SECURITIES AND EXCHANGE COMMISSION

17 CFR Parts 240 and 249

[Release No. 34–40761; File No. S7–13–98]

RIN 3235–AH39

Amendment to Rule Filing Requirements for Self-Regulatory Organizations Regarding New Derivative Securities Products

AGENCY: Securities and Exchange Commission.

ACTION: Final rule.

SUMMARY: The Securities and Exchange Commission is adopting an amendment to Rule 19b–4 under the Securities Exchange Act of 1934. The amendment permits self-regulatory organizations to list and trade new derivative securities products pursuant to existing self-regulatory organization trading rules, procedures, surveillance programs and listing standards without submitting a proposed rule change pursuant to section 19(b).

EFFECTIVE DATE: February 22, 1999.

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SUPPLEMENTARY INFORMATION:

I. INTRODUCTION

A. Purpose Of Amendment

On April 17, 1998, the Securities and Exchange Commission (''SEC'' or ''Commission'') proposed for comment an amendment to Rule 19b–4 (''Proposed Rule'')[1] under the Securities Exchange Act of 1934, as amended (''Exchange Act'' or ''Act''),[2] to expand the scope of self-regulatory organization (''SRO'')[3] matters that do not constitute proposed rule changes, within the meaning of section 19(b) of the Act[4] and Rule 19b–4[5] thereunder. In particular, under the amendment, an SRO rule change would not include the listing and trading of certain new derivative securities products, as defined below, pursuant to existing trading rules, procedures, surveillance programs and listing standards. Today, the Commission adopts the amendment without any material changes from the proposal. In response to certain commenters, the Commission also is providing clarification on the amendment.

B. Description Of Amendment

The Commission previously adopted rules that interpret the terms ''stated policy, practice or interpretation'' and ''proposed rule change.''[6] For example, paragraph (c) of Rule 19b–4[7] provides that certain stated policies, practices and interpretations of SROs do not constitute proposed rule changes. Specifically, a ''stated policy, practice or interpretation'' of an SRO is not a proposed rule change if it is reasonably and fairly implied by an existing SRO rule.

Similarly, today the Commission is adopting an amendment to Rule 19b–4, in substantially the same form that it was proposed, so that the listing and trading of new derivative securities products would not be proposed rule changes so long as existing SRO trading rules, procedures, surveillance programs and listing standards apply to the product class covering a specific new derivative securities product.[8] Specifically, the Commission is adding a new paragraph (e) to Rule 19b–4 which states:

> the listing and trading of a new derivative securities product by (an SRO) shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of (Rule 19b–4), if the Commission has approved, pursuant to section 19(b) of the Act [], such (SRO's) trading rules, procedures and listing standards for the product class that would include the new derivative securities product, and the SRO has a surveillance program for the product class.[9]

In adopting new paragraph (e), the Commission believes that when the Commission has approved, pursuant to section 19(b) of the Act, an SRO's trading rules, procedures and listing standards for the product class that would include the new derivative securities product, the listing and trading of the new derivative securities product is reasonably and fairly implied by the SRO's existing trading rules, procedures and listing standards. The Commission therefore is deeming the listing and trading of new derivative securities products to not be proposed rule changes under rule 19b–4(c)(1) when certain conditions are met.

II. Background

A. Current Procedures For Submission and Approval of SRO New Derivative Securities Product Rule Filings

Over the years, the Commission has sought to revise the rule filing requirements to meet the changing needs of the SROs in a competitive international marketplace. The Commission previously has responded to the need for flexibility in regulating new derivative securities products by developing streamlined filing procedures to ease the SROs' regulatory burden in many circumstances. Today, the Commission is adopting an amendment to Rule 19b–4 under the Act that expands the scope of SRO matters that do not constitute proposed rule changes to include the listing and trading of new derivative securities products pursuant to existing SRO trading rules, procedures, surveillance programs and listing standards.

