

*C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others*

No written comments were solicited or received with respect to the proposed rule change.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal Register** within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions shall 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 Room in 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-97-48 and should be submitted by February 24, 1998.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>5</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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<sup>5</sup> 17 CFR 200.30-3(a)(12).

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-39581; File No. SR-CBOE-97-38]

**Self-Regulatory Organizations; Order Granting Approval and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Listing and Trading Standards for Index Portfolio Receipts**

January 26, 1998.

**I. Introduction**

On August 14, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt new Interpretation .02 to Rule 1.1, Rule 30.10, Interpretation .03 to Rule 30.20, Interpretation .01 to Rule 30.33, Rule 30.36, Rule 30.54, Rule 30.55, Rule 31.5 and Rule 31.94 to provide for the listing and trading of Index Portfolio Receipts ("IPRs"), which are securities issued by a unit investment trust and holding a portfolio of securities linked to an index.

The proposed rule change together with the substance of the proposal was published for comment in the **Federal Register** on October 9, 1997.<sup>3</sup> No comments were received on the proposal. The Exchange filed Amendment No. 1 to the proposed rule filing on January 16, 1998.<sup>4</sup> This order approves the proposal.

**II. Background and Description**

The Exchange proposes to adopt new Interpretation .02 to Rule 1.1, Rule 30.10, Interpretation .01 to Rule 30.33, Rule 30.36, Rule 30.54, Rule 30.55, Rule 31.5 and Rule 31.94 to accommodate trading on the CBOE of IPRs, *i.e.*, securities which are interests in a unit investment trust ("Trust") holding a portfolio of securities linked to an index. Each Trust will provide investors with an instrument that (i) closely tracks the underlying portfolio of securities, (ii) trades like a share of common stock,

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

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

<sup>3</sup> Securities Exchange Act Release No. 39189 (October 2, 1997), 62 FR 52798.

<sup>4</sup> The amendment withdraws a proposed general exemption of IPRs from the Exchange's short sale rule. See letter from Ilan Huberman, Schiff, Hardin & Waite (CBOE counsel), to Kevin Ehrlich, Attorney, Division of Market Regulation ("Division"), Commission, dated January 16, 1998.

and (iii) pays holders of the instrument periodic dividends proportionate to those paid with respect to the underlying portfolio of securities, less certain expenses (as described in the Trust prospectus).<sup>5</sup>

The proposed rules are substantially similar to existing rules of the American Stock Exchange ("AMEX") applicable to Portfolio Depository Receipts ("PDRs"), which are substantively very similar to IPRs.<sup>6</sup> IPRs will be issued by one or more Trusts to be formed by an entity serving as the sponsor for the Trusts (the "Sponsor").<sup>7</sup> Upon receipt of securities and cash in payment for a creation order placed through the Distributor as described below, the Trustee will issue a specified number of IPRs referred to as a "Creation Unit."

Each series of IPRs will be based on a published index or portfolio of securities. IPRs of each such series are intended to produce investment results that generally correspond to the price and yield performance of the component common stocks of the selected index or portfolio. Each Trust will provide investors with an interest in a portfolio of securities that is intended to closely track the value of the index or portfolio on which it is based. IPRs will trade like shares of common stock and will pay periodic dividends proportionate to those paid

<sup>5</sup> The CBOE has a request pending before the Division seeking exemptive, interpretive, or no-action relief from Rules 10a-1, 10b-7, 10b-10, 10b-13, 10b-17, 11d1-2, 15c1-5, 15c1-6 and Rules 101, 102 and 104 of Regulation M under the Act and Section 16 of the Act, relating to IPRs.

<sup>6</sup> See File No. SR-AMEX-92-18 (adopting new rules related to the listing and trading of PDRs); SR-AMEX-95-16 (providing that the minimum tick applicable to the MidCap SPDR, a PDR product, will be 1/64 of \$1.00); SR-AMEX-94-52 (listing and trading of MidCap 400 SPDRs under the rules originally adopted to trade PDRs); SR-AMEX-93-41 (limiting the AMEX's liability in connection with its administration of proprietary indices and products); and SR-AMEX-92-45 (providing that the minimum tick applicable to SPDRs will be 1/32 of \$1.00).

