

protection of investors. The Commission, based on the information submitted to it, will issue an order granting the application after the date mentioned above, unless the Commission determines to order a hearing on the matter.

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

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. 97-28028 Filed 10-22-97; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

### Issuer Delisting; Notice of Application To Withdraw From Listing and Registration; (UNC Incorporated, 9 1/8% Senior Notes Due July 15, 2003, Issued Pursuant to the Indenture Dated as of July 15, 1993) File No. 1-7795

October 17, 1997.

UNC Incorporated ("Company") has filed an application with the Securities and Exchange Commission ("Commission"), pursuant to Section 12(d) of the Securities Exchange Act of 1934 ("Act") and Rule 12d2-2(d) promulgated thereunder, to withdraw the above specified security ("Security") from listing and registration of the New York Stock Exchange, Inc. ("NYSE" or "Exchange").

The reasons cited in the application for withdrawing the Security from listing and registration include the following:

The Security was issued pursuant to the Indenture, dated as of July 15, 1993, as amended (the "Indenture") between the Company and the Chase Manhattan Bank, as successor Trustee ("Trustee") and were sold pursuant to a registration statement filed with the Commission and declared effective July 22, 1993. The Security is registered pursuant to Section 12(d) of the Act and listed for trading on the NYSE.

As a result of the Merger, on September 18, 1997. Standard & Poor's Rating Group raised its rating of the Security to AAA. On September 30, 1997, the Company completed a debt tender and consent solicitation for all of the issued and outstanding Security. Through the debt tender, the Company purchased \$87,952,000 to the \$100,000,000 aggregate principal amount of the Security outstanding. After the debt tender, there remained issued and outstanding \$11,900,000 aggregate principal amount of the Notes held of record by 11 persons, including the Depository Trust Company (DTC).

Through DTC, there are approximately 37 holders. Pursuant to the terms of the Indenture, the Company will commence a Change in Control offer for the remaining Notes at a price of 101% of par plus accrued and unpaid interest. Since the price is below the price offered in the recent offer, the Company does not anticipate that any of the remaining holders will tender into the Change in Control offer. Therefore, the Company intends to redeem the outstanding Security on June 15, 1998, the earliest possible redemption date pursuant to the Indenture.

The Company believes that its application to withdraw the Security from listing and registration on the NYSE should be granted for, among others, the following reasons:

(a) The small principal amount of the Security outstanding. Only \$11,900,000 aggregate principal amount of the Security remains issued and outstanding.

(b) The Security is held by small number of holders.

(c) The Security is the Company's only listed security.

(d) The costs of satisfying the Company's reporting obligations under the Act. The Company represents that it is no longer subject to the report requirements of the Act for any other Securities. Furthermore, as a result of the consent solicitation, the Company is no longer obligated under the terms of the Indenture to file reports with the Commission. As a consequence the Company will not be required to incur the costs of preparing separate annual and periodic reports. The Company represents that it is not obligated under the Indenture or any other document to maintain the listing or registration of the Security on the NYSE or on any other national securities exchange.

The Company notified the NYSE on September 29, 1997 that it was requesting delisting of the Security and the NYSE raised no objection to such delisting.

Any interested person may, on or before November 7, 1997, submit by letter to the Secretary of the Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549, facts bearing upon whether the application has been made in accordance with the rules of the exchange and what terms, if any, should be imposed by the Commission for the protection of investors. The Commission, based on the information submitted to it, will issue an order granting the application after the date mentioned above, unless the Commission determines to order a hearing on the matter.

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

**Jonathan G. Katz,**

*Secretary.*

[FR Doc. 97-28029 Filed 10-22-97; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39244; File No. SR-CBOE-97-25]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Incorporated, Relating to the Listing and Trading of Options on the Lipper Analytical/Salomon Brothers Growth and Growth & Income Fund Indexes

October 15, 1997.

#### I. Introduction

On June 4, 1997, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed a proposed rule change with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to list and trade options on two mutual fund indexes designed by Lipper Analytical Services, Inc. in conjunction with Salomon Brothers Inc.