1. Standard Statutory Procedures

Section 19(b)(1)[10] of the Act requires an SRO to file with the Commission its proposed rule changes accompanied by a concise general statement of the basis and purpose of the proposed rule change. Once a proposed rule change has been filed, the Commission is required to publish notice of it and provide an opportunity for public comment. The proposed rule change

[1] Securities Exchange Act Release No. 39885 (April 17, 1998) 63 FR 23584 (April 29, 1998) (''Proposing Release'').

[2] 15 U.S.C. 78a *et seq.*

[3] Section 3(a)(26) of the Exchange Act, 15 U.S.C. 78c(a)(26), defines SRO to mean any national securities exchange, registered securities association, registered clearing agency, and for purposes of section 19(b) of the Act, 15 U.S.C. 78s(b), and other limited purposes, the Municipal Securities Rulemaking Board.

[4] 15 U.S.C. 78s.

[5] 17 CFR 240.19b–4.

[6] Sections 3(a)(26), 3(a)(27), 15 U.S.C. 78c(a)(27), 3(a)(28), 15 U.S.C. 78c(a)(28) and section 3(b), 15 U.S.C. 78c(b), of the Act provide that the Commission may promulgate rules regarding, among other things, ''stated policies, practices and interpretations'' of SROs Section 19(b) authorizes the Commission to promulgate rules regarding ''proposed rule changes'' of SROs. Section 23(a), 15 U.S.C. 78w(a), of the Act provides that the Commission shall have power to make such rules and regulations as may be necessary or appropriate to implement the provisions of the Exchange Act for which it is responsible or for the execution of the functions vested in it by the Exchange Act, and may for such purposes classify persons, securities, transactions, statements, applications, reports and other matters within its jurisdiction, and prescribe greater, lesser or different requirements for different classes thereof. (See *e.g.*, Securities Exchange Act Release No. 34140 (June 1, 1994) 59 FR 29393 (June 7, 1994)). In addition, in 1996, Congress granted the Commission the authority, under section 36(a), 15 U.S.C. 78mm(a), to exempt any class of person, security or transaction from any provision of the Act. Pub. L. 104–290, 110 Stat. 3416 (1996). The rule adopted today effectively exempts SROs from certain requirements under Section 19(b) of the Act that otherwise would apply to the listing and trading of new derivative securities products.

[7] 17 CFR 240.19b–4(c).

[8] See IV. A. *Definition of ''New Derivative Securities Product''*, infra, for a complete discussion of the technical changes to the definition of new derivative securities product in response to commenters' requests for clarification.

[9] See *Text Of The Final Rule*, infra.

[10] 15 U.S.C. 78s(b)(1).

may not take effect unless it is approved by the Commission or is otherwise permitted to become effective under section 19(b) of the Act.[11] Section 19(b)(2)[12] of the Act sets forth the standards and time periods for Commission action either to approve a proposed rule change or to institute and conclude a proceeding to determine whether a proposed rule change should be disapproved. Generally, the Commission must either approve the proposed rule change or institute disapproval proceedings within 35 days of the publication of notice of the filing or within a longer period as the Commission finds appropriate or to which the SRO consents. The Commission must approve a proposed rule change if it finds that the rule change is consistent with the requirements of the Act, and the rules and regulations thereunder, applicable to the SRO proposing the rule change. If the Commission does not make that finding, it must institute proceedings to determine whether to disapprove the proposed rule change. The Commission also may approve a proposed rule change on an accelerated basis prior to 30 days after publication of the notice if the Commission finds good cause for so doing and publishes its reasons for so finding.[13]

Currently, SROs obtain Commission approval of proposals submitted under section 19(b)(2) to adopt listing standards in order to list and trade various derivative securities products, including, but not limited to: narrow-based stock index options[14] and warrants;[15] portfolio depositary receipts (''PDRs'');[16] foreign currency options;[17] index fund shares;[18] and equity linked term notes (''ELNs'').[19]