<sup>7</sup> The CBOE anticipates that all of the Trusts will be governed by a master trust agreement providing for the issuance, in series, of IPRs based on different underlying indices. The Sponsor will file (i) a registration statement under the Investment Company Act of 1940 ("Investment Company Act") registering the trust (consisting of such series of Trusts) as an investment company under the Investment Company Act, and (ii) a separate registration statement under the Securities Act of 1933 (the "Securities Act") registering the offer and sale of each series of IPRs. The Sponsor will also file an application under Section 6(c) of the Investment Company Act requesting exemption of the Trusts and the Sponsor from certain provisions of the Investment Company Act and permitting the Trusts and the Sponsor to engage in certain affiliated transactions otherwise prohibited by Section 17(d) of the Investment Company Act and Rule 17d-1 thereunder. The Commission notes that no Sponsor has been identified as of the date of the approval order.

with respect to the underlying portfolio of securities, less certain expenses, as described in the prospectus for each series of IPRs. The Exchange expects that the Trusts will terminate 125 years from the initial date of deposit of the trust corpus into each respective Trust or on such earlier date as may be required in order to permit such Trust to comply with the rule against perpetuities, in the event that the Trust is governed by the law of a state in which the rule against perpetuities remains in effect.<sup>8</sup>

The Sponsor will enter into a trust agreement with a trustee in accordance with Section 26 of the Investment Company Act. The CBOE will establish a relationship with an entity that will act as the underwriter of IPRs on an agency basis ("Distributor"). All orders to create IPRs in Creation Units will be required to be placed with the Distributor, and it will be the responsibility of the Distributor to transmit such orders to the Trustee. The Distributor will be a registered broker-dealer and a member of the National Association of Securities Dealers, Inc. ("NASD").

Payment with respect to creation orders for a Trust placed through the Distributor will be made by (1) the "in-kind" deposit with the Trustee of a specified portfolio of securities that contains substantially the same securities in substantially the same proportions or "weighting" as the component securities of the index or portfolio on which the Trust is based and (2) a cash payment sufficient to enable the Trustee to make a distribution ("Dividend Equivalent Payment") to the holders of beneficial interests in the Trust on the next dividend payment data as if all the securities had been held for the entire accumulation period for the

<sup>8</sup> Each Trust however may be terminated earlier under the following circumstances: (1) Delisting of the IPRs issued by such Trust by the primary market on which the IPRs are traded; (2) termination of the license agreement with the owner of the index on which the Trust is based; or (3) if either the Trustee, Sponsor, Distributor, Depository Trust Company ("DTC") or the National Securities Clearing Corporation ("NSCC") is unable to perform its functions or duties with respect to operation of a Trust and a suitable successor entity is unavailable. In addition, the Sponsor may also terminate a Trust if, after six months from inception, the Trust net asset value falls below \$150 million or such other amount as may be specified in the prospectus, or if, after three years from inception, the Trust net asset value falls below \$350 million or such other amount as may be specified in the prospectus. IPRs cannot be traded after the termination of a Trust. However, on termination the Trust will be liquidated, and IPR holders at that time will receive a distribution equal to their pro rata share of the assets of the Trust, net of certain fees and expenses.

distribution, subject to certain specified adjustments (see "Distributions" below) plus or minus a "Balancing Amount" to compensate for any differences between the market value of the securities paid and the net asset value of a Creation Unit of such Trust. The Dividend Equivalent Payment and the Balancing Amount are collectively referred to as the "Cash Component." The portfolio of securities and the Cash Component accepted by the Trustee are referred to as the "Portfolio Deposit."<sup>9</sup>

