

exchange their shares for shares of MidAmerican.

Pursuant to 10 CFR 50.80 the Commission may approve the transfer of control of a license, after notice to interested persons, upon the Commission's determination that the holder of the license following the transfer of control is qualified to have the control of the license and the transfer of the control is otherwise consistent with applicable provisions of law, regulations and orders of the Commission. Iowa-Illinois has requested consent under 10 CFR 50.80 for transfer of the licenses to reflect the effective change in control of such ownership interest in the Quad Cities Nuclear Power Station, Units 1 and 2.

For further details with respect to this action, see the November 21, 1994, letter, which is available for public inspection at the Commission's Public Document Room, the Gelman Building, 2120 L Street, NW., Washington, DC, and at the local public document room located at the Dixon Public Library, 221 Hennepin Avenue, Dixon, Illinois 61021.

Dated at Rockville, Maryland this 4th day of January 1995.

For the Nuclear Regulatory Commission.

Robert A. Capra,

Director, Project Directorate III-2, Division of Reactor Projects—III/IV, Office of Nuclear Reactor Regulation.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-35184; International Series Release No. 766; File No. SR-CBOE-94-32]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Listing and Trading of Warrants on the Nikkei Stock Index 300

December 30, 1994.

I. Introduction

On September 2, 1994, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to

list and trade warrants on the Nikkei Stock Index 300 ("Nikkei 300 Index" or "Index"). On December 12, 1994, the Exchange Filed Amendment No. 1 to the proposed rule change.³

Notice of the proposed rule change appeared in the **Federal Register** on October 25, 1994.⁴ No comments were received on the proposed rule change. This order approves the proposed rule change, including Amendment No. 1 on an accelerated basis.

II. Description of the Proposal

The CBOE proposes to list index warrants based on the Nikkei 300 Index, an index comprised of 300 representative stocks of the first section⁵ of the Tokyo Stock Exchange ("TSE"). On July 15, 1994, the Commission approved a proposal by the Exchange to list and trade options and full-value and reduced-value long-term options on the Index.⁶

A. Composition and Maintenance of the Index

The Nikkei 300 Index was designed by Nihon Keizai Shimbun, Inc. ("NKS"). The CBOE represents that Index component stocks were selected by NKS for their high market capitalizations, and their high degree of liquidity, and are representative of the relative distribution of industries within the broader Japanese equity market.

As of December 8, 1994, the total capitalization of the Index was approximately US\$2.24 trillion.⁷ Market capitalizations of the individual stocks in the Index ranged from a high of US\$76.99 billion to a low of US\$0.69

³ See letter from James R. McDaniel, Schiff, Hardin & Waite, to Michael Walinskas, Branch Chief, Division of Market Regulation, SEC, dated December 8, 1994 ("Amendment No. 1"). In amendment No. 1, the CBOE represents that (1) it will require that Nikkei 300 Index warrants be sold only to customers whose accounts have been approved for options trading pursuant to Exchange Rule 9.7; (2) customers with positions in Index warrants will be subject to the margin requirements applicable to options; (3) the CBOE will employ the same surveillance procedures that it currently has in place for index warrants listed and traded on the Exchange to surveil trading in warrants on the Index; (4) the Exchange will continue its efforts to enter into a comprehensive surveillance sharing agreement with the Tokyo Stock Exchange covering Nikkei 300 Index warrants; and (5) the CBOE, prior to the commencement of trading, will distribute to its membership a circular calling attention to certain compliance responsibilities when handling orders in Index warrants.

⁴ See Securities Exchange Act Release No. 34854 (October 18, 1994), 59 FR 53691 (October 25, 1994).

⁵ First section stocks are distinguished from second section stocks by more stringent listing standards.

⁶ See Securities Exchange Act Release No. 34388 (July 15, 1994), 59 FR 37789 (July 25, 1994) (File No. SR-CBOE-94-14).

⁷ Based on the December 8, 1994 exchange rate of ¥100.46 per US\$1.00.

billion, with a median of US\$3.36 billion and a mean of US\$7.46 billion. In addition, the average daily trading volume of the stocks in the Index, for the six-month period ending June 30, 1994, ranged from a high of 4,740,000 shares to a low of 6,000 shares, with a mean and median of approximately 676,000 and 417,000 shares, respectively. As of December 8, 1994, the highest weighted component stock in the Index accounted for 3.438 percent of the Index. The five largest Index components accounted for approximately 14.495 percent of the Index's value. The lowest weighted component stock comprised 0.013 percent of the Index, and the five smallest Index components accounted for approximately 0.203 percent of the Index's value.

