

received the company's election. See Investment Company Act Release No. 11703 (March 26, 1981).

For the Commission, by the Division of Investment Management, under delegated authority.

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39338; File No. SR-CBOE-97-48]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change Relating to a Reduction in the Value of the Standard & Poor's 100 Stock Index and a Corresponding Increase in the Existing Position and Exercise Limits for the Option Traded on the Index

November 19, 1997.

I. Introduction

On September 19, 1997, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to 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 double current position and exercise limits in connection with a reduction by Standard & Poor's ("S&P") of the value of its S&P 100 Stock Index ("Index") option ("OEX") to one-half of its present value by doubling the divisor used in calculating the Index.

The proposed rule change appeared in the **Federal Register** on October 10, 1997.³ No comments were received on the proposed rule change. This order approves the CBOE's proposal.

II. Description of the Proposal

In March 1983, the CBOE began trading OEX options,⁴ which are American-style, cash-settled options on the Index. The Exchange notes that the value of the OEX has doubled in value since mid-1995, such that the value of the Index stood at 928.20 as of August 7, 1997. As a result of the significant increase in the value of the underlying Index, the premium for OEX options

also has increased. This has caused OEX options to trade at a level that may be uncomfortably high for retail investors, a large and important part of the market for OEX options.

As a result, pursuant to CBOE's request, S&P (the reporting authority and sole party responsible for maintaining the Index) has agreed to a "two-for-one split" of the Index. The change, which will be implemented immediately following the November expiration,⁵ will result in a halving of the Index level, as well as a doubling of the number of OEX contracts outstanding, such that for each OEX contract held, the holder will receive two contracts at the reduced value, with a strike price of one-half of the original strike price.⁶

In addition to the above, the CBOE proposes to double the position limits applicable to the OEX from 25,000 to 50,000 contracts.⁷ The CBOE also proposes to double the exercise limits applicable to OEX options from 15,000 to 30,000 contracts. The Exchange believes this increase in the position and exercise limits is justified because the reduction in the divisor would result in each contract overlying only one-half of the value of a current OEX contract. Consequently, the revised position and exercise limits would be equivalent to the current levels in terms of the value of the Index.

The CBOE announced the effective date of the change by way of an Exchange circular to its membership, which also described the changes to the strike prices and the position and exercise limits.⁸

The Exchange expects the proposed changes to attract additional customer business in OEX in those series in

⁵The Index is scheduled to be split on November 24, 1997. Telephone conversation between Timothy Thompson, Senior Attorney, CBOE, and Michael Walinskas, Senior Special Counsel, Division of Market Regulation, Commission, on November 10, 1997.

⁶The value of reduced-value Long-Term Anticipation Securities ("LEAPS") based on the Index will not be affected by the proposed change in the value of the Index. Therefore, reduced value OEX LEAPS, based on one-tenth of the value of the Index, will be based on one-fifth of the value of the Index after the value of the Index is reduced by one-half. See Letter from Timothy H. Thompson, Senior Attorney, CBOE, to Michael Walinskas, Division of Market Regulation, Commission, dated November 11, 1997.

⁷The Exchange has separately requested an increase in the position and exercise limits for OEX. See Securities Exchange Act Release No. 38525 (April 18, 1997) 62 FR 20046 (April 24, 1997) (noticing SR-CBOE-97-11).

⁸In this regard, the Commission notes that in a circular dated November 13, 1997, the CBOE provided notice to its members and member organizations of the S&P's intent to reduce the value of the Index by one-half and of the CBOE's intent to double the position and exercise limits for OEX.

which retail customers are interested most in trading. The Exchange believes the proposed change will permit some retail investors to trade these options who otherwise have been priced out of the market due to the recent market surge. The Exchange further believes that OEX options provide an important opportunity for investors to hedge and speculate upon the market risk associated with the stocks comprising this broad-based, widely followed Index. By reducing the value of the Index, investors will be able to utilize this trading vehicle, while extending a smaller outlay of capital. The Exchange believes that this should attract additional investors and create a more active and liquid trading environment.

The Exchange believes that reducing the value of the Index does not raise manipulation concerns and will not cause adverse market impact because the Exchange will continue to employ the same surveillance procedures and has proposed an orderly procedure to achieve the Index split, including adequate prior notice to market participants.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of Section 6(b) of the Act⁹ and the rules and regulations thereunder applicable to a national securities exchange.¹⁰ Specifically, because reducing the value of the Index will enhance the depth and liquidity of the market for both members and investors in general, the Commission believes that this rule change is consistent with and furthers the objectives of Section 6(b)(5) of the Act¹¹ in that it would remove impediments to and perfect the mechanism of a free and open market in a manner consistent with the protection of investors and the public interest.

By reducing the value of the Index, the Commission believes that a broader range of investors will be provided with a means to hedge their exposure to the market risk associated with the stocks underlying the Index. Similarly, the Commission believes that reducing the value of the Index may attract additional investors, thus creating a more active and liquid trading market in OEX.

The Commission also believes that CBOE's adjustments to its position and exercise limits are appropriate and consistent with the Act. In particular,

⁹ 15 U.S.C. 78f(b).

¹⁰ 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).

¹¹ 15 U.S.C. 78f(b)(5).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 39192 (October 3, 1997) 62 FR 53040.

⁴ See Securities Exchange Act Release No. 19264 (November 22, 1997) 47 FR 53981 (November 30, 1982).

the Commission believes that the position and exercise limits are reasonable in light of the fact that the size of the OEX contract will be halved. Doubling the position and exercise limits, therefore, will permit market participants to maintain, after the split of the Index, their current level of investment in OEX options.

The Commission further believes that doubling the Index's divisor will not have an adverse market impact or make trading in OEX options susceptible to manipulation. After the split, the Index will continue to be comprised of the same stocks with the same weightings and will be calculated in the same manner, except for the proposed change in the divisor. The Commission notes that the CBOE's surveillance procedures also will remain the same.

Finally, the Commission notes that the Exchange provided notice of the proposed changes to the Index and the OEX contract to its membership through a circular.¹² The Commission believes that the CBOE provided adequate notice to market participants regarding this change to the Index value and the OEX contract prior to its implementation.

IV. Conclusion

For the foregoing reasons, the Commission finds that the CBOE's proposal 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,¹³ that the proposed rule change (SR-CBOE-97-48) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39337; File No. SR-CHX-97-30]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Codifying the Exchange's Clearing the Post Policy

November 19, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

("Act"),¹ notice is hereby given that on October 23, 1997, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change, as described in Items I, II, and III below, which Items have been prepared by the self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to add interpretation and policy .02 to Rule 10 of Article XX relating to clearing the post. The text of the proposed rule change is as follows: Additions are italicized.

Article XX

Rule 10. Manner of Bidding and Offering.

No change in text.

* * * Interpretations and Policies

.02 Clearing the Post.

Policy. All orders received by floor brokers or originated by market makers on the floor of the Exchange must effectively clear the post before the orders may be routed to another market, either via the ITS System or through the use of alternative means.

Floor brokers who receive an order on the floor have a fiduciary responsibility to seek a best price executive for such order. This responsibility includes clearing of the Exchange's post prior to routing an order to another market so that other buying and selling interest at the post can be checked for a potential execution that may be as good as or better than the execution available in another market.

Market makers are required to provide depth and liquidity to the Exchange market, among other things. Exchange Rules require that all market maker transactions constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market. In so doing, market makers must adhere to traditional agency/auction market principles on the floor. Transactions by Exchange market makers on other exchanges which fail to clear the Exchange post do not constitute such a course of dealings.

Notwithstanding the above, it is understood that on occasion a customer will insist on special handling for a particular order that would preclude it from clearing the post on the Exchange

floor. For example, a customer might request that a specific order be given a primary market execution. These situations must be documented and reported to the Exchange. Customer directives for special handling of all orders in a particular stock or all stocks, however, will not be considered as exceptions to the clearing the post policy.

All executions resulting from bids and offers reflected on Instinet terminals resident on the Exchange floor constitute "orders" which are "communicated" to the Exchange floor. Therefore, all orders resulting from interest reflected on Instinet terminals on the Exchange floor must be handled as any other order communicated to the floor. All such orders must be presented to the post during normal trading hours. All trades between Instinet and Exchange floor members are Exchange trades and must be executed on the Exchange.

Method of Clearing the Post. The Exchange's clearing the post policy requires the floor broker or market maker to be physically present at the post. A market maker, after requesting the specialist's market quote, must bid or offer the price and size of his intended interest at the post. A floor broker must clear the post by requesting a market quote from the specialist. If the specialist or any other member who has the post indicates an interest to trade at the price that was bid or offered by the market maker or the price of the floor broker's order (even though that order has not yet been bid or offered), then the trade may be consummated with the specialist (or whomever has the post) in accordance with existing Exchange priority, parity and precedence rules. If the specialist (or any other member who has the post) indicates interest to trade at that price but the member communicating the intended interest, including Instinet interest, determines not to consummate the trade with the specialist or such member, then, to preserve the Exchange's existing priority, parity and precedence rules, the trade may not be done with any other Exchange floor member. (See Article XXX, Rule 2.) If the trade is consummated with the specialist or other member who has the post, the specialist (or any customer represented by the specialist) is not required to pay any fees to the broker or market maker in connection with the execution of the order, unless such fee is expressly authorized by an Exchange Rule. If the specialist does not indicate an interest to trade, then the trade may be consummated with another Exchange

¹² See *supra* note 8.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 17 CFR 200.30-3(a)(12).

¹⁵ 15 U.S.C. 78s(b)(1).