#### *Issuance of IPRs*

Upon receipt of a Portfolio Deposit for a Trust in payment for a creation order placed through the Distributor as described above, the Trustee will issue a specified number of IPRs of that Trust equal to the Creation Unit. IPRs may be created only in a Creation Unit or multiples thereof. The Exchange anticipates that a Creation Unit for a series of IPRs will consist of 50,000 IPRs or such other number as the Exchange may designate taking into account the value of individual IPRs of that particular series and such other factors as the Exchange deems to be relevant. It is anticipated that the Trust and Sponsor will obtain necessary regulatory approval to allow individual IPRs to be traded in the secondary market similar to other equity securities.<sup>9</sup> It is excepted that Portfolio Deposits will be made by institutional investors and arbitrageurs as well as Market-Makers and Designated Primary Market-Makers as defined in the CBOE's rules.

To maintain the correlation between the portfolio of securities held in a Trust and that of the underlying index or portfolio, the Trustee will adjust the composition of the Portfolio Deposits from time to time to conform to changes to the index or portfolio made by the organization that compiles and maintains such index or portfolio. The Trustee will aggregate certain of these adjustments and make periodic

<sup>9</sup> At such time as the Exchange seeks to list series of IPRs, the Sponsor and the Trusts will file with the Commission an application seeking, among other things, an order: (1) Permitting secondary market transactions in IPRs at negotiated prices, rather than at a current public offering price described in the prospectus for the applicable series of IPRs as required by Section 22(d) of the Investment Company Act and Rule 22c-1 thereunder; and (2) permitting the sale of IPRs to purchasers in the secondary market unaccompanied by a prospectus, when prospectus delivery is not required by Section 4(3) of the Securities Act but may be required according to Section 24(d) of the Investment Company Act for redeemable securities issued by a unit investment trust. These exemptions, if granted, will permit IPRs to be traded in secondary market transactions just as interests in a closed-end investment company are traded.

conforming changes to the Trust portfolio.

It is expected that the Trustee or Sponsor will make available (a) on a daily basis, a list of the names and required number of shares for each of the securities in the then current Portfolio Deposit for each of the Trusts; (b) on at least a minute-by-minute basis throughout the day, a number representing the value (on a per IPR basis) of the securities portion of each Portfolio Deposit; and (c) on a daily basis, the accumulated dividends, less expenses, per each outstanding IPR unit.

Transactions in IPRs may be effected on the Exchange until 3:15 p.m. Chicago time each business day.<sup>10</sup> IPRs will trade in round lots of 100.

#### *Redemption*

IPRs will be redeemable in kind by tendering them to the Trustee, but only in Creation Unit aggregations. While holders may sell any number of IPRs in the secondary market at any time, they must accumulate a minimum number of IPRs equal to a Creation Unit in order to redeem through a Trust. IPRs will remain outstanding until redeemed or until termination of the Trust by which they were issued. Creation Units of a Trust will be redeemable on any business day in exchange for a portfolio of the securities held by the Trust substantially identical in weighing and composition to the securities portion of the Portfolio Deposit for such Trust in effect on the date request is made for redemption, together with the Cash Component. The number of shares of each of the securities transferred to the redeeming holder will be the number of shares of each of the component stocks in such a Portfolio Deposit on the day the redemption notice is received by the Trustee, multiplied by the number of Creation Units being redeemed. Nominal service fees will be charged in connection with the creation and redemption of Creation Units. The Trustee will cancel all tendered Creation Units upon redemption.

#### *Distributions*

The Trusts will pay dividends quarterly. It is expected that the regular quarterly ex-dividend dates for an underlying index or portfolio of securities traded on the New York Stock Exchange, Inc. ("NYSE") will be the third Friday in March, June, September and December, unless such day is an NYSE holiday, in which case the ex-

<sup>10</sup> See CBOE Rule 30.4(c) which provides that the "hours during which transactions in \* \* \* UIT interest may be made on the Exchange shall be as provided in Rule 24.6 in respect of index options." Rule 24.6 provides a 3:15 p.m. closing time.