Notice of the proposal was published for comment and appeared in the **Federal Register** on June 17, 1997.<sup>3</sup> No comment letters were received on the proposed rule change. This order approves the Exchange's proposal.

#### II. Description of the Proposal

The Exchange is proposing to list and trade cash-settled, European-style options on two mutual fund indexes designed by Lipper Analytical Services, Inc. ("Lipper Analytical" or LAS®)<sup>4</sup> in conjunction with Salomon Brothers Inc.—the Lipper Analytical/Salomon Brothers Growth Fund Index ("Growth Fund Index") and the Lipper Analytical/Salomon Brothers Growth & Income Fund Index ("Growth & Income Fund Index").

##### A. Index Design

The Indexes are composed of the 30 largest U.S. funds in each investment

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 38730 (June 10, 1997), 62 FR 32846.

<sup>4</sup> Lipper Analytical is a major provider of mutual fund information and currently calculates approximately 100 other mutual fund indexes designed to track specific investment objectives.

objective (*i.e.*, Growth or Growth & Income), based on their total net assets as of the close on the last trading day of December. The Indexes include only those funds that report net asset values ("NAV") through the facilities of the National Association of Securities Dealers Automated Quotation System ("Nasdaq"). Some mutual funds are composed of more than one class which have different fees and expenses. If there is more than one class of a specific mutual fund, only the class with the highest total net assets will be included. As of December 31, 1996, the Growth Fund Index had total net assets ("TNA") of \$218.6 billion, an average TNA per component of \$7.3 billion and a median TNA per component of \$4.2 billion. The TNAs ranged from \$2.5 billion to \$54.0 billion. As of the same date, the Growth & Income Fund Index had a TNA of \$241.2 billion, an average TNA per component of \$8.0 billion and a median TNA per component of \$5.0 billion. The TNAs ranged from \$2.5 billion to \$30.9 billion.

Lipper Analytical determines the investment objective of each fund by reviewing both the language in the prospectus and the fund's investment characteristics as shown in the Lipper-Equity Analysis Report on the Weighted Average Holdings of Large Investment Companies. A Growth Fund is described as a fund that normally invests in companies whose long-term earnings are expected to grow significantly faster than earnings of the stocks represented in the major unmanaged stock indexes. A Growth & Income Fund is described as a fund that combines a growth of earnings orientation and an income requirement for level and/or rising dividends.

#### B. Calculation

The Indexes are equal-dollar weighted and re-balanced quarterly after the close on expiration Fridays in March, June, September, and December. The Index value is calculated in essentially the same manner as other equal-dollar weighted indexes. The total number of shares for each component is calculated by dividing \$1,000 by the closing NAV, adjusted for distributions, of the component on the re-balancing date and rounding to two decimal places. The share amount is held constant throughout the quarter. The Indexes are calculated by summing the product of the current NAV adjusted for distributions and the share amount for each component and then dividing by the index divisor. The divisors were calculated to produce a value of 150.00 for the Growth Fund Index and 250.00 for the Growth and Income Fund Index

as of December 31, 1996, the base date. The Indexes are calculated once per day as soon as the NAVs for each of the components are available.<sup>5</sup> The Index values will be disseminated by CBOE through the facilities of the Options Price Reporting Authority ("OPRA") prior to the opening on the next business day.

Lipper has informed the Exchange that it has not had any difficulty in obtaining net asset values for the funds in the Indexes. The funds comprising the Indexes are among the largest funds in existence. In the unlikely event that any of these funds do not comply with Rule 22c-1 under the Investment Company Act of 1940, which requires daily computation of a fund's current net asset value, the Exchange would follow the same procedure it uses for dissemination of standard indexes when a component price is unavailable; it will use the last available price.<sup>6</sup>

#### C. Maintenance

Lipper Analytical has the sole responsibility of maintaining the Indexes. Salomon Brothers acted as an adviser to provide technical support, including advice on index design and the methodology of index construction.<sup>7</sup> Lipper Analytical reviews the components annually after the close on the last trading day of December to include the thirty largest funds by total net assets. Any component changes

<sup>5</sup> The Exchange represents that Index values are updated only at the close of trading each day because that is the only time when the fund net asset values comprising the Indexes are determined and disseminated. The Exchange believes that this should not pose an obstacle to options trading, any more than it prevents investors from entering intraday orders to purchase or redeem shares of the funds themselves at closing net asset values that are unknown at the time the orders are entered.

