for standardized options on each of the designated and benchmark indexes expiring on the same day. The exercise settlement value for Equity Differential Options will be calculated based on the primary exchange regular-way opening sale price of the designated stock, or, if the stock is traded through the Nasdaq system, the first reported regular-way sale that occurs after the best bid and best offer for that security are unlocked and uncrossed and is greater than or equal to the best bid and less than or equal to the best offer at the time of the reported sale and the exercise settlement value for standardized options on the benchmark index expiring on the same day. The exercise settlement value for Paired Stock Differential Options will be calculated based on the primary exchange regular-way opening sale prices of the designated and benchmark stocks, or, if the stock is traded through the Nasdaq system, the first reported regular-way sale that occurs after the best bid and best offer for that security are unlocked and uncrossed and is greater than or equal to the best bid and less than or equal to the best offer at the time of the reported sale.

d. Applicable Exchange Rules. Proposed PCX Rules 7.20 through 7.31 and Rule 8.102 will apply to Differential Index Options contracts. These Rules cover issues such as surveillance, exercise price and position limits. Differential Index Options will also be subject to (1) the PCX's surveillance procedures currently used to monitor trading in each of the Exchange's index and equity options, and (2) sales practice and suitability rules applicable to standardized options. The Exchange currently intends to create Differential Index Options using the indexes and options currently traded on the PCX.

Differential Index Options are "securities" under section 3(a)(10) of the Act, and therefore are exempt pursuant to section 28(a) of the Act from any state law that prohibits or regulates the making or promoting of wagering or gaming contracts, or the operation of "bucket shops" or other similar or related activities. Differential Index Options will be traded pursuant to the Exchange's rules and rule amendments discussed herein, subject to prior approval by the Commission.

e. Position Limits. The Exchange proposes that the position limits for Differential Index Options be set at the lower of the separate position limits for standardized index options trading on the designated index or the benchmark index. In the event that one or both of the indexes is not currently the subject of standardized index options trading, but rather has been approved for index warrant trading only, then the Exchange will establish position limits as the lesser of those that would be in effect for standardized options on the indexes if such options were trading.[6] For Equity Differential Options, the Exchange proposes that the limits be set at the position limit of standardized options trading on the designated stock. In the event that standardized options currently do not trade on the designated stock, the Exchange will establish a position limit at the level that would be in effect if standardized options did trade on such stock. For Paired Stock Differential Options, the Exchange proposes that the position limits be set at the lower of the separate position limits of standardized equity options trading on the designated or benchmark stocks. In the event that one or both of the stocks is not currently the subject of standardized options trading, then the Exchange will establish position limits as the lesser of those that would be in effect for standardized options on the stocks if such options were trading.

The Exchange also proposes, for position and exercise limit purposes, to require that positions in Differentials with the same designated or benchmark stock or narrow-based index be aggregated. For example, if a Paired Stock Differential Option has been created using Microsoft Corporation stock as the benchmark and Compaq, Inc. as the designated stock, positions in that Differential Option will be aggregated for position and exercise limit compliance purposes with positions in other Paired Stock Differentials that use one of these two stocks. Furthermore, Equity Differential Options using narrow-based indexes versus either Microsoft or Compaq as the benchmark or designated stock also will be aggregated for position and exercise limit compliance purposes with positions in Paired Stock Differential Options using one of those two stocks. However, with respect to the use of broad-based indexes as either the benchmark or designated index in an Equity or Index Differential, no aggregation of positions will be required. For example, if Equity Differentials are created using the PSE Tech 100 Index as the benchmark index and Apple Computer, Inc., Philip Morris Companies, Inc. and Telecommunications, Inc. as designated stocks, members will not be required to aggregate positions in those differentials to determine whether an account is in compliance with position and exercise limit rules.

The Exchange further proposes that Differential Index Options not be aggregated with other standardized options on the underlying designated stock or index nor on the underlying benchmark stock or index for purposes of determining whether an account is in compliance with position and exercise limit rules. The Exchange believes this policy is appropriate for the following reasons. First and foremost, the value of Differential Index Options will be calculated in a different manner from the value of other currently trading standardized equity and index options. In fact, because of the subtraction of the benchmark from the designated stock or index, the value of a Differential Index Option may appreciate (depreciate) even as the value of the corresponding standardized option on the designated stock or index decreases (increases). Further, the value of a Differential Index Option is in part a function of the correlation between the designated stock or index and the benchmark (*i.e.*, the tendency of the designated stock or index and the benchmark to move concurrently). This correlation component of the Differential Index Option price is not considered in determining the value of other standardized options on either the designated or benchmark stock or index. As a result, the Differential index Option is likely to be more or less sensitive to movements in the designated stock or index than the other standardized options on that stock or index, and changes in Differential Index Option may be in the opposite direction from changes in other standardized options prices. Therefore, any attempt to aggregate Differential Index Options with other standardized options for determination of position limits would be combining contracts that, by nature, can change in value quite differently.