dividend date will be the preceding Thursday. Holders of IPRs on the business day preceding the ex-dividend date will be entitled to receive an amount representing dividends accumulated through the quarterly dividend period preceding such ex-dividend date net of fees and expenses for such period. The payment of dividends will be made on the last Exchange business day in the calendar month following the ex-dividend date ("Dividend Payment Date"). On the Dividend Payment Date, dividends payable will be distributed for those securities with ex-dividend dates falling within the period from the ex-dividend date most recently preceding the current ex-dividend date through the business day preceding the current ex-dividend date.<sup>11</sup> The Trustee will compute on a daily basis the dividends accumulated for each Trust within each quarterly dividend period. Dividend payments will be made through DTC and its participants to all such holders with funds received from the Trustee. IPRs will be registered in book entry form only, which records will be kept by DTC.

#### *Criteria for Initial and Continued Listing*

The CBOE's proposed standards for listing and delisting of IPRs allow some flexibility in listing each series of IPRs. With respect to initial listing, the Exchange proposes that, for each series, the Exchange will establish a minimum number of IPRs required to be outstanding at the time of commencement of Exchange trading. For IPRs having a Creation Unit size of 50,000 IPRs, a minimum of 150,000 IPRs of each such series (*i.e.*, three Creation Units) will be required to be outstanding when trading on such series of IPRs begins.

Because the Trusts operate on an open-end basis, and because the number of holders of IPRs of each Trust is subject to substantial fluctuation depending on market conditions, the Exchange believes it would be inappropriate and burdensome on IPR holders to consider suspending trading in or delisting a series of IPRs, with the consequent termination of the Trust by which they were issued, unless the

number of holders remains severely depressed during an extended time period. Therefore, following twelve months from the formation of a Trust and commencement of Exchange trading, the Exchange will consider suspension of trading in, or removal from listing of, IPRs of any series when, in its opinion, further dealing in such securities appears unwarranted under the following circumstances:

(a) The Trust by which IPRs of such series are issued has more than 60 days remaining until termination and there have been fewer than 50 record and/or beneficial holders of IPRs of such series for 30 or more consecutive trading days; or

(b) The index on which the Trust is based is no longer calculated or available; or

(c) Such other event shall occur or condition exist which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

A Trust shall terminate upon removal from Exchange listing, and the series of IPRs representing interests in such Trust will be redeemed as described in the prospectus for such series. A Trust may also terminate under such other conditions as may be described in the prospectus for such series. For example, the Sponsor, following notice to IPR holders, will have discretion to direct that a Trust be terminated if the value of securities held by such Trust falls below a specified amount. A Trust based on an index or portfolio licensed to the Exchange by a third party will also terminate if the required license terminates.<sup>12</sup>

#### *Trading Halts*

Prior to commencement of trading in IPRs, the Exchange will issue a circular to members informing them of Exchange policies regarding trading halts in such securities. The circular will make clear that, in addition to other factors that may be relevant, the Exchange may consider factors such as those set forth in Exchange Rule 24.7 in exercising its discretion to halt or suspend trading. These factors would include whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the value of the applicable current index group or whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present. Also, IPR trading would be halted (along with trading in other securities on the Exchange) if the

circuit breaker parameters under Exchange Rule 6.3B are reached.

#### *Terms and Characteristics*

The Exchange proposes to require that members and member organizations provide to all purchasers of each series of IPRs a written description of the terms and characteristics of such securities, in a form prepared by the Exchange, not later than the time a confirmation of the first transaction in each series is delivered to such purchaser. The Exchange also proposes to require that such description be included with any sales material on that series of IPRs that is provided to customers or the public. In addition, the Exchange proposes to require that any other written materials provided by a member or member organization to customers or the public making reference to a specific series of IPRs as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of IPRs] is available from your broker or the Exchange. It is recommended that you obtain and review such circular before purchasing [the series of IPRs]. In addition, upon request you may obtain from your broker a prospectus for [the series of IPRs]." Finally, as noted above, the Exchange requires that members and member organizations provide the prospectus for a series of IPRs to customers upon request.

