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

The purpose of the proposed rule change is to list and trade Dollar Denominated Delivery ("3D") foreign currency options ("FCOs") on the Japanese Yen. In March 1994, the Commission approved the listing and trading of 3D FCOs on the German Mark.<sup>4</sup> 3D FCOs are cash-settled, European-style options issued by the **Options Clearing Corporation ("OCC")** that allow holders to receive U.S. dollars representing the difference between the current foreign exchange spot price 5 and the exercise price of the option. Specifically, upon exercise of an in-the-money 3D FCO structured as a call, the holder will receive, from OCC, U.S. dollars representing the difference between the exercise strike price and the closing settlement value of the 3D FCO contract multiplied by the number of units of currency covered by the contract. For a 3D FCO structured as a put, the holder will receive U.S. dollars representing the excess of the exercise price over the closing settlement value of the 3D FCO contract multiplied by the number of units of foreign currency covered by the contract.

Unlike other Phlx-traded FCOs, 3D FCOs which are in-the-money by any amount on the expiration date will be exercised automatically by OCC. 3D FCOs which are out-of-the-money at expiration will expire worthless.

German 3D FCOs were originally listed with one-week and two-week expirations to provide a hedging vehicle to sophisticated retail customers, portfolio managers and multi-national corporations which needed to hedge their short term foreign currency exposure and also to banks which needed to hedge the risks associated with trading in the forward and cash markets. Recently, the Exchange received approval from the Commission to list German 3D FCO contracts with longer term expirations up to twelve months <sup>6</sup> due to the interest expressed by the users of the product who did not wish to establish foreign bank credit

<sup>6</sup>See Securities Exchange Act Release No. 35756 (May 24, 1995), 60 FR 28638 (June 1, 1995). lines or worry about the potential of exchanging currency at exercise and assignment.

The Exchange is now proposing to list and trade 3D FCOs on the Japanese yen (U.S. dollar/Japanese yen). The contract size will be 6,250,000 yen, the same as physically settled Japanese yen contract. Pursuant to Phlx Rule 1012(a)(ii), the contracts will be listed with expirations at one week and two weeks and one, two, three, six and nine months (twelve month options will not be listed at this time). The options will be on the March, June, September, December cycle and no month end or long term expirations will be listed. The expiration date for the consecutive and cycle month options will be the Monday preceding the third Wednesday of each month. The Exchange expects that the symbols for these options will be as follows:

XJA first Monday of month expiration XJB second Monday of month expiration XJC third Monday of month expiration XJD fourth Monday of month expiration

- XJE fifth Monday of month expiration
- XJS settlement symbol

The 1, 2, 3, 6, and 9 month options will be listed with the symbol XJB or XJC depending on whether expiration will be the second or third Monday of that month and will carry that symbol to expiration. For example, a Sept 1995 option which would expire on Monday Sept. 18, would listed as an XJC Sept 85 call whereas the Nov 1995 option which would expire on Monday, Nov. 13, would be listed as an XJB Nov 85 call.

Similar to the 3D German mark contracts, the Exchange proposes that a series of 3D Japanese yen options will trade during normal trading hours for foreign currency options, specifically, 2:30 a.m. to 2:30 p.m. E.T. Monday through Friday. The expiring FCO contract will cease trading at 10:30 a.m. and expire at 11:59 p.m. on its expiration Monday, unless such Monday is an Exchange holiday or an Exchange designated bank holiday, when, under Phlx Rule 1000(b)(21) "Expiration date," as amended, the 3D FCO will expire at 11:59 p.m. on the preceding business date.

Accordingly, on Exchange holidays and Exchange designated bank holidays, the expiring 3D FCOs will cease trading at 10:30 a.m. on the preceding business day. In addition, when Monday is an exchange holiday, a new two-week contract will be listed on the following Tuesday at 2:30 a.m. E.T. as opposed to the normal Monday morning listing.

The closing settlement value, which will be disseminated through the Options Price Reporting Authority ("OPRA"), will be determined by a

designated agent(s) of the Exchange under Phlx Rule 1057, "Cash/Spot Foreign Currency Option Closing Settlement Value." Pursuant to Phlx Rule 1057, at 10 a.m. (E.T.), on every expiration date for 3D FCOs, the market information vendor(s), acting as the Exchange's designated agent will collect a bid and offer quotation for the current Japanese yen spot price from the quotations submitted by at least 15 interbank foreign exchange participants, which the designated agent will select randomly from a list of at least 25 active interbank foreign exchange market participants.<sup>7</sup> After discarding the five highest offers and five lowest bids, the designated agent will arithmetically average the remaining ten bids and ten offers to arrive at a closing settlement value. This value will be calculated and sent to the Phlx every 30 seconds until 10:30 a.m. when the designated agent will determine the final settlement value. At that time, the settlement value will be automatically entered into the Phlx's systems, and then the Phlx disseminates it to OPRA and the OCC for entry into the OCC clearing systems.

The position limits and exercise limits for the 3D yen will be the same as the position and exercise limit for the physically settled Japanese yen contracts pursuant to Phlx Rule 10018 and Rule 1002 and positions in the 3D yen will be aggregated with positions in the physically settled Japanese yen contracts. The Phlx proposes to initially list exercise strike prices for each expiration around the current spot price and new strikes may be added during the life of the option in accordance with Phlx Rule 1012 at half-cent intervals for the 3 near term month and at one cent intervals for the six and nine month options.

The 3D Japanese yen options will trade in accordance with the rules governing all Phlx FCOs, including sales practice rules and floor trading rules. For example, Phlx Rule 1014, "Obligations and Restrictions Applicable to Specialists and Registered

<sup>8</sup> Position and exercise limits on the Japanese yen are 100,000 contracts on either side of the market, however, the Phlx has recently proposed to raise this limit to 200,000 contracts. This proposal is currently under review at the Commission. See Securities Exchange Act Release No. 35688 (May 8, 1995), 60 FR 26062 (May 16, 1995).

<sup>&</sup>lt;sup>4</sup> See Securities Exchange Act Release No. 33732 (March 8, 1995), 59 FR 12023 (March 15, 1994).

<sup>&</sup>lt;sup>5</sup> The "spot price" with respect to an option contract on a foreign currency option contract means the price for the sale of one foreign currency for another, quoted by various commercial banks in the interbank foreign exchange market for the sale of a single unit of such foreign currency for immediate delivery (which generally means delivery within two business days following the date on which the terms of such sale are agreed upon). See Phlx Rule 1000(b)(16).

<sup>&</sup>lt;sup>7</sup>The Phlx will select the list of interbank market participants by evaluating the number of times each contributor supplies Japanese yen spot quotes to the market information vendor(s) on Monday mornings between 10 a.m. and 10:30 a.m. The pool of quote contributors will be reviewed monthly based on these criteria and substitutions will be made, if necessary. If at any time an interbank market participant ceases to distribute JY spot quotes or is no longer in the business of making JY markets, that entity will be replaced.