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None.

Dated: July 2, 1998.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40157; File No. SR-Amex-96-44]

Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 3, 4, 5 and 6 to the Proposed Rule Change by the American Stock Exchange, Inc. Relating to the Listing and Trading of Options on Exchange-Traded Fund Shares

July 1, 1998.

I. Introduction

On November 21, 1996, the American Stock Exchange, Inc. ("Amex" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to list and trade options on securities representing interests in open-end, exchange-listed investment companies that hold securities constituting or based on an index or portfolio of securities ("Exchange-Traded Fund

Shares" or "Fund Shares"). The Exchange filed Amendment Nos. 1 and 2 to the proposal on January 16, 1997, and February 19, 1997, respectively.³ Notice of the proposal, and Amendment Nos. 1 and 2 appeared in the **Federal Register** on February 25, 1997.⁴ No comment letters were received on the proposed rule change. On January 7, 1998, the Amex filed Amendment No. 3 to the proposed rule change.⁵

Among other things, Amendment No. 3 revises the proposal to permit the Amex to trade FLEX Equity options on Fund Shares. On March 12, 1998, the Amex filed Amendment No. 4 to the proposal⁶ and on April 28, 1998, the Exchange filed Amendment No. 5.⁷ Finally, on June 19, 1998, the Exchange filed Amendment No. 6 to the proposed rule change.⁸ This order approves the

³ Amendment Nos. 1 and 2 have been replaced and superseded by Amendment No. 5.

⁴ See Securities Exchange Act Release No. 38308 (February 19, 1997), 62 FR 8467.

⁵ See Letter from Claire P. McGrath, Vice President & Senior Counsel, Amex, to Sharon Lawson, Senior Special Counsel, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), dated January 6, 1998 ("Amendment No. 3"). Amendment No. 3 makes a number of changes to the proposal which are discussed herein.

⁶ See Letter from Claire P. McGrath, Vice President and Special Counsel, Amex, to Sharon Lawson, Senior Special Counsel, OMS, Division, Commission, dated March 11, 1998 ("Amendment No. 4"). Amendment No. 4 provides that options on Fund Shares can either meet the uniform options listing standards set forth in Rule 915 and commentary .01 thereunder or meet the criteria set forth in proposed commentary .06 to Rule 915. The portion of Amendment No. 4 that addresses comprehensive surveillance sharing agreements with regard to non-U.S. stocks in the index or portfolio on which the fund shares are based has been replaced and superseded by Amendment No. 5.

⁷ See Letter from Claire P. McGrath, Vice President and Special Counsel, Amex, to Sharon Lawson, Senior Special Counsel, OMS, Division, Commission, dated April 27, 1998 ("Amendment No. 5"). In Amendment No. 5 the Amex proposes the following surveillance sharing standard: (1) that any Fund Share with non-U.S. stocks in the underlying index or portfolio that are not subject to comprehensive surveillance sharing agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in anyone country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive agreements do not represent 33% or more of the weight of the index. Amendment No. 5 supersedes and replaces Amendment Nos. 1 & 2, and the portion of Amendment No. 4 that addresses surveillance sharing.

⁸ See Letter from Claire P. McGrath, Vice President and Special Counsel, Amex, to Sharon Lawson, Senior Special Counsel, OMS, Division, Commission, dated June 19, 1998 ("Amendment No. 6"). In Amendment No. 6 the Exchange clarifies that Fund Shares that hold securities based upon a narrow-based index or portfolio must have options margin that equals at least 100% of the current market value of the contracts plus 20% of the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Exchange's proposal, and Amendment Nos. 3, 4, 5, and 6 on an accelerated basis.

II. Description of the Proposal

The purpose of the proposed rule change is to provide for the trading of options and FLEX Equity options⁹ on Fund Shares. As noted above, Fund Shares are exchange-listed securities representing interests in open-end unit investment trusts or open-end management investment companies ("Funds") that hold securities based on an index or a portfolio of securities.¹⁰ Fund Shares are issued in exchange for an "in kind" deposit of a specified portfolio of securities, together with a cash payment, in minimum size aggregations or multiples thereof ("Creation Units"). The size of the applicable Creation Unit size aggregation is set forth in the Fund's prospectus, and varies from one series of Fund Shares to another, but generally is of substantial size (e.g., value in excess of \$450,000 per creation unit). A Fund, generally, will issue and sell Fund Shares in Creation Unit size through a principal underwriter on a continuous basis at the net asset value per share next determined after an order to purchase Fund Shares and the appropriate securities are received. Following issuance, Fund Shares are traded on an exchange like other equity securities, and equity trading rules apply. Likewise, redemption of Fund Shares is made in Creation Unit size and "in kind," with a portfolio of securities and cash exchanged for the Fund Shares that have been tendered for redemption.