<sup>6</sup> The Commission notes that pursuant to Article XVII, Section 4 of the OCC by-laws, OCC is empowered to fix an exercise settlement amount in the event it determines a current index value is unreported or otherwise unavailable. See Securities Exchange Act Release No. 37315 (June 17, 1996), 61 FR 42671 (order approving SR-OCC-95-19).

<sup>7</sup> Because Salomon's only role is to continue to provide technical support on such things as index design and the index construction methodology, and is not involved in any way with the ongoing maintenance of the Indexes, it is not necessary to erect informational barriers at Salomon with regard to the Indexes at this time. The Commission notes, however, that should Salomon's role change so that it is involved, whether through consultation or directly, in any maintenance of the Indexes, it may need to erect an informational barrier between personnel having access to information and Salomon's sales and trading personnel concerning changes and adjustments to the Indexes. Accordingly, should Salomon become involved in any maintenance of the Indexes, the CBOE should contact the Commission's Division of Market Regulation immediately to determine if CBOE may continue to list and trade options overlying the Indexes until such informational barriers are in place.

resulting from the annual review will be announced by LAS and CBOE at least two weeks prior to implementation which will occur after the close on expiration in March. The index calculation reflects reinvestment of all distributions of component funds. Generally, there will be no need for any other adjustments intra-quarter.

#### D. Index Option Trading

The proposed options on the Indexes will be cash-settled, European-style options.<sup>8</sup> Standard options trading hours for broad-based index options (8:30 a.m. to 3:15 p.m. Chicago time) will apply to the contracts. The multiplier for each Index will be 100. The Exchange intends to list up to three near-term months plus up to 3 months on a quarterly cycle. The Exchange proposes to base trading in options on the Lipper Analytical Indexes on the full-value of each Index. Further, the exchange also may list full-value long-term index option series ("LEAPS"<sup>®</sup>), as provided in Rule 24.9. The Exchange also may provide for the listing of reduced-value LEAPS, for which the underlying value would be computed at one-tenth of the value of the Index. The current and closing index value of any such reduced-value LEAP will, after such initial computation, be rounded to the nearest one-hundredth.

#### E. Exercise and Settlement

Options on the Indexes will settle based on the closing NAVs of the component funds two business days prior to expiration. The proposed options will expire on the Saturday following the third Friday of the expiration month. Thus, the last day for trading in an expiring series will be two business days (ordinarily a Thursday) preceding the expiration date. The settlement value (which is the same as Thursday's closing value) will be disseminated prior to the opening on Friday.

#### F. Exchange Rules Applicable

Except as modified herein, the Rules in Chapter XXIV will be applicable to mutual fund index options. Index option contracts based on the Lipper Analytical Indexes will be subject to a position limit and exercise limit of 75,000 contracts, with no more than 50,000 contracts in the nearest expiration month. Ten reduced-value options will equal one full-value contract for such purposes. The Exchange believes that the proposed position limits are reasonable and

<sup>8</sup> A European-style option can be exercised only during a specified period before the option expires.

appropriate for this product, and are consistent with the position and exercise limits that apply to other index options.

The Exchange is proposing to amend Rule 24.9 Interpretation and Policy .01(a) to include 2½ point strike price intervals for mutual fund indexes with strike prices less than \$200. Broad-based margins will apply to mutual fund index options. CBOE is also amending Rule 24.1(e) to reflect the fact that mutual funds can underlie indexes. CBOE is also proposing to amend Exchange Rule 24.14 in order to include specific reference to Lipper Analytical Services as entitled to the benefit of the disclaimer of liability in respect of the Indexes.