2. Recent Efforts To Streamline Procedures for Certain New Derivative Securities Product Rule Filings

Section 19(b)(3) of the Act[20] provides that, in certain circumstances, a proposed rule change may become effective immediately upon filing with the Commission and without the notice and approval procedures required by Section 19(b)(2). Paragraph (A) of Section 10(b)(3) permits certain types of proposed rule changes to take effect in this manner if appropriately designated by the SRO as: (1) Constituting a stated policy, practice or interpretation with respect to the meaning, administration, or enforcement of an existing rule of the SRO; (2) establishing or changing a due, fee, or other charge imposed by the SRO; or (3) concerned solely with the administration of the SRO. Section 19(b)(3)(A)(iii)[21] also gives the Commission the authority to expand, by rule, the scope of proposed rule changes that may become effective under section 19(b)(3)(A) if the Commission determines that the expansion is consistent with the public interest and the purposes of Section 19(b). Currently, existing Rule 19b–4(e) under the Act[22] details the scope of proposed rule changes that may be filed under section 19(b)(3)(A) of the Act.

For the past several years, the commission has worked with the SROs to develop procedures to streamline the review process of new derivative securities product rule filings. As a result, SROs can submit a proposed rule change in accordance with section 19(b)(3)(A) of the Act for certain proposed new derivative securities products. For example, on June 3, 1994, the Commission approved proposed rule changes submitted by several SROs to establish generic listing standards for options on narrow-based stock indices and to adopt streamlined procedures for introducing trading in options that satisfy these listing standards.[23] In addition, certain SROs have in place rules similar to the streamlined procedures for listing warrants on narrow-based stock indices.[24]

Furthermore, the Commission has approved rules for an SRO that allow for the listing of specific broad-based[25] stock index warrant issuances without further Commission approval pursuant to section 19(b) of the Act, as long as the index has been previously approved by the Commission for broad-based index option trading. In addition, the Commission has approved rules for certain SROs that permit the listing of specific narrow-based[26] stock index warrant issuances without further Commission approval pursuant to section 19(b) of the Act, as long as the listing complies with the SRO's Generic Narrow-Based Index Warrant Approval Orders and the Commission has already approved the underlying stock index for

[11] See generally, Senate Comm. on Banking, Housing & Urban Affs., Report to Accompany S. 249: Securities Acts Amendments of 1975, S. Rep. No. 94–75, 94th Cong., 1st Sess. 22–38 (Comm. Print 1975), reprinted in, (1975) U.S. Code Cong. & Ad. News 179, 200–15 (excerpt on ''Self-Regulation and SEC Oversight'').

[12] U.S.C. 78s(b)(2).

[13] Section 19(b)(2)(B) of the Act, 15 U.S.C. 78s(b)(2)(B).

[14] See *e.g.*, Securities Exchange Act Release No. 39453 (December 16, 1997), 62 FR 67101 (December 23, 1997) (order approving Chicago Board Options Exchange's, Incorporated) (''Amex'' proposal to list and trade options based on the Dow Jones High Yield Select 10 Index). See also, CBOE Rule 24.2.

[15] See *e.g.*, Securities Exchange Act Release No. 39079 (September 15, 1997), 62 FR 49543 (September 22, 1997) (order approving American Stock Exchange's Incorporated (''Amex'') proposal to list and trade warrants based on the ING Barings, Inc.'s BEMI Latin America Index (''BEMI Latin America Index Order'')). See also, Amex Rules 1100–1110 and Section 106 of the Amex Company Guide.

[16] See *e.g.*, Securities Exchange Act Release No. 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) (order approving Amex rules to provide for the listing and trading of PDRs, and specifically PDRs based on the Standard and Poors Corporation (''S&P'') 500 Index known as SPDRs). See also, Amex Rules 1000–1004.

[17] See *e.g.*, Securities Exchange Act Release No. 36505 (November 22, 1995) 60 FR 61277 (November 29, 1995) (order approving Philadelphia Stock Exchange's, Incorporated (''Phlx'') proposal to list and trade dollar-denominated delivery foreign currency options on the Japanese Yen). See also, Phlx Rule 1000.