The Index is maintained by NKS. To maintain the continuity of the Index, NKS will adjust the Index divisor to reflect certain events relating to the component stocks. These events include, but are not limited to, changes in the number of shares outstanding, spin-offs, certain rights issuances, and mergers and acquisitions. The CBOE represents that NKS reviews the composition of the Index periodically.

B. Calculation of the Index

The Nikkei 300 Index is capitalization-weighted and reflects changes in the prices of the Index component securities relative to the base date of the Index (October 1, 1982). The value of the Index is calculated by multiplying the price of each component security by the number of shares outstanding of each such security, adding the products, and dividing by the current Index divisor. The Index divisor is adjusted to reflect certain events relating to the component stocks.⁸ The Index had a closing value of 280.5 on December 8, 1994.

Because trading does not occur on the TSE during the CBOE's trading hours, the daily dissemination of the Index value is calculated by the CBOE once each day based on the most recent official closing price of each Index component security as reported by the TSE. This closing value is disseminated throughout the trading day on the CBOE.

C. Warrant Listing Standards and Customer Safeguards

The Exchange proposes to trade Nikkei 300 Index warrants pursuant to CBOE Rule 31.5(E).⁹ Under that rule, the

⁸ See *supra* Section II.A. The Index divisor was set to give the Index a value of 100 on its base date.

⁹ In File No. SR-CBOE-94-34, the CBOE has proposed to adopt new listing criteria and customer

¹ 15 U.S.C. 78s(b)(1) (1982).

² 17 CFR 240.19b-4 (1993).

CBOE may approve for listing warrants on established foreign and domestic market indexes. The Commission previously has approved the listing and trading on the CBOE of certain foreign index warrants based on the FT-SE 100 Index,¹⁰ the FT-SE Eurotrack 200 Index,¹¹ and the CAC-40 Index,¹² all listed in accordance with Rule 31.5(E).

The CBOE represents that the Index warrant issues will conform to the index warrant listing guidelines contained in Rule 31.5(E). Specifically, the listing guidelines of the CBOE will require that (1) the issuer thereof shall have assets in excess of \$100,000,000 and otherwise substantially exceed the size and earnings requirements of CBOE Rule 31.5(A);¹³ (2) the term of warrants shall be for a period ranging from one to five years from the date of issuance; and (3) the minimum public distribution of such issues shall be 1,000,000 warrants, together with a minimum of 400 public holders, and a minimum aggregate market value of \$4,000,000. The CBOE has proposed applying the same margin treatment as it requires for CBOE-listed options to the purchase of Index warrants.¹⁴

The CBOE also proposes that Nikkei 300 Index warrants will be direct obligations of their issuer, subject to cash settlement in U.S. dollars, and either exercisable throughout their life (*i.e.*, American style) or exercisable only on their expiration date (*i.e.*, European style). Upon exercise, or at the warrant expiration date (if not exercisable prior to such date), the holder of a warrant structured as a "put" would receive payment in U.S. dollars to the extent that the Index has declined below a pre-stated cash settlement value. Conversely, holders of a warrant structured as a "call" would, upon exercise or at expiration, receive payment in U.S. dollars to the extent that the Index has increased above the pre-stated cash settlement value. If "out-

protection and margin requirements for stock index warrants, currency index warrants and currency warrants. As proposed, these standards will apply only to warrants issued after the new framework goes into effect.

¹⁰ See Securities Exchange Act Release No. 28627 (November 19, 1990), 55 FR 49357 (November 27, 1990) (File No. SR-CBOE-90-17).

¹¹ See Securities Exchange Act Release No. 30462 (March 11, 1992), 57 FR 9290 (March 17, 1992) (File No. SR-CBOE-91-13).

¹² See Securities Exchange Act Release No. 28587 (October 30, 1990), 55 FR 46595 (November 5, 1990) (File No. SR-CBOE-90-16).

¹³ Rule 31.5(A) requires the issuer to have net worth of at least \$4,000,000 and pre-tax income of at least \$750,000 in its last fiscal year, or in two of its last three fiscal years and net income of \$400,000.