Generally, options on Exchange-Traded Fund Shares are proposed to be traded on the Exchange pursuant to the same rules and procedures that apply to trading in options on equity securities. However, the Exchange is also

proposing to list FLEX Equity options on Fund Shares and some options will have a unit of trading of 1000 Exchange-Traded Fund Shares. The Exchange will list option contracts covering either 100 or 1000 Fund Shares, or both, depending on the price and volatility of the underlying Fund Shares and the popularity of the options.¹¹ Strike prices for both the 100 and 1000 share contracts will be set to bracket the Fund Shares at one point intervals up to a share price of \$200.¹² The proposed position and exercise limits for options on Fund Shares would be the same as those established for stock options as set forth in Amex Rules 904 and 905. The Amex anticipates that most options on Fund Shares initially will qualify for only the lowest position limit. As with standardized equity options, the position limits will be increased for options if the volume of trading in the Fund Shares increases to meet the requirements of a higher limit.¹³ As is currently the case for all FLEX Equity options, no position and exercise limits will be applicable to FLEX Equity options overlying Fund Shares until, at least, September 9, 1999.¹⁴

The listing and maintenance standards proposed for options on Exchange-Traded Fund Shares are set forth in proposed Commentary .06 under Exchange Rule 915 and in proposed Commentary .08 under Exchange Rule 916, respectively. Pursuant to the proposed initial listing standards, Amex only will list Fund Shares that are principally traded on a national securities exchange or through the facilities of a national securities association and reported as national market securities. In addition, the initial listing standards require that either: (1) the Fund Shares meet the uniform options listing standards in Commentary .01 to Rule 915, which include minimum public float, trading volume, and share price of the underlying security in order to list the option;¹⁵ or (2) the Exchange-Traded

Fund Shares must be available for creation or redemption each business day in cash or in kind from the Fund at a price related to the net asset value, and the Exchange will require that the underlying Fund Shares may be created even though some or all of the securities needed to be deposited have not been received by the Fund.¹⁶

In addition, the initial listing standards require that: (1) any Fund Share with non-U.S. stocks in the underlying index or portfolio that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index or portfolio; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.¹⁷

The Exchange's proposed maintenance standards provide that if a particular series of Exchange-Traded Fund Shares should cease to trade on an exchange or as national market securities in the over-the-counter market, there will be no opening transactions in the options on the Fund Shares, and all such options will trade on a liquidation-only basis. In addition, the Amex will consider the suspension of opening transactions in any series of options of the class covering Fund Shares if: (1) the options fail to meet the uniform equity option maintenance standards Commentary .01 to Rule 916,¹⁸ when the options were listed pursuant to the equity option listing

float of 7,000,000 shares, 2000 holders, trading volume of 2,400,000 shares in the preceding 12 months, a share price of \$7.50 for the majority of the business days during the three calendar months preceding the date of the selection, and that the issuer of the underlying security is in compliance with the Act.

¹⁶ Provided the authorized creation participant has undertaken to deliver the shares as soon as possible and such undertaking has been secured by the delivery and maintenance of collateral consisting of cash or cash equivalents satisfactory to the Fund which underlies the option, as described in the Fund prospectus. See Amendment No. 3, *supra* note 5.

¹⁷ See Amendment No. 5, *supra* note 7.

¹⁸ Specifically, Commentary .01 to Rule 916 provides that an underlying security will not meet the Exchange's requirements for continued listing when, among other things; (1) there are fewer than 630,000 publicly-held shares; (2) there are fewer than 1600 holders; (3) trading volume was less than 1,800,000 shares in the preceding twelve months; and (4) the share price of the underlying security closed below \$5 on a majority of the business days during the preceding 6 months.

market value of equivalent units of the underlying security value.

⁹ In general, FLEX Equity options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices.