Exchange rules applicable to options on both Indexes will be identical to the rules applicable to other broad-based index options for purposes of trading rotations, halts, and suspension,<sup>9</sup> and margin treatment.<sup>10</sup>

#### G. Surveillance

As with any other option product, the CBOE will closely monitor activity in these options and therefore, should be able to identify any potentially unusual activity in the options. It should be noted that with respect to the component funds that comprise the Indexes, trading in the funds themselves has no effect on the value of the Indexes. Instead, the value of the Indexes depends entirely on the net asset values of the component funds, which in turn depends on the values of the stocks held in the portfolios of the various funds. The Exchange believes that the concerns with manipulative activity are not as great with respect to options on these Indexes as they are on stock index options. First, the Indexes are equal-dollar weighted, thus no single component dominates the Index. Therefore any person attempting to manipulate the Indexes would have to manipulate the NAVs of a majority of the Index components. Second, in order to manipulate the NAVs of the component funds, a person would have to have knowledge of the component securities held by the funds. This information is not disseminated to the public until after the fact (generally only quarterly);<sup>11</sup> thus the Exchange believes

that it would be difficult for any individual to know, with any degree of certainty, the components of enough of the funds to make any manipulative efforts worthwhile. The CBOE also states that if it became necessary, the CBOE could examine the activity in the underlying stocks being held by various funds if it detects unusual activity in the Index options.

#### H. Capacity

CBOE has the necessary systems capacity to support new series that would result from the introduction of the Lipper Analytical/Salomon Brothers Index options. CBOE has also been informed that OPRA has the capacity to support such new series.

### 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.<sup>12</sup> Specifically, the Commission finds that the trading of options based on the Lipper Analytical/Salomon Brothers Growth and Growth & Income Fund Indexes, including full-value and reduced-value LEAPS, 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 some of the largest U.S. mutual funds holding securities representing the growth and growth & income portion of the U.S. equity market.<sup>13</sup>

The Commission believes that the Indexes are broad-based, and the proposed options are designed to reduce the potential for manipulation, and is consistent with the CBOE's obligation to promote investor protection.<sup>14</sup>

principal amount, and aggregate fair market value of each such security. 15 U.S.C. 78m(f).

<sup>12</sup> 15 U.S.C. 78f(b)(5). In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</sup> 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 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.

<sup>14</sup> The CBOE is a member of the Intermarket Surveillance Group ("ISG") which was formed on July 14, 1983 to, among other things, coordinate

Moreover, 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 options based on the Lipper Analytical/Salomon Brothers Growth and Growth & Income fund Indexes.

#### A. Index Design and Structure

The Commission finds that it is appropriate and consistent with the Act for the CBOE to designate the Indexes as broad-based. Specifically, the Commission believes the Indexes, representing the growth and growth & income portion of the U.S. equity market, are broad-based for the following reasons. First, the indexes each consist of the 30 largest U.S. funds in each investment objective, based on their total net assets as of the close on the last trading day of December. The Indexes include only those funds that report net asset values ("NAV") through the facilities of the National Association of Securities Dealers Automated Quotation System ("Nasdaq"). Second, the total net assets of the mutual funds comprising the Indexes are very large. As of December 31, 1996, the Growth Fund Index had total net assets ("TNA") of \$218.6 billion, an average TNA per component of \$7.3 billion and a median TNA per component of \$4.2 billion. The TNAs ranged from \$2.5 billion to \$54.0 billion. As of the same date, the Growth & Income Fund Index had a TNA of \$241.2 billion, an average TNA per component of \$8.0 billion and median TNA per component of \$5.0 billion. The TNAs ranged from \$2.5 billion to \$30.9 billion. Third, no one particular mutual fund or group of mutual funds dominates the weight of the Index. As noted above, each Index value is calculated using an equal-dollar weighting methodology. Specifically,