¹⁴ See Amendment No. 1, *supra*, note 3.

of-the-money" at the time of expiration, the warrants would expire worthless.

Because warrants are derivative in nature and closely resemble index options, the CBOE has proposed safeguards that are designed to meet the investor protection concerns raised by the trading of index options. First, the Exchange represents that it will require that Index warrants only be sold to investors whose accounts have been approved for options trading pursuant to CBOE Rule 9.7.¹⁵ Second, pursuant to CBOE Rule 30.50, Interpretation .02, the Exchange's options suitability standards contained in Rule 9.9 shall apply to recommendations in Index warrants. Third, pursuant to Rule 30.50, Interpretation .04 and Rule 9.10(a), discretionary orders in Index warrants must be approved and initialled on the day entered by a Senior Registered Options Principal or a Registered Options Principal. Finally, the CBOE, prior to commencement of trading in Index warrants, will distribute a circular to its membership to call attention to certain compliance responsibilities when handling transactions in Index warrants.¹⁶

D. Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other index warrants to monitor trading in Index warrants.

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) of the Act.¹⁷ Specifically, the Commission finds that the trading of warrants based on the Nikkei 300 Index will serve to protect investors, promote the public interest, and help to remove impediments to a free and open securities market by providing investors with a means to hedge exposure to market risk associated with the Japanese equity market and provide a surrogate instrument for trading in the Japanese securities market.¹⁸ The trading of

¹⁵ See Amendment No. 1, *supra*, note 3.

¹⁶ See Amendment No. 1, *supra*, note 3.

¹⁷ 15 U.S.C. 78f(b)(5) (1988).

¹⁸ 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 product is in the public interest. Such a finding would be difficult with respect to a warrant that served no hedging or other economic function, because any benefits that might

warrants based on the Nikkei 300 Index should provide investors with a valuable hedging vehicle that should reflect accurately the overall movement of the Japanese equity market.

In addition, the Commission believes, for the reasons discussed below, that the CBOE has adequately addressed issues related to customer protection, index design, surveillance, and market impact of Nikkei 300 Index warrants.

A. Customer Protection

Due to the derivative nature of index warrants, the Commission believes that Nikkei 300 Index warrants should only be sold to investors capable of evaluating and bearing the risks associated with trading in such instruments and that adequate risk disclosure be made to investors. In this regard, the Commission notes that the rules and procedures of the Exchange that address the special concerns attendant to the secondary market trading of index warrants will be applicable to the Nikkei 300 Index warrants. In particular, by imposing the special suitability, account approval, disclosure, and compliance requirements noted above, the CBOE has adequately addressed potential public customer problems that could arise from the derivative nature of Nikkei 300 Index warrants. Moreover, the CBOE will distribute a circular to its members identifying the specific risks associated with warrants on the Nikkei 300 Index.¹⁹ Pursuant to the CBOE's listing guidelines, only substantial companies capable of meeting their warrant obligations will be eligible to issue Nikkei 300 Index warrants.

B. Index Design and Structure

The Commission finds, as it did in approving Nikkei 300 Index options, that it is appropriate and consistent with the Act to classify the Index as a broad-based index. Specifically, the Commission believes the Index is broad-based because it reflects a substantial segment of the Japanese equity market, and, among other things, contains a large number of stocks that trade in that market. First, the Index consists of 300 actively-traded stocks traded on the first section of the TSE, representing 36 different industry groups in Japan. Second, the market capitalizations of the stocks comprising the Index are very

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.

¹⁹ The CBOE has agreed to submit a draft of the circular to the Commission staff for approval prior to distribution. See Amendment No. 1, *supra*, note 3.

large. Specifically, the total capitalization of the Index, as of December 8, 1994, was US\$2.24 trillion, with the market capitalizations of the individual stocks in the Index ranging from a high of US\$76.99 billion to a low of US\$0.69 billion, with a median value of US\$3.36 billion and a mean of US\$7.46 billion. Third, no one particular stock or group of stocks dominates the Index. Specifically, no single stock comprises more than 3.438 percent of the Index's total value, and the percentage weighting of the five largest issues in the Index accounts for 14.495 percent of the Index's value. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based.

C. Surveillance

As a general matter, the Commission believes that comprehensive surveillance sharing agreements between the relevant foreign and domestic exchanges are important where an index product comprised of foreign securities is to be traded in the United States. In most cases, in the absence of such a comprehensive surveillance sharing agreement, the Commission believes that it would not be possible to conclude that a derivative product, such as a Nikkei 300 Index warrant, was not readily susceptible to manipulation.