A member or member organization carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase IPRs for such omnibus account will be deemed to constitute an agreement by the non-member to make such written description available to its customers on the same terms as are applicable to members and member organizations.

#### *Trading of IPRs*

Dealings in IPRs on the Exchange will be conducted pursuant to the Exchange's rules governing the trading of equity securities in general. The Exchange's general dealing and settlement rules will apply, including its rules on clearance and settlement of securities transactions and its equity margin rules. Other generally applicable Exchange equity rules and procedures will also apply, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of market-makers.

### **III. Discussion**

The Commission finds that the proposed rule change is consistent with

<sup>11</sup> Because the Trusts intend to qualify for and elect tax treatment as regulated investment companies under the Internal Revenue Code, the Trustee will also be required to make additional distributions to the minimum extent necessary (i) to distribute the entire annual taxable income of each Trust, including any net capital gains from sales of securities in connection with adjustments to the portfolio of securities held by such Trust, or to generate cash for distributions, and (ii) to avoid imposition of the excise tax imposed by Section 4982 of the Internal Revenue Code.

<sup>12</sup> See supra note 8.

the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b)(5).<sup>13</sup> The Commission believes that providing for the exchange-trading on the CBOE and IPRs will offer investors an efficient way of participating in the securities markets. In particular, the Commission believes that the trading on the CBOE and IPRs will provide investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a low-cost security replicating the performance of a portfolio of stocks at negotiated prices throughout the business day.<sup>14</sup> The Commission also believes that IPRs will benefit investors by allowing them to trade securities based on unit investment trusts in secondary market transactions.<sup>15</sup>

The Commission believes that the trading on the CBOE of a security like IPRs, which replicate the performance of an index or portfolio of stocks, could benefit the equities markets by, among other things, helping to ameliorate the volatility occasionally experienced in such markets. The Commission believes that the creation of one or more products where actual portfolios of stocks or instruments representing a portfolio of stocks, such as IPRs, can trade at a single location in an auction market environment could alter the dynamics of program trading, because the availability of such single transaction portfolio trading could, in effect, restore the execution of program trades to more traditional block trading techniques.<sup>16</sup>

The 1987 Market Break Report noted the potential benefits to be derived from providing a market where institutional

investors and member firms could focus their equity transactions at posts trading a portfolio of stocks in a single transaction. In particular, the 1987 Market Break Report noted that the specialist(s) and the trading crowd(s) at the portfolio post could provide additional liquidity, that is currently unavailable at the posts for trading in each of the individual stocks, as well as provide the additional efficiencies associated with effecting a single transaction in a portfolio of securities as opposed to numerous transactions in individual stocks. The additional layer of liquidity to the market could help absorb the velocity and concentration of trading associated with index-related trading strategies involving individual stocks. Because market portfolio instruments would be traded at a single location on an exchange floor, the potentially adverse effects of program trading order flows during volatile market conditions, such as imbalances in particular stocks, would be diminished. Moreover, the trading of a single security replicating the performance of a broad portfolio of stocks, in general, will provide an easy and inexpensive methods to clear and settle a portfolio of stocks. Accordingly, given the design of the IPRs in general, the Commission believes that the benefits to the marketplace noted above resulting from the trading of a "basket" product likely will result from the trading of IPRs.

The Commission also believes that IPRs will provide investors with several advantages over standard open-end index mutual fund shares. In particular, provided the necessary Investment Company Act relief is obtained, investors will have the ability to trade IPRs continuously throughout the business day in secondary market transactions at negotiated prices.<sup>17</sup> In contrast, pursuant to Investment Company Act Rule 22c-1,<sup>18</sup> holders and

prospective holders of open-end mutual fund shares are limited to purchasing or redeeming securities of the fund based on the net asset value of the securities held by the fund as designated by the board of directors.<sup>19</sup> Accordingly, IPRs will allow investors to (1) respond quickly to changes in the market; (2) trade at a known price; (3) engage in hedging strategies nor currently available to retail investors; and (4) reduce transaction costs for trading a portfolio of securities.