more effectively surveillance and investigative information sharing arrangements in the stock and options markets. See Intermarket Surveillance Group Agreement, July 14, 1983. The most recent amendment to the ISG Agreement, which incorporates the original agreement and all amendments made thereafter, was signed by ISG members on January 29, 1990. See Second Amendment to the Intermarket Surveillance Group Agreement, January 29, 1990. The members of the ISG are: the Amex; the Boston Stock Exchange, Inc.; the CBOE; the Chicago Stock Exchange, Inc.; the National Association of Securities Dealers, Inc. ("NASD") the NYSE; the Pacific Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. Because of potential opportunities for trading abuses involving stock index futures, stock options, and the underlying stock and the need for greater stock options, and the underlying stock and the need for greater sharing of surveillance information for these potential intermarket trading abuses, the major stock index futures exchanges (e.g., the Chicago Mercantile Exchange and the Chicago Board of Trade) joined the ISG as affiliate members in 1990.

<sup>9</sup> See CBOE Rule 24.7

<sup>10</sup> See CBOE Rule 24.11

<sup>11</sup> Section 13(f) of the Act requires institutional investment managers to file reports with the Commission, generally quarterly, that disclose each equity security held on the last day of the reporting period by accounts with respect to which the institutional investment manager exercises investment discretion, the name of the issuer and the title, class, CUSIP number, number of shares or

each component will account for approximately 3.33% of its respective Index, and the Exchange will re-balance to equal-dollar weighting quarterly. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based.

#### B. Customer Protection

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 the Lipper Analytical/Salomon Brothers Growth and Growth & Income Fund Indexes (including full-value and reduced value LEAPS), can commence 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;<sup>15</sup> (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. Accordingly, because options on both Indexes will be subject to the same regulatory regime as the other standardized options currently traded on the CBOE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in options on the Lipper Analytical/Salomon Brothers Growth and Growth & Income Fund Indexes.

#### C. Surveillance

The Commission believes that it is important to ensure the availability of information necessary to detect and deter potential manipulation and other trading abuses, thereby making the mutual fund index product less likely to be manipulated. Further, the Commission believes that an exchange

<sup>15</sup> The Commission notes that in order to promote investor protection and to ensure adequate disclosure in connection with Mutual Fund Index options, the rules pertaining to standardized options and the requirements of Exchange Act Rule 9b-1 will apply to trading in Growth and Growth & Income Fund Index Options. The Commission believes it is important to provide investors with information regarding the rights and characteristics of these options. In this regard, Growth and Growth & Income Fund Index options investors will receive a special supplement to The Options Clearing Corporation's ("OCC") Options Disclosure Document ("ODD Supplement") explaining in detail the risks and characteristics of Packaged Spreads. In reviewing any disclosure materials submitted, the Commission intends to assure that the materials specifically describe the risks and characteristics associated with trading Mutual Fund Index Options. The CBOE's trading of Growth and Growth & Income Fund Index options is expressly contingent upon the Commission's approval of such an ODD supplement.

proposing to list a mutual fund index derivative where the mutual fund components themselves are not traded in the secondary market, must have in place appropriate surveillance procedures for the derivative product and the markets trading the underlying securities that comprise the mutual fund components. In this regard, the Commission notes that the CBOE will closely monitor activity in these options and should be able to identify any potentially unusual activity in the options. Moreover, the CBOE represents that if it became necessary, the CBOE could examine the activity in the underlying stocks if it detects unusual activity in the Index options. The Commission believes that this arrangement ensures the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the Index options and full-value and reduced-value Index LEAPS less susceptible to manipulation.