¹⁰ Currently, the Exchange trades unit investment trust securities known as Portfolio Depository ReceiptsSM ("PDRs") based on the Standard & Poor's 500® Composite Stock Price Index, the Standard & Poor's MidCap 400 Index, and the Dow Jones Industrial Average. In addition, the Exchange trades Index Fund Shares which are issued by an open-end management investment company consisting of seventeen separate series known as World Equity Benchmark SharesSM ("WEBS") based on seventeen foreign equity market indexes. PDRs and WEBS are listed on the Amex pursuant to Rule 1000, et seq. and Rule 1000A et seq., respectively, and trade like shares of common stock. The Commission notes that not all PDRs or WEBS currently trading on the Amex may meet the standards for options trading approved by this order.

¹¹ See Amendment No. 3, *supra* note 5. In the event the Exchange lists options covering both 100 and 1000 of the same underlying Fund Shares, the Exchange will assign separate trading symbols to the options and will issue an Information Circular to all its members advising of the trading symbols. Telephone conversation between Claire P. McGrath, Vice President & Senior Counsel, Amex, and James T. McHale, Special Counsel, OMS, Division, Commission, on June 17, 1998.

¹² See Amendment No. 3, *supra* note 5.

¹³ *Id.*

¹⁴ See Securities Exchange Act Release No. 39032 (September 9, 1997) (Order eliminating position and exercise limits for FLEX Equity options on a two year pilot basis) ("FLEX Equity Position Limit Pilot").

¹⁵ Specifically, Commentary .01 to Rule 915 requires the underlying security to have a public

standards of Commentary .01 to Rule 915;¹⁹ (2) following the initial twelve-month period beginning upon the commencement of trading of the Fund Shares on a national securities exchange or as national market securities through the facilities of a national securities association there are fewer than 50 record and/or beneficial holders of Fund Shares for 30 or more consecutive trading days; (3) the value of the index or portfolio of securities on which the Fund Shares are based is no longer calculated or available; or (4) such other event shall occur or condition exist that in the opinion of the Exchange makes further dealing in such options on the Exchange inadvisable.

Options on Fund Shares will be physically-settled and will have the American-style exercise feature used on all standardized equity options, and not the European-style feature originally proposed.²⁰ The Exchange, however, also proposes to trade FLEX Equity options which will be available with both the American-style and European-style exercise feature, as well as other FLEX Equity features.²¹

The proposed margin requirements for options on Exchange-Traded Fund Shares are at the same levels that apply to options generally under Exchange Rule 462, except, with respect to Fund Shares based on a broad-based index or portfolio, and those Fund Shares approved by the Commission to date, minimum margin must be deposited and maintained equal to 100% of the current market value of the option plus 15% of the market value of equivalent units of the underlying security value. Fund Shares that hold securities based upon a narrow-based index or portfolio must have options margin that equals at least 100% of the current market value of the contract plus 20% of the market value of equivalent units of the

underlying security value.²² In this respect, the margin requirements proposed for options on Exchange-Traded Fund Shares are comparable to margin requirements that currently apply to broad-based and narrow-based index options.

The Exchange believes it has the necessary systems capacity to support the additional series of options that would result from the introduction of options on Fund Shares, and it has been advised that the Options Price Reporting Authority ("OPRA") also will have the capacity to support these additional series now that it has implemented an additional outgoing high speed line from the OPRA processor.²³

III. Commission Findings and Conclusions

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).²⁴ Specifically, the Commission believes that providing for the listing and trading of options and FLEX Equity options²⁵ on Exchange-Traded Fund Shares should give investors a better means to hedge their positions in the underlying Fund Shares. Further, the Commission believes that pricing of the underlying Fund Shares may become more efficient and market makers in these shares, by virtue of enhanced hedging opportunities, may be able to provide deeper and more liquid markets. In sum, the Commission believes that options on Fund Shares likely will engender the same benefits to investors and the market place that exist with respect to options on common stock,²⁶ thereby serving to promote the public interest, remove impediments to a free and open securities market, and promote

efficiency, competition, and capital formation.²⁷

As a general matter, the Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as options on Fund Shares, can commence trading on a national securities exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) The special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. With regard to position and exercise limits, the Commission finds that it is appropriate to adopt the tiered approach used in setting position and exercise limits for standardized stock options. This approach should serve to minimize potential manipulation and market impact concerns. In addition, the Commission believes that the rationale for allowing FLEX Equity options generally to trade without position and exercise limits until September 9, 1999, is equally applicable in the context of FLEX Equity options on Fund Shares.²⁸ Accordingly, because options and FLEX Equity options on Fund Shares will be subject to the same regulatory regime as the other options and FLEX Equity options currently traded on the Amex, the Commission believes that adequate safeguards are in place to ensure the protection of investors in options and FLEX Equity options on Fund Shares.

The Commission also believes that it is appropriate to permit the Amex to list and trade options, including FLEX Equity options, on Exchange-Traded Fund Shares given that these options must meet specific requirements related to the protection of investors.²⁹ First, the Exchange's listing and delisting criteria for options on Fund Shares are adequate. With regard to initial listing, the proposal requires that either: (1) the

¹⁹ See Amendment No. 4, *supra* note 6. The Commission notes that even if options on Fund Shares were not listed under the uniform equity option listing standards, Amex Rules 1002 and 1002A require a minimum number of Fund Shares to be outstanding before trading in a series of Fund Shares may commence. In addition, the Amex has represented that although there is no comparable public float maintenance standard for the underlying Fund Shares, as a practical matter there can never be trading in a series of Fund Shares in which there is less than one Creation Unit outstanding, since Fund Shares only may be created and redeemed in Creation Unit size, and if the last outstanding Creation Unit should ever be redeemed, the series (and the options on that series) will cease to trade.

²⁰ See Amendment No. 3, *supra* note 5. An American-style option may be exercised at any time prior to its expiration. A European-style option, however, may be exercised only on its expiration date.

²¹ *Id.*

²² See Amendment No. 6, *supra* note 8.

²³ See letter from Joseph P. Corrigan, Executive Director, OPRA, to Ivette Lopez, Assistant Director, OMS, Division, Commission, dated November 8, 1996.

²⁴ 15 U.S.C. 78f(b)(5).

²⁵ The Commission hereby incorporates by reference its findings and conclusions with respect to the appropriateness of FLEX Equity options generally. See Securities Exchange Act Release No. 37336 (June 19, 1996), 61 FR 33558 (June 27, 1996).

²⁶ Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new securities product upon a finding that the introduction of such new product is in the public interest. Such a finding would be difficult for a derivative instrument that served no hedging or economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

²⁷ 15 U.S.C. 78c(f).

²⁸ See FLEX Equity Position Limit Order, *supra* note 14. Pursuant to the FLEX Equity Position Limit Pilot, the Commission expects the Amex to include its experience with FLEX Equity options on Fund Shares in its report to the Commission.

²⁹ The Commission notes, and Amex has verified, that holders of options on Fund Shares who exercise and receive the underlying Fund Shares must receive, like any purchaser of Fund Shares, a product description or prospectus, as appropriate. Telephone Conversation between Claire P. McGrath, Vice President and Senior Counsel, Amex, Sharon Lawson, Senior Special Counsel, OMS, Division, Commission, and James McHale, Special Counsel, OMS, Division, Commission, on June 25, 1998.

underlying Fund Shares meet the Amex's uniform options listing standards; or (2) the Exchange-Traded Fund Shares must be available for creation or redemption each business day in cash or in kind from the Fund at a price related to the net asset value, and the Exchange will require that the underlying Fund Shares may be created even though some or all of the securities needed to be deposited have not been received by the Fund.³⁰ This listing requirement should ensure that there exists sufficient supply of the underlying Fund Shares so that a short call writer, for example, will have the ability to secure delivery of the Fund Shares upon exercise of the option.

In reviewing the Amex's proposal, as originally submitted, the Commission had been concerned with the ability to produce Fund Shares upon exercise of the option. The Commission believes the Amex has adequately addressed these concerns through the adoption of the listing standards set forth above. In particular, options listed pursuant to the uniform options listing standards will have to meet the options maintenance listing standards which require, among other things, that a minimum number of Fund Shares be outstanding to continue trading the options.³¹ The alternative listing criteria, noted above, should also help to ensure that the underlying Fund Shares will be available upon exercise by requiring the Fund to allow market participants to create Fund Shares even though some or all of the necessary securities needed to be deposited are not available.³² Although there is no absolute assurance that market participants will go ahead and create Fund Shares in the event a short call writer needs to purchase Fund Shares to meet an exercise notice, it is likely that arbitrage opportunities will create an incentive to do so. Further, in the event there are not enough Fund Shares to meet exercise requirements, as with other physically-settled equity options, the Options Clearing Corporation ("OCC") has rules that would apply to such situations.