Although IPRs are not leveraged instruments, and, therefore, do not possess any of the attributes of stock index options, their prices will still be derived and based upon the securities held in their respective Trusts. In essence, IPRs are equity securities that are priced off a portfolio of stocks based on a selected index or basket of stocks. Accordingly, the level of risk involved in the purchase or sale of an IPR is similar to the risk involved in the purchase or sale of traditional common stock, with the exception that the pricing mechanism for IPRs is based on a basket of stocks. Nonetheless, the Commission has several specific concerns regarding the trading of these securities. In particular, IPRs raise disclosure, market impact, and secondary market trading issues that must be addressed adequately. As discussed in more detail below, the Commission believes the CBOE has adequately addressed these concerns.

#### Disclosure

The Commission believes that the CBOE proposal contains several provisions that will ensure that investors are adequately apprised of the terms, characteristics, and risks of trading IPRs. As noted above, the proposal contains four aspects addressing disclosure concerns. First, CBOE members must provide their customers trading IPRs with a written explanation of any special characteristics and risks attendant to trading such IPR securities, in a form approved by the CBOE.<sup>20</sup> Second, members and member organizations must include this written product description with any sales material relating to the series of IPRs that is

or resell. The net asset value of a mutual fund generally is computed once daily Monday through Friday as designated by the investment company's board of directors. The Commission notes that the CBOE would need to apply for an exemption to allow particular IPR products to trade at negotiated prices in the secondary market.

<sup>19</sup> *Id.*

<sup>20</sup> The Commission notes that the CBOE will be required to prepare a product description for members and submit it to the Division for review prior to listing and trading any IPR product.

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of exchange trading for new products upon a finding that the introduction of the product is in the public interest. Such a finding would be difficult with respect to a product that served no investment, hedging or other economic function, because any benefits that might be derived by market participants would likely be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

<sup>15</sup> The Commission notes, however, that unlike open-end funds where investors have the right to redeem their fund shares on a daily basis, investors could only redeem IPRs in creation unit share sizes. Nevertheless, IPRs would have the added benefit of liquidity from the secondary market and IPR holders, unlike holders of most other open-end funds, would be able to dispose of their shares in a secondary market transaction.

<sup>16</sup> Program trading is defined as index arbitrage or any trading strategy involving the related purchase or sale of a "basket" or group of fifteen or more stocks having a total market value of \$1 million or more.

<sup>17</sup> Because of potential arbitrage opportunities, the Commission believes that IPRs will not trade at a material discount or premium in relation to their net asset value. The mere potential for arbitrage should keep the market price of IPRs comparable to their net asset value, and therefore, arbitrage activity likely will be minimal. In addition, the Commission believes a Trust generally should track its underlying index more closely than an open-end index fund because a Trust will accept only in-kind deposits, and, therefore, will not incur brokerage expenses in assembling its portfolio. In addition, a Trust will redeem only in kind, thereby enabling the Trust to invest virtually all of its assets in securities comprising the underlying index.

<sup>18</sup> Investment Company Act Rule 22c-1 generally requires that a registered investment company issuing a redeemable security, its principle underwriter, and dealers in that security, may sell, redeem, or repurchase the security only at a price based on the net asset value next computed after receipt of an investor's request to purchase, redeem,

provided to customers or the public. Third, any other written materials provided by a member or member organization to customers or the public referencing IPRs as an investment vehicle must include a statement, in a form specified by the CBOE, that a circular and prospectus are available from a broker upon request. A member or member organization carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of IPRs for such omnibus account will be deemed to constitute agreement by the non-member to make the written product description available to its customers on the same terms as member firms. Accordingly, the Commission believes that investors in IPR securities will be provided with adequate disclosure of the unique characteristics of the IPR instruments and other relevant information pertaining to the instruments. Fourth, CBOE Rule 30.50, Doing Business with the Public, which includes customer suitability provisions, will apply to the trading of IPRs.<sup>21</sup>