Differential Index Options also have certain terms not found in many other standard equity and index options. Differential Index Options are cash settled, based on opening prices of the designated stock or index and the benchmark and feature European exercise. Each Differential Index Option contract changes in value as a function of the differential performance of a $10,000 long position in the designated stock or index and a $10,000 short position in the benchmark. May standardized equity options are settled by physical delivery of 100 shares of the underlying stock, worth $5,000 per contract for a $50 stock, and feature American exercise. Standardized index options typically feature European exercise, cash settlement and represent

[6] In the event that one or both of the indexes is the subject of index warrant trading only, the position limit for a differential option using a narrow-based index warrant will be established using PCX's narrow-based index options rules. *See* PCX Rule 7.3. The Exchange will consult with the Commission to establish a position limit for a differential option using a broad-based index warrant. *See* Amendment No. 2, *supra* note 4.

approximately $25,000 worth of a basket of stocks (with the index at the 250 level). Any meaningful aggregation of positions in contracts with different terms would be difficult to establish as a simple rule, and would require a case-by-case analysis of the terms for each Differential Index Option contract compared to other standardized contracts on the designated and/or benchmark stock or index.

The Exchange also believes that the aggregation of position limits hinders the probability of success of any new product. The aggregation of positions in Differential Options with positions in standardized options will result in the new product competing with the established product for a limited amount of potential volume. Thus, in the Exchange's view, with aggregated position limits, new products cannot ''grow the pie'' and increase overall liquidity in all the products; they start at a disadvantage which may be impossible to overcome.

f. Customer Margin. Since Differential Index Options are similar to other index options, the Exchange proposes to apply standard index options margin treatment to Differential Index Options.[7] Differential Index Options on the relative performance of one broad-based index versus another will be margined as broad-based index options and short positions therein will require margin equal to the current market value of the option plus an amount equal to 15% of the market value of the Differential Index reduced by any out of the money amount to a minimum of the current market value of the option plus 10% of the Differential Index. All other Index Differential Options, Equity Differential Options, and Paired Stock Differential Options will be margined as narrow-based index options and short positions therein will require an amount equal to the current market value of the Differential Index Option plus an amount equal to 20% of the market value of the Differential Index reduced by any out of the money amount to a minimum of the current market price of the options plus 10% of the Index. The Exchange believes that this method of determining customer margin is appropriate because the range of volatities expected for Differential Indexes should not be significantly different than the expected rage for other indexes and equities. The volatility of a Differential Index is based upon the volatilities of the designated and benchmark indexes or stock and the correlation of these components.[8]

2. Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,[9] in general, and furthers the objectives of section 6(b)(5),[10] in particular, because it is designed to promote just and equitable principles of trade, to facilitate transactions in securities, and to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose 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

The Exchange did not solicit or receive written comments on the proposed rule change.

II. 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 20549–0609. 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 the filing will also be available for inspection and copying at the principal office of the PCX. All submissions should refer to File No. SR–PCX–98–62 and should be submitted by June 1, 1999.

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

Margaret H. McFarland,

Deputy Secretary.

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[7] *See* PCX Rule 2.16(c) for margin requirements for standard index options.

[8] *See* Amendment No. 1, *supra,* note 3.

[9] 15 U.S.C. 78f(b).

[10] 15 U.S.C. 78f(b)(5).

[11] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41350; File No. SR–PCX–99–02]

Self-Regulatory Organizations; Pacific Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Relating to Matters Subject to Arbitration

I. Introduction

On February 3, 1999, the Pacific Stock Exchange, Inc. (''PCX'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC'') a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Exchange Act'') [1] and Rule 19b–4 thereunder.[2] The proposed rule change would amend PCX Rule 12.1 to allow for claims related to employment, including sexual harassment, or any discrimination claim in violation of a statute, to be eligible for submission to arbitration only where all parties have agreed to arbitration after the claim has arisen. Notice of the proposed rule change, together with the substance of the proposal, was provided in a Commission release and in the **Federal Register**.[3] The Commission received no comment letters. This Order approves the proposed rule change.

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

[2] 17 CFR 240.19b–4.

[3] Exchange Act Release No. 41206 (March 23, 1999) 64 FR 15388 (March 31, 1999).