[18] See *e.g.*, Securities Exchange Act Release No. 36947 (March 8, 1996) 61 FR 10606 (March 14, 1996) (order approving Amex proposal to list and trade index fund shares that are series of the World Equity Benchmark Shares issued by Foreign Fund, Inc. and based on 17 Morgan Stanley Capital International indices). See also, Amex Rules 1000A–1003A.

[19] See *e.g.*, Securities Exchange Act Release No. 32345 (May 20, 1993), 58 FR 30833 (May 27, 1993) (order approving the listing and trading of ELNs on the Amex). See also, Section 107B of the Amex Company Guide.

[20] 15 U.S.C. 78s(b)(3).

[21] 15 U.S.C. 78s(b)(3)(A)(iii).

[22] 17 CFR 240.19b–4(e). As discussed in V. *Technical Changes*, infra, existing Rule 19b–4(e) is being redesignated as Rule 19b–4(f).

[23] Securities Exchange Act Release No. 34157 (June 3, 1994) 59 FR 30062 (June 10, 1994) (order approving generic narrow-based index options listing standards for the Amex, the CBOE, the New York Stock Exchange Incorporated, (''NYSE''), the Pacific Exchange, Inc. (''PCX''), and the Phlx (''Generic Narrow-Based Index Option Approval Order'')). Moreover, as of April 28, 1997, the NYSE transferred its options business to the CBOE. See Securities Exchange Act Release Nos. 38541 and 38542 (April 23, 1997) 62 FR 23516 and 23521 (April 30, 1997) (orders approving proposed rule changes by the CBOE and NYSE, respectively, regarding the transfer of the NYSE's options business to the CBOE). These SROs are the only U.S. exchanges that list standardized options products, which are issued, cleared, and settled through The Options Clearing Corporation (''OCC'').

[24] Securities Exchange Act Release Nos. 37007 (March 21, 1996) 61 FR 14165 (March 29, 1996) (Amex, CBOE, and Phlx) and 37445 (July 16, 1996) 61 FR 38494 (July 24, 1996) (NYSE) (orders approving uniform listing and trading guidelines for narrow-based stock index warrants (''Generic Narrow-Based Index Warrant Approval Orders'')).

[25] Securities Exchange Act Release No. 36296 (September 28, 1995) 60 FR 52234 (October 5, 1995) (order approving the National Association of Securities Dealers', Incorporated (''NASD'') proposal to adopt uniform listing and trading guidelines for broad-based index warrants on the NASD's Automated Quotation Stock Market).

[26] Securities Exchange Act Release Nos. 36165 (August 29, 1995) 60 FR 46653 (September 7, 1995) (NYSE); 36166 (August 29, 1995) 60 FR 46660 (September 7, 1995) (PCX); 36167 (August 29, 1995) 60 FR 46667 (September 7, 1995) (Phlx); 36168 (August 29, 1995) 60 FR 46637 (September 7, 1995) (Amex); and 36169 (August 29, 1995) 60 FR 36169 (CBOE) (September 7, 1995) (orders approving uniform listing and trading guidelines for index, currency and currency index warrants).

warrant or options trading. The Commission also has approved rules allowing for the listing of warrants overlying a single currency without a section 19(b) rule filing provided that the underlying currency has been approved for options trading.[27] Moreover, the Commission has approved rules allowing for the listing of warrants overlying a currency index without a section 19(b) rule filing provided the index previously has been approved by thee Commission pursuant to a section 19(b) rule filing.[28]