#### *Market Impact*

The Commission believes the CBOE has adequately addressed the potential market impact concerns raised by the proposal. The CBOE has developed policies regarding trading halts in IPRs. Specifically, the Exchange would halt IPR trading if the circuit breaker parameters under CBOE Rule 6.3B were reached. In addition, in deciding whether to halt trading or conduct a delayed opening in IPRs, the CBOE represents that it will be guided by, but not necessarily bound to, relevant stock index option trading rules. Specifically, consistent with CBOE Rule 24.7, the CBOE may consider whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value or whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

The CBOE has not proposed at this time a specific IPR that it intends to trade. The CBOE's proposed listing standards provide it with broad

authority to list IPRs "based on one or more stock indices or securities portfolios." Accordingly, it is difficult for the Commission to assess the potential market impact of trading a particular IPR series. To date, several products nearly identical to IPRs, notably Standard & Poor's Depository Receipts ("SPDRs") and Standard & Poor's MidCap 400 Depository Receipts ("MidCap SPDRs") trade on one or more U.S. exchanges. These products have not adversely impacted U.S. equities markets. In fact, such products appear to provide substantial benefits to the marketplace and investors, including, among others, enhancing the stability of the markets for individual stocks. All of the current approved/traded IPR-like products, however, are based on broad-based stock indices containing large capitalized, liquid stocks.

IPRs theoretically can serve as substitutes for transactions in the cash market, resulting in order flow in individual stocks smaller than would otherwise be the case. Such an occurrence is more likely to cause a noticeable market impact where the subject stocks have relatively low capitalization and are liquid. As a result, the Commission believes that the CBOE should contact the Division and provide it with advance notice of the listing of a specific IPR. The Division may determine that a rule filing, pursuant to Section 19 of the Act, will be required in order to approve a particular index or portfolio as appropriate for IPR trading.

#### *Trading Rules*

The Commission finds that the CBOE's proposal contains adequate rules and procedures to govern the trading of IPR securities. IPRs are Unit Investment Trust ("UIT") securities, which, under CBOE rules, subjects them to the fully panoply of rules governing the trading of such securities on the CBOE, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of market-makers.<sup>22</sup> IPRs will also be subject to the same margin requirements as equity securities.<sup>23</sup> Further, the Commission notes that the CBOE has submitted surveillance procedures for the trading of IPRs and believes that those procedures, which incorporate and rely

upon existing CBOE surveillance procedures governing equities, are adequate under the Act. In addition, the CBOE has developed specific listing and delisting criteria for IPRs that will help to ensure that the markets for IPRs will be deep and liquid. As noted above, the CBOE's proposal provides for trading halt procedures governing IPRs. Finally, the Commission notes that CBOE Rule 30.50, Doing Business with the Public, which includes customer suitability provisions, will apply to the trading of IPRs in general.

The CBOE has not represented that it intends to trade IPRs (or securities traded on other exchanges that are nearly identical to IPRs) pursuant to unlisted trading privileges. However, if the CBOE chose to trade instruments such as SPDRs and MidCap SPDRs pursuant to unlisted trading privileges, adoption of IPR listing standards satisfies Rule 12f-5 of the Act which requires that an exchange have in effect "rules providing for transactions in the class or type of security to which the exchange extends unlisted trading privileges." Nevertheless, prior to trading IPRs (or similar securities) pursuant to unlisted trading privileges, the CBOE should make certain that it has adequately addressed other potential issues, and particularly, should ensure that the required product description is made available to investors.<sup>24</sup> The Commission notes that while the CBOE would not be required to make further 19(b) rule filings to trade PDRs pursuant to UTP, the CBOE should submit materials such as the relevant product description and circular to Division staff for review prior to commencing trading.

#### **IV. Conclusion**

The Commission finds that the listing and trading of IPRs 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). As discussed above, the trading of IPRs should provide a variety of benefits to the marketplace and investors trading portfolios of securities. Accordingly, the Commission believes that IPRs will serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and,

<sup>21</sup> CBOE Rule 30.50 provides, in part, that every member organization shall use due diligence to learn the essential facts relative to every customer and to every order or account accepted and shall supervise diligently the handling of all customer accounts. Rule 30.50 Interpretations, and Policies .02 further provides, in part, that customers should be provided with an explanation of any special characteristics and risks attendant to trading UIT interests.