Although the CBOE and the TSE do not yet have a written comprehensive surveillance sharing agreement that covers the trading of Nikkei 300 Index warrants, a number of factors support approval of the proposal at this time. First, while the size of an underlying market is not determinative of whether a particular derivative product based on that market is readily susceptible to manipulation, the size of the market for the securities underlying the Nikkei 300 Index makes it less likely that the proposed Index warrants are readily susceptible to manipulation.²⁰ In addition, the Commission notes that the TSE is under the regulatory oversight of the Japanese Ministry of Finance ("MOF"). The MOF has responsibility for both the Japanese securities and derivatives markets. Accordingly, the

²⁰ In evaluating the manipulative potential of a proposed index derivative product, as it relates to the securities that comprise the index and the index product itself, the Commission has considered several factors, including (1) the number of securities comprising the index or group; (2) the capitalizations of those securities; (3) the depth and liquidity of the group or index; (4) the diversification of the group or index; (5) the manner in which the index or group is weighted; and (6) the ability to conduct surveillance on the product. See Securities Exchange Act Release No. 31016 (August 11, 1992), 57 FR 37012 (August 17, 1992).

Commission believes that the ongoing oversight of the trading activities on the TSE by the MOF will help to ensure that the trading of Nikkei 300 Index warrants will be carefully monitored with a view toward preventing unnecessary market disruptions.

Finally, the Commission and the MOF have concluded a Memorandum of Understanding ("MOU") that provides a framework for mutual assistance in investigatory and regulatory matters.²¹ Moreover, the Commission also has a longstanding working relationship with the MOF on these matters. Based on the longstanding relationship between the Commission and the MOF and the existence of the MOU, the Commission is confident that it and the MOF could acquire information from one another similar to that which would be available in the event that a comprehensive surveillance sharing agreement were executed between the CBOE and the TSE with respect to transactions in TSE-traded stocks related to Nikkei 300 Index warrant transactions on the CBOE.²²

Nevertheless, the Commission continues to believe strongly that a comprehensive surveillance sharing agreement between the TSE and the CBOE covering Nikkei 300 Index warrants would be an important measure to deter and detect potential manipulations or other improper or illegal trading involving Nikkei 300 Index warrants. Accordingly, the Commission believes it is critical that the TSE and the CBOE continue to work together to consummate a formal comprehensive surveillance sharing agreement to cover Nikkei 300 Index warrants and the component securities as soon as practicable.

D. Market Impact

The Commission believes that the listing and trading of Nikkei 300 Index warrants on the CBOE will not adversely impact the securities markets in the United States or in Japan. First, the existing index warrant surveillance procedures of the CBOE will apply to warrants on the Index. In addition, the Commission notes that the Index is broad-based and diversified and includes highly capitalized securities that are actively traded on the TSE.

²¹ See Memorandum of United States Securities and Exchange Commission and the Securities Bureau of the Japanese Ministry of Finance on the Sharing of Information, dated May 23, 1986.

²² It is the Commission's expectation that this information would include transaction, clearing, and customer information necessary to conduct an investigation.

IV. Accelerated Approval of Amendments No. 1

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication on notice of filing thereof in the **Federal Register**. Amendment No. 1 is consistent with Section 6(b)(5), in that it contains representations by the Exchange, concerning margin, options approved accounts, and surveillance, which serve to protect investors and the public interest, promote just and equitable principles of trade, and prevent fraudulent and manipulative acts and practices. Therefore, the Commission finds that no new regulatory issues are raised by Amendment No. 1. Accordingly, the Commission believes it is consistent with Sections 19(b)(2) and 6(b)(5) of the Act to approve Amendment No. 1 on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1 to the proposed rule change. 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 foregoing that are filed with Commission, and all written communications relating to the foregoing 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 filings also will be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to File No. SR-CBOE-94-32, and should be submitted by January 31, 1995.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²³ that the proposed rule change (SR-CBOE-94-32), as amended, is hereby approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁴

Margaret H. McFarland,
Deputy Secretary.

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²³ 15 U.S.C. 78s(b)(2) (1988).

²⁴ 17 CFR 200.30-3(a)(12) (1993).