Second, the Commission believes that the surveillance standard developed by the Amex for options on Fund Shares is adequate to address the concerns associated with the listing and trading of such securities. Specifically, the

Amex has proposed that: (1) any Fund Share with non-US stocks in the underlying index or portfolio that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index or portfolio; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.³³

As a general matter, the Commission believes that comprehensive surveillance agreements provide an important deterrent to manipulation because they facilitate the availability of information needed to fully investigate a potential manipulation if it were to occur. These agreements are especially important in the content of derivative products based on foreign securities because they facilitate the collection of necessary regulatory, surveillance and other information from foreign jurisdictions. In evaluating the current proposal, the Commission believes that requiring comprehensive surveillance agreements to be in place between the Amex and the primary markets for foreign securities that comprise 50% or more of the weight of the underlying index or portfolio upon which Fund Shares are based, as well as the other conditions discussed above, provides an adequate mechanism for the exchange of surveillance sharing information necessary to detect and deter possible market manipulations. Although the Commission recognizes that up to 50% of the Portfolio's value may not be covered by comprehensive surveillance agreements, the other requirements will ensure that a significant percentage of the portfolio is not made up of securities from uncovered countries. Further, as to the domestically-traded Fund Shares themselves and the domestic stocks in the underlying index or portfolio upon which Fund Shares are based, the Intermarket Surveillance Group ("ISG")³⁴ Agreement will be applicable

to the trading of options on Fund Shares.³⁵

Finally, the Commission believes that it is appropriate to require minimum margin of 100% of the current market value of the option plus 15% of the market value of the underlying security value ("broad-based margin") for options on Fund Shares based on a broad-based index or portfolio and for options on Fund Shares which have been approved to date.³⁶ Moreover, the Commission believes that requiring minimum margin of 100% of the current market value of the option plus 20% of the market value of the underlying security value ("narrow-based margin") for options on Fund Shares based on a narrow-based index or portfolio is appropriate.³⁷ The Commission notes that these margin requirements for options on Exchange-Traded Fund Shares are comparable to margin requirements that currently apply to broad-based and narrow-based index options.

The Commission finds good cause for approving Amendment Nos. 3, 4, 5, and 6 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 3, strengthens the proposal by: (1) providing that the Exchange will not list options on Fund Shares unless the Fund has agreed to issue Fund Shares even though some or all of the securities needed to be deposited have not been received, thus ensuring a minimum level of liquidity; and (2) adopting standardized options position and exercise limits. Amendment No. 3 also: (1) provides the options on Fund Shares

surveillance and investigative information sharing arrangements in the stock and options markets. See Intermarket Surveillance Group Agreement, July 14, 1983. The members of ISG include all of the registered National Securities Exchanges and the National Association of Securities Dealers, Inc. ("NASD"). In addition, the major stock index futures exchanges (e.g., the Chicago Mercantile Exchange and the Chicago Board of Trade) are affiliate members of ISG.

³⁵ For example, the ISG Agreement would allow for the exchange of surveillance and investigative information between the Amex, trading PDRs on the S&P 500 index, and the markets trading the 500 stocks represented in the S&P 500 index. In addition, should other markets begin trading Fund Shares in the future, trading information with regard to the Fund Shares themselves would be readily available to the Amex pursuant to the ISG and the Amex could list options on those Fund Shares, assuming the options met all of the listing standards and requirements discussed herein.

³⁶ The Commission notes that the portfolios or indexes comprising WEBS have not been designated as broad-based by the Commission. In this order, the Commission is only determining that broad-based margin treatment for the WEBS is appropriate, without addressing the issue of whether such WEBS are broad-based.

³⁷ See Amendment No. 6, *supra* note 8.

³⁰ Provided the authorized creation participant has undertaken to deliver the shares as soon as possible and such undertaking has been secured by the delivery and maintenance of collateral consisting of cash or cash equivalents satisfactory to the Fund which underlies the option, as described in the Fund prospectus.

³¹ See *supra* note 18.

³² See *supra* note 30.

³³ The Exchange uses the term "comprehensive surveillance agreement" to mean an agreement which requires that the parties provide each other, upon request, information about market trading, clearing activity under the identity of the ultimate purchasers and sellers of securities. Telephone conversation between Claire P. McGrath, Vice President and Senior Counsel, Amex, and James T. McHale, Special Counsel, OMS, Division, Commission, on June 17, 1998.

³⁴ ISG was formed on July 14, 1983, to, among other things, coordinate more effectively

shall have the American-style exercise feature; (2) allows for the trading of FLEX Equity options on Fund Shares; (3) permits the Exchange to list options on Funds Shares covering 100 or 1000 Fund Shares or both; (4) sets strike prices for both 100 and 1000 share contracts to bracket the Fund Shares price at one point intervals up to a share price of \$200; and (5) makes various non-substantive references to "Exchange-Traded Fund Shares" throughout Amex's Rules, where appropriate. The Commission finds that these changes are not controversial because they do not alter the fundamental nature of the proposal.

Amendment No. 4 provides the Exchange with the flexibility to list Fund Shares pursuant to the uniform option listing standards in Rule 915 and Commentary .01, in lieu of obtaining a commitment from the unit investment trust or management investment company to issue Fund Shares even though some or all of the securities needed to be deposited have not been received. The Commission believes that this strengthens the proposal because the uniform option listing standards help to ensure that the Fund Shares underlying the options are actively traded, with substantial public float and number of holders. That portion of Amendment No. 4 that addresses comprehensive surveillance sharing agreements has been replaced and superseded by Amendment No. 5.

The Commission also believes that Amendment No. 5, concerning surveillance requirements, strengthens the Amex's proposal. Amendment No. 5, provides a clear, objective standard for determining the comprehensive surveillance requirements for trading options on Fund Shares where the underlying index or portfolio contains non-U.S. stocks.

The Commission finds that Amendment No. 6 also strengthens the Amex's proposal. Amendment No. 6 provides that the Amex will apply narrow-based margin to options on Fund Shares which are based on a narrow-based index or portfolio of securities. This requirement should ensure that purchasers of options on Fund Shares based on a narrow-based index or portfolio post sufficient margin to address any concerns associated with the potentially increased volatility inherent in a narrow-based index.

Finally, the Commission notes that no comments were received on the original Amex proposal, which was subject to full 21-day comment period. Accordingly, the Commission believes that there is good cause, consistent with Section 6(b)(5) of the Act, to approve

Amendment Nos. 3, 4, 5, and 6 to the proposed rule change on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 3, 4, 5 and 6 to the proposed rule change, including whether the Amendments 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 in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-96-44 and should be submitted by July 31, 1998.

For the foregoing reasons, the Commission finds that the Amex's proposal to list and trade options and FLEX Equity Options on Fund Shares is consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,³⁸ that the proposed rule change (File No. SR-Amex-96-44), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40166; File No. SR-CBOE-97-03]

Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 2 and 3 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Options on Interests in Listed, Open-End, Indexed Investment Companies

July 2, 1998.

I. Introduction

On January 22, 1997, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change to adopt rules to permit the trading of options on securities representing interest in open-end, exchange-listed investment companies that hold a portfolio of securities comprising or based on a broad-based stock index ("Exchange-Traded Fund Shares" or "Fund Shares"). Notice of the proposal appeared in the **Federal Register** on March 5, 1997.³ No comment letters were received on the proposed rule change.⁴ On January 12, 1998, the Exchange filed Amendment No. 2 to the proposal.⁵ On May 18, 1998, the CBOE

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 38342 (February 26, 1997), 62 FR 10098.

⁴ On May 2, 1997, the CBOE filed an amendment to the proposed rule change. See Letter from Michael L. Meyer, Esq., Schiff Hardin & Waite, to Howard L. Kramer, Senior Associate Director, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated May 2, 1997 ("Amendment No. 1"). Amendment No. 1 made no changes to the proposal, but merely clarified the Exchange's original filing. Amendment No. 1 is no longer relevant, and has been replaced and superseded by Amendment Nos. 2 and 3.

⁵ See Letter from Michael L. Meyer, Esq., Schiff Hardin & Waite to Howard L. Kramer, Senior Associate Director, OMS, Division, Commission, dated January 9, 1998 ("Amendment No. 2"). In Amendment No. 2 the Exchange proposes to revise the listing standards for Fund Shares set forth in Interpretation and Policy .06 under Rule 5.3 to require, in addition to other criteria, either: (1) that the underlying Fund Shares or units must satisfy the same criteria and guidelines under CBOE rules that apply to determine the eligibility for listing options on underlying equity securities; or (2) that the issuer is obligated to issue Fund Shares in a specified aggregate number in return for a cash deposit in an amount equal to the value of the securities that comprise the index or portfolio represented by the Fund Shares. In addition, Amendment No. 2 provides that the same tiered

³⁸ 15 U.S.C. 78s(b)(2).

³⁹ 17 CFR 200.30-3(a)(12).