<sup>22</sup> Telephone conversation between James McDaniel, Schiff, Hardin & Waite (CBOE counsel), and Kevin Ehrlich, Attorney, Division, Commission (January 22, 1998).

<sup>23</sup> Telephone conversation between James McDaniel, Schiff, Hardin & Waite (CBOE counsel), and Kevin Ehrlich, Attorney, Division, Commission (January 22, 1998).

<sup>24</sup> For a more detailed description of potential unlisted trading privilege-related issues, see Release Nos. 39076 (Sept. 15, 1997), 62 FR 49270 (Sept. 19, 1997) ("CHX Approval Order"); 39268 (Oct. 22, 1997), 62 FR 56211 (Oct. 29, 1997) ("CSE Approval Order"); 39461 (Dec. 17, 1997), 62 FR 6764 (Dec. 29, 1997) ("PCX Approval Order").

protect investors and the public interest.<sup>25</sup>

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 1 withdraws from the proposed rule change a proposed general exemption of IPRs from the Exchange's short sale rule. The CBOE originally anticipated that the Commission would grant a general exemption from Rule 10a-1 of the Act for all IPRs prior to the approval of this filing. However, to date, such an exemption has not been granted. Accordingly, the Commission believes that there is good cause, consistent with Section 6(b)(5) of the Act, to approve Amendment No. 1 to the proposal on an accelerated basis.

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1, including whether this proposed amendment is 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 other 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submission should refer to File No. SR-CBOE-97-38 and should be submitted by February 24, 1998.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>26</sup> that the proposed rule change (SR-CBOE-97-38) is approved, as amended.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>27</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>25</sup> In approving this rule, the Commission has consisted the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>26</sup> 15 U.S.C. 78s(b)(2).

<sup>27</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39585; File No. SR-CBOE-98-02]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change By Chicago Board Options Exchange, Inc. To Limit Number of Consecutive Terms Executive Committee Chairman May Serve

January 27, 1998.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on January 16, 1998, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. 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 CBOE proposes to amend Section 8.1(a) of the Exchange Constitution to limit the number of consecutive terms that may be served by the Chairman of the Executive Committee. The text of the proposed rule change is available at the Office of the Secretary, CBOE, and at the Commission.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The purpose of the proposed amendment to Section 8.1 of the CBOE's Constitution is to limit the number of terms that may be served by the Chairman of the Executive Committee, who also serves as the Vice Chairman of the Exchange. Section 7.2 of the CBOE

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

Constitution provides the Executive Committee members are elected for a term of one year. Currently, Section 8.1 of the CBOE's Constitution does not provide for any limit to the number of terms a Vice Chairman may serve. The CBOE is proposing to amend Section 8.1 to provide that the same person may be elected to the office of Vice Chairman up to three consecutive one year terms. For purposes of this limit, a combination of at least six months of a one-year term plus the next two one-year terms is considered to be three consecutive one-year terms. A person becomes eligible to serve as Vice Chairman again, once that person has been out of that office for a period of six months or more.

The purpose of the proposed amendment to impose term limits on the office of the Vice Chairman is to ensure a diversity of experience and ideas in this strategic position of the Exchange. The proposed term limit will apply to the Vice Chairman in office at the time this rule change becomes effective and will take account any prior terms served by that person.

By amending the constitution to impose term limits on the office of Vice Chairman, the Exchange will ensure that the office of Vice Chairman will be dynamic and will present the Exchange with fresh ideas. Therefore, the rule change is consistent with Section 6 of the Act, in general, and Section 6(b)(5), in particular, in that it promotes just and equitable principles of trade, fosters cooperation among persons engaged in facilitating securities transactions, and protects investors and the public interest.

##### B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any burden on competition.

##### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

No written comments were solicited or received with respect to the proposed rule change.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory