Consistent with the Phlx's other approved foreign currencies, Exchange Rule 1033 will be amended to specify the bid and offer rules for Customized FCOs based on the Lira and Peseta. Similarly, Rule 1034 will be amended to provide that the Exchange will determine the minimum fractional change applicable to Customized FCOs on the Lira and Peseta.

## **Contract Specifications**

Customized FCOs based on the Lira will have the following characteristics: (1) the contract size will be 50,000,000 Lira; <sup>9</sup> (2) the premiums will be quoted in thousandths of a cent per unit for U.S. dollar/Italian lira contracts; and (3) the minimum premium will be \$0. (00000) 01 per unit (*i.e.*, \$5.00).

Customized FCOs based on the Peseta will have the following characteristics: (1) The contract size will be 5,000,000 pesetas; <sup>10</sup> (2) the premiums will be quoted in thousandths of a cent per unit for U.S. dollar/Spanish peseta contracts; and (3) the minimum premium will be \$0. (0000) 01 per unit (*i.e.*, \$5.00).

## **Customer Margin**

For customer margin purposes, the Exchange is proposing to amend Rule 722 to set the customer margin "addon" <sup>11</sup> percentage for Customized FCOs on both the Lira and Peseta at 7% for both initial and maintenance margin, with no adjustment for out-of-themoney Customized FCOs. <sup>12</sup> The

those provided in Rule 1014(c). Because the Phlx does not list regular FCOs on either the Lira or Peseta (and will not be able to list regular FCOs on either currency pursuant to this approval order), Rules 1014(c) and 1069 will provide that there will be no quote spread parameters for Customized FCOs involving either the Lira or Peseta. The Exchange will conduct a study of the markets for Customized FCOs based on the Lira and Peseta to build an historical pricing reference database on which to analyze whether quote spread parameters should be imposed in the future for these Customized FCOs. Telephone conversation between Michele Weisbaum, Assistant General Counsel and Assistant Vice President, Phlx, and Brad Ritter, Senior Counsel, OMS, Division, Commission, on September 7, 1995.

<sup>9</sup> Based on an exchange rate of 1,615.00 Italian lira/U.S. dollars on August 23, 1995, as published in *The Wall Street Journal*, this would correspond to an opening position for an Italian lira customized FCO transaction (*i.e.*, 100 contracts) valued at approximately \$3,096,000.

<sup>10</sup> Based on an exchange rate of 126.25 Spanish pesetas/U.S. dollars on August 23, 1995, as published in *The Wall Street Journal*, this would correspond to an opening position for a Spanish peseta customized FCO transaction (*i.e.*, 100 contracts) valued at approximately \$3,960,000.

<sup>11</sup> For these purposes, "add-on" is the percentage of the current market value of the currency a Customized FCO that the holder of a "short" position must pay in addition to the current market value of each Customized FCO.

<sup>12</sup> According to the Exchange, the 7% margin addon level is sufficient to cover 98.84% and 99.10% of all seven day price changes during the past three

Exchange will conduct a regular review of the margin levels for Customized FCOs involving either the Lira or Peseta.<sup>13</sup> In this review, which will be conducted at least quarterly,14 the Exchange will determine the frequency distributions reflecting the percentage price returns for the Lira and Peseta, each in relation to the U.S. dollar, for all seven day periods during the preceding three year period. If the Exchange determines as a result of one of these reviews that the current margin add-on for each currency is not sufficient to cover at least 97.5% of all seven day price returns during that period, the Exchange will take immediate steps to increase the margin levels for each currency to one that will cover at least 97.5% of all such instances and will immediately notify the Commission of any such increases. In no event will the Exchange reduce the margin levels for Customized FCOs involving either the Lira or Peseta below the 7% level without the prior approval of the Commission pursuant to Section 19(b) of the Act. Whenever the customer margin levels for Customized FCOs on either the Lira or Peseta are changed, the Exchange will promptly notify the Exchange's membership and the public.

## **Customized Cross-Rates**

Pursuant to Phlx Rule 1069(a)(1)(B), the Exchange may list cross-rate Customized FCOs on any two approved currencies, exclusive of the U.S. dollar ("Customized Cross-Rates"). 15 Customized Cross-Rates are currently margined using a two-tier system.

Because the margin add-on percentage for Customized FCOs on the Lira and Peseta are initially being set at levels significantly higher than those for the Phlx's other approved currencies, the Phlx will begin using a three-tier system for Customized Cross-Rates: 16 Tier I will consist of all approved currency pairings not involving the Lira or Peseta whose daily price changes have a correlation greater than or equal to .25 during the most recent 24 month period; Tier II will consist of all remaining pairings of approved currencies not involving the Lira or Peseta; and Tier III will consist of all Customized Cross-Rates involving the Lira or the Peseta.

years involving the Lira and Peseta, respectively, in relation to the U.S. dollar. *See* Amendment No. 1, *supra* note 5.

The initial and maintenance margin requirements for Tier I and Tier II Customized Cross-Rates will remain at current levels (*i.e.*, 100% of the underlying value plus 4% and 6%, respectively), subject to any changes resulting from the Phlx's periodic reviews of margin adequacy.<sup>17</sup>

The initial and maintenance margin requirements for Tier III Customized Cross-Rates will initially be set at 100% of the underlying value plus 7%.18 the Phlx will continue to conduct its regular periodic reviews of the margin adequacy for all approved currency combinations, however, Tier III currency pairings will not be eligible to be moved to either Tier I or Tier II based on such reviews. As a result, for Tier III currency pairings, the Phlx will need to conduct only the second stage of the review that it presently conducts for Customized Cross-Rates in Tiers I and II,19 as modified below. Specifically, on at least a quarterly basis, 20 the Exchange will determine whether the actual margin level for Tier III (i.e., 7% add-on) is adequate to cover seven day price changes for all possible cross-rate combinations within Tier III. If the margin add-on is not sufficient to cover at least 97.5% of all such changes during the preceding three year period, the Exchange will take immediate steps to increase the margin level to one that will cover at least 97.5% of all such instances and will immediately notify the Commission of such increases. In no event will the initial or maintenance

<sup>&</sup>lt;sup>13</sup> Telephone conversation between Michele Weisbaum, Associate General Counsel and Assistant Vice President, Phlx, and Brad Ritter, Senior Counsel, OMS, Division, Commission, on August 30, 1995.

<sup>&</sup>lt;sup>14</sup> Id.

 $<sup>^{15}\,</sup>See$  Exchange Act Release No. 34925, supra note 3.

<sup>16</sup> See Amendment No. 1, supra note 5.

<sup>&</sup>lt;sup>17</sup>The Exchange conducts a regular two-step review of the margin levels for Customized Cross-Rates. The first review, which is conducted at least monthly, examines the correlations between all of the possible combinations of approved currencies for the most recent two-year period. If a monthly or any special review reveals that a combination of approved currencies should be in another tier based on the correlation of those approved currencies, the Exchange will take immediate steps to implement the change. The second review examines whether the actual margin levels are adequate to cover seven day price changes for all possible cross-rate combinations within Tiers I and II. Frequency distributions of seven day price movements for all currency combinations are reviewed on a monthly basis to determine whether the percentage of margin "add-on" is sufficient to cover 95% of all instances over the preceding two year period for all currency combinations within each tier. If the percentage falls to less than 95%, the Exchange will take steps to increase the margin level for those pairings to one that will cover at least 97.5% of all instances. If the margin adequacy level is greater than 99%, the Exchange will take steps to lower the margin requirements for those pairings to one which will cover 99%. In no event, however, will the initial or maintenance margin levels for any pairing of approved currencies be reduced below the 4% and 6% levels discussed above without the prior approval of the Commission. See Exchange Act Release No. 34925, supra note 3.

<sup>&</sup>lt;sup>18</sup> See Amendment No. 1, supra note 5.

<sup>19</sup> See supra note 17.

<sup>20</sup> See supra note 13.