#### D. Market Impact

The Commission believes that the listing and trading of Growth and Growth & Income Fund Index options on the CBOE will not adversely impact the securities markets in the United States.<sup>16</sup> First, the Commission notes that the Indexes are broad-based and diversified and include component mutual funds that comprise the 30 largest U.S. funds in each investment objective. Second, the 75,000 contract position and exercise limit, with no more than 50,000 contracts in the nearest expiration month, will serve to minimize potential manipulation and other market impact concerns. Third, the risk to investors of contra-party non-performance will be minimized because the Index options, and full-value and reduced-value LEAPS, will be issued and guaranteed by The Options Clearing Corporation, similar to all other standardized options traded in the United States.

#### E. Index Calculation and Dissemination

As discussed above, the CBOE is proposing to update the Indexes' values at the close of trading each day when the net asset values of the component funds of the Indexes are determined and disseminated. The result of this is that the disseminated value during the trading day is based on the prior day net asset value established at the prior day close.

<sup>16</sup> In addition, the CBOE has represented that it and OPRA have the necessary systems capacity to support those new series of index options that would result from the introduction of options and LEAPS based on both Indexes.

Generally, the Commission believes that continually updated index values on a real-time basis are essential to the trading of any index product. The Commission has only allowed exceptions to this for certain indexes composed of foreign securities where the primary market for the component securities are closed during the U.S. trading hours for the overlying options and thus the value of the components are generally not changing during the U.S. trading day. In contrast, in the case of the Growth Fund Index and the Growth Fund Index, the Index values are based on closing NAVs, even though the component funds' portfolio securities are themselves trading during the same trading hours as the Index options thereby causing the value of the portfolio to fluctuate throughout the trading day.

Nevertheless, the Commission has determined to allow the CBOE to trade options overlying the Indexes using the Indexes' values established at the prior day close because only the fund manager will have knowledge of the funds' portfolio securities and their values on a regular basis throughout the trading day. Information regarding the component funds' portfolios will only be generally available to the public on a quarterly basis as required under Section 13(f) of the Act and all investors should have equal access to this information when it is disseminated.<sup>17</sup> Further, CBOE surveillance should also help to detect and deter manipulation through the misuse of such intra-day information available only to the component fund managers. Finally, there are other widely published resources and indexes available that track growth and growth & income stocks which investors may use to determine an indicative value for the Growth and the Growth & Income Fund Indexes.<sup>18</sup>

#### IV. Conclusion

Based upon the aforementioned factors, the Commission finds that the proposed changes relating to the listing and trading of Growth and Growth & Income Fund Index options are consistent with the requirements of Section 6(b)(5) and the rules and regulations thereunder. The initiation of Growth and Growth & Income Fund Index options trading, however, is conditioned upon the issuance of an order approving an ODD Supplement, pursuant to Rule 9b-1 of the Act.

<sup>17</sup> See *supra* note 11.

<sup>18</sup> If any one of these factors were not present, the Commission may have determined it was not appropriate to allow the product to trade without real-time dissemination of Index values.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>19</sup> that the proposed rule change (File No. SR-CBOE-97-25) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>20</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-28027 Filed 10-22-97; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39245; File No. SR-CSE-97-09]

### Self-Regulatory Organizations; Cincinnati Stock Exchange, Inc.; Order Granting Approval to Proposed Rule Change Increasing Net Capital Requirements

October 16, 1997.

On July 30, 1997, the Cincinnati Stock Exchange, Inc. ("CSE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" <sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to increase net capital requirements for members and Designated Dealers.

#### I. Introduction

The proposed rule change was published for comment in Securities Exchange Act Release No. 38956 (August 21, 1997), 62 FR 45893 (August 29, 1997). No comments were received on the proposal.

#### II. Description of the proposals

Exchange Article II, Section 5.1 presently requires a minimum net capital level on non-specialist Exchange members equal to the greater of the net capital level required by Commission Rule 15c3-1<sup>3</sup> or \$25,000. The Exchange proposes to amend this rule to increase that requirement from \$25,000 to \$250,000. As previously required, members would still be subject to any higher net capital requirements imposed by Commission Rule 15c3-1.<sup>4</sup>

The Exchange also proposes to amend Exchange Rule 11.9(a). That rule currently requires Designated Dealers to maintain net capital of at least the greater of \$100,000 or the amount required under Commission Rule 15c3-

1. The Exchange proposes to amend this rule to increase the Exchange requirement from \$100,000 to \$500,000. Again, members would still be subject to any higher net capital requirement imposed by Commission Rule 15c3-1.<sup>5</sup>

#### III. Discussion

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, with the requirements of Sections 6(b) and 11(b) of the Act.<sup>6</sup> In particular, the Commission believes the proposal is consistent with the Section 6(b)(5) requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, and, in general, to protect investors and the public.<sup>7</sup> The Commission also believes that the proposal is consistent with Section 11(b) of the Act,<sup>8</sup> and Rule 11b-1<sup>9</sup> thereunder, which allows securities exchanges to promulgate rules relating to specialists in order to maintain fair and orderly markets. The proposal is consistent with Rule 11b-(a)(2)(i)<sup>10</sup> which requires that the rules of a national securities exchange which permit a member to register as a specialist and to act as a dealer include, among other things, adequate minimum capital requirements in view of the markets for securities on such exchange.

The Commission finds that the rule change will help ensure greater financial stability of the Exchange's members by requiring those members to maintain higher capital levels. The Commission examined this issue when it revised Rule 15c3-1 in 1992.<sup>11</sup> In proposing to raise the minimum net capital requirements under Commission rules, the Commission noted that under Rule 15c3-1 customers are placed at risk by brokers that do not receive or hold customer securities because such brokers have indirect access to customer funds and securities, and can direct the movement of such assets by placing orders with clearing firms. Customers are often unaware of or unable to distinguish between introducing brokers and clearing firms, and tend to rely

heavily upon the representations of brokers of introducing firms. Higher net capital requirements will help ensure the financial integrity of such introducing firms and thereby help to protect investors.<sup>12</sup> The Commission concurs with the Exchange that better capitalized introducing firms are less likely to become insolvent and in the event that an introducing firm does become insolvent, higher net capital levels would help increase the changes that the firm can quickly find a purchaser of its assets and minimize the impact of such a failure on the investing public.<sup>13</sup> Finally, the Commission has previously stated its belief that raising minimum net capital levels will further the antifraud provisions of the federal securities laws.<sup>14</sup> The Exchange noted that member firms have access to customer securities and funds either directly, as a clearing firm, or indirectly, as an introducing firm that places orders with a clearing firm on behalf of its customers. In either case, firms can convert those assets to their own benefit. A firm with sufficient net capital may be less likely to attempt to convert funds in this manner.

The Commission also believes that it is important that Designated Dealers are adequately prepared to provide depth and liquidity to the Exchange's markets in times of market stress or volatility. The Commission agrees with the Exchange that the growth in the U.S. capital markets generally, and in the CSE's market in particular, has created market conditions which have created a need for greater capital levels on the CSE. The Commission finds that the increased net capital requirement for Designated Dealers will better protect the integrity and quality of the Exchange's market.

#### IV. Conclusion

*It is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>15</sup> that the proposed rule change (SR-CSE-09) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-28030 Filed 10-22-97; 8:45 am]

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> 15 U.S.C. § 78s(b)(2).

<sup>16</sup> 17 CFR 200.30-3(a)(12).

<sup>19</sup> 15 U.S.C. 78s(b)(2).

<sup>20</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. § 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 17 CFR 240.15c3-1.

<sup>4</sup> *Id.*

<sup>5</sup> *Id.*

<sup>6</sup> 15 U.S.C. § 78f(b); 15 U.S.C. § 78k(b).

<sup>7</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. § 78c(f).

<sup>8</sup> 15 U.S.C. § 78k(b).

<sup>9</sup> 17 CFR 240.11b-1.

<sup>10</sup> 17 CFR 240.11b-1(a)(2)(i).

<sup>11</sup> Securities Exchange Act Rel. No. 31512 (Nov. 24, 1992), 57 FR 57027 (Dec. 2, 1992).