B. Reasons for Expanding the Scope of SRO Matters That Do Not Constitute Proposed Rule Change

Despite the streamlined procedures discussed above, the Commission believes that, consistent with investor protection, more can be done to speed the introduction of new derivative securities products. Over the years, the Commission has approved numerous SRO trading rules, procedures and listing standards for various classes of new derivative securities products. Based on this experience, the Commission believes that once it has approved, pursuant to section 19(b) of the ACT, an SRO's trading rules, procedures and listing standards for the product class that would include a new derivative securities product, the listing and trading of the new derivative securities product are reasonably and fairly implied by the SRO's existing trading rules, procedures and listing standards.[29]

SRO's are facing increasing competition from overseas and over-the-counter (''OTC'') derivatives markets.[30] SROs need to bring new derivative securities products to market quickly to provide investors with tailored products that directly meet their evolving investment needs. Although the existing generic rules have helped to speed the process of reviewing new derivative securities product proposals, the Commission now believes that further changes are warranted. Expanding the scope of SRO matters that do not constitute a proposed rule change to include the listing and trading of certain new derivative securities products will significantly speed the introduction of new derivative securities products and enable SROs to maintain their competitive balance with the overseas and OTC derivative markets. The amendment should foster innovation and create a streamlined procedure for SROs to promptly list new products subject to appropriate trading rules, procedures, surveillance programs and listing standards.

Moreover, the Commission believes that there is less need for SEC review, notice and approval prior to an SRO trading a new derivative securities product pursuant to existing trading rules, procedures, a surveillance program and listing standards. SROs have over 20 years of experience with SEC review of new derivative securities product proposals. SROs that have sought approval from the Commission to list and trade such new derivative securities products are familiar with the factors discussed in this release that must be considered when listing and trading such new derivative securities products. The procedures discussed below will enable the Commission to continue to effectively protect investors and promote the public interest.

III. Summary of Comments

In the proposing Release, commenters were asked whether the proposed amendment provides appropriate review of the listing and trading of new derivative securities products subject to existing trading rules, procedures, surveillance programs and listing standards. Commenters were asked whether more or less information was needed on Form 19b–4(e) for the effective Commission review.[31] The Commission received ten comment letters on the Proposing Release.[32] Commenters generally supported deeming the listing and trading of certain new derivative securities products to not be proposed rule changes pursuant to Rule 19b–4(c)(1). The majority of commenters recommended specific modifications to the Proposed Rule.

First, the Amex questioned what types of securities are covered by the definition of new derivative securities product due to other definitions of ''derivative securities,'' ''warrants'' and ''underlying instruments'' in other rules under the Act.[33] The Amex questioned whether the Commission intended to encompass securities under the amendment such as issuer call warrants, convertible securities and continent value rights (''CVRs'').[34] The same commenter suggested that ''(d)ue to the broad language of the [definition], SROs and issuers will be unable to determine whether the phrase 'any type of option' is limited to 'standardized options'.'' [35] The commenter also sought clarifications as to whether the qualifier ''any type of'' applies only to the word ''option'' or to the entire definition. In addition, the commenter ''request[ed] that the term 'hybrid securities product' be defined (in a manner) consistent with the CFTC prior statements and rulemaking.'' [36] The commenter also asked whether the words ''based upon''

[27] Supra note 26.

[28] Supra note 26.

[29] As the Commission noted in the Proposing Release, as is the current practice with equity issues, once an SRO has received approval for its trading rules, procedures and listing standards, the listing and trading of a specific new equity issue is not deemed a proposed rule change that requires a filing under Rule 19b–4 of the Act. Rather, an SRO can immediately list and trade a new equity issue so long as that equity issue satisfies the previously Commission approved trading rules, procedures and listing standards of the SRO.

[30] In order to further promote competition, the Commission has adopted, in a separate release issued today (Securities Exchange Act Release No. 40760 (December 8, 1998)), Rule 19b–5 under the Act that permits SROs to operate new pilot trading systems subject to certain conditions, for a period not to exceed two years, without submitting a Rule 19b–4 filing.

[31] Specifically, the Commission asked whether Form 19b–4(e) should require the SRO to cite its relevant standards under which it has listed a new derivative securities product. Commenters were also asked to discuss whether there were any legal or policy reasons why the Commission should consider a different approach in regulating new derivative securities products. The Commission did not receive any comments on these questions.

[32] The comment letters have been placed in Public File S7–13–98, which is available for inspection in the Commission's Public Reference Room. Commenters consisted of six SROs, two futures markets and one federal agency. See letters from: James E. Buck, Senior Vice President and Secretary, NYSE, dated May 27, 1998, (''NYSE Letter''); Jean A. Webb, Secretary, U.S. Commodity Futures Trading Commission (''CFTC''), dated May 29, 1998 (''CFTC Letter''); Charles J. Henry, President and Chief Operating Officer, CBOE, dated May 29, 1998 (''CBOE Letter''); Thomas R. Donovan, President and Chief Operating Officer, Chicago Board of Trade (''CBOT''), dated May 29, 1998 (''CBOT Letter''); T. Eric Kilcolin, President and Chief Operating Officer, Chicago Mercantile Exchange (''CME''), dated May 29, 1998 (''CME Letter''); James L. Duffy, Executive Vice President and General Counsel, Amex, dated July 2, 1998 (''Amex Letter'');' H. Warren Langley, President and Chief Operating Officer, PCX, dated July 6, 1998 (''Amex Letter''); H. Warren Langley, President and Chief Operating Officer, PCX, dated July 6, 1998 ''PCX Letter''(); Edity Hallahan, Vice President and Associate General Counsel, Phlx, dated July 24, 1998 (''Phlx Letter''); Alden S. Adkins, Senior Vice President and General Counsel, NASD Regulation, Incorporated ''NASDR''), dated July 29, 1998 (''NASD Regulation Letter''); and Joan C. Conley, Corporate Secretary, NASD, dated August 10, 1998 (''NASD Letter''). The NASDR Letter did not contain substantive comments, but rather merely stated that a substantive comment letter would be provided in August 1998 by the NASD. The NASD Letter provided no specific comments except to express that the NASD ''fully support(s) the (Proposing Release).'' NASD Letter at 2.

[33] Amex Letter at 3–6. See *Text of the Final Rule*, infra, for the complete definition of new derivative securities product.

[34] See also Amex Letter at 19 (requesting a list of SRO rule filings from prior years that would have satisfied the conditions of the amendment).

[35] Amex Letter at 4. See Section IV. D. *Compliance With Other Federal Securities Laws*, infra, for a more detailed discussion of ''standardized options.''

[36] Amex Letter at 5.

are intended to mean ''based in whole'' or ''based in part.''

Second, several commenters asked that the term ''product class'' be clarified. One commenter was concerned ''that, depending upon how the crucial term 'product class' is interpreted, the scope of the Propos(ed Rule) could be so restricted that it would have limited impact on the introduction of new derivative securities products in the listed markets.'' [37] The CBOE and PCX requested that the Commission ''clarify in the adopting release for the rule that the term 'product class' is to be construed broadly, perhaps providing examples of product classes and permissible changes to product class characteristics that would not require a rule filing under section 19(b) of the Act.'' [38] The CBOE believed that ''it is important for the adopting release to make it clear that 'product class' is to be interpreted broadly, so that the Propos(ed Rule) may fulfill its intended purpose of providing meaningful relief to SROs in connection with the introduction of new derivative (securities) products.[39]

Third, several commenters suggested that the Commission broadly interpret what is meant by the phrase ''existing SRO trading rules, procedures, surveillance programs and listing standards.'' One commenter ''urge(d) that the Commission be flexible in the degree of specificity it will require for the 'generic' listing standards and that, in adopting the proposal, it provide guidance as to what it will seek in such listing standards.'' The same commenters proposed ''that the required 'generic' standards provide a general description of the type of security authorized for listing, but not contain detailed specifications for the product.'' [40] Another commenter sought clarification as to whether ''a narrow-based index option must meet the current generic criteria index option listing standards.'' The commenter believed that ''more flexible generic listing standards are necessary to accommodate products that do not currently fit the generic option listing standards * * * but do not pose significant new legal or regulatory issues.'' [41] Another commenter ''assume(d) that * * * the Commission would not object to the establishment by SROs of broad ranges or formulas for position limits, margin requirements and other characteristics of (new) derivative securities products in the rules initially filed with the Commission for approval under section 19(b)(2) (of the Act,) thereby allowing SROs to avoid subsequent rule filings and approvals for changes to such rules or procedures that are within the previously approved ranges or formulas.'' [42]

Fourth, two commenters raised concerns regarding the requirement that SROs ''ensure'' that certain standards are met before listing and trading a new derivative securities product. One commenters found that the Proposed Rule ''appear(ed) to set forth high standards for SROs to satisfy in 'ensuring' that various conditions and requirements are satisfied, even extending to some areas that are beyond the SROs' control, with the suggestion that if some of these conditions and requirements are not met, the SRO would not be able to rely on the proposed amendment, and the listing of products in the absence of section 19(b)(2) filings and approvals would be in violation of the Act.'' [43] To avoid this possibility, the two SROs suggested that the Commission ''acknowledge in the adopting release that certain elements described as conditions in the Proposing Release, such as the requirement to maintain adequate systems capacity, are obligations of the SROs generally, and are not elevated to special status by virtue of the (Proposed Rule.'') [44] Such SROs suggested that the Commission ''indicate that the SROs may rely on the (Proposed R)ule provided they act in good faith in determining that the requirements of the (Proposed R)ule have been satisfied with respect to a particular product.'' [45]

Fifth, the Amex had several detailed questions regarding the standards that new derivative securities products in general, and index based new derivative securities products in particular, should meet in order to be consistent with the Act.[46] The Amex sought guidance regarding the requirement of SROs to obtain representations from relevant price reporting authorities regarding the systems capacity for each new derivative securities product.[47] The Amex also sought clarification regarding quotation dissemination for underlying securities not subject to transaction reporting, foreign securities and instruments that are not securities.[48] The Amex also requested more detailed information regarding the requirement that an index underlying a new derivative securities product be constructed according to established criteria for initial inclusion and maintenance of component securites.[49] For example, the Amex desired quanitiable standards regarding the number, weight and liquidity of component securities that an index should include and maintain.[50]

Sixth the Amex raised several detailed questions regarding comprehensive information sharing agreements (''ISAs'') with other markets.[51] Specifically, the Amex did not believe that the Commission should require an SRO to obtain the identity of the ultimate purchasers and sellers of securities pursuant to a comprehensive ISA because the Amex represents that, under an ISA, SROs ''do not have the authority to obtain information regarding the ultimate purchasers and sellers of securities even with respect to their own members trading in their own markets.'' [52] In addition, the Amex requested that the Commission provide a list of the comprehensive ISAs and SEC memoranda of understanding (''MOU'') with specific countries that SROs may rely upon when listing and trading new derivative securities products.[53] In addition, the Amex believed that ''it would be appropriate to interpret the Commission's (ISA) coverage standard (for index based new derivative securities products), if not

[37] CBOE Letter at 3.

[38] CBOE Letter at 7 and PCX Letter at 2.

[39] CBOE Letter at 3.

[40] NYSE Letter at 1 and 2.

[41] Phlx Letter at 1–2.

[42] CBOE Letter at 7–8.

[43] CBOE Letter at 4.

[44] CBOE Letter at 10 and PCX Letter at 2.

[45] PCX Letter at 2.

[46] Amex Letter at 10–12.

[47] Amex Letter at 10.

[48] Amex Letter at 10.

[49] Amex Letter at 6–10. The Amex suggests that, for purposes of classifying an index as broad-based, it is ''reasonable and appropriate for SROs to employ'' the criteria discussed in the Interpretation and Statement of General Policy issued by the SEC and the CFTC. Securities Exchange Act Release No. 20578 (January 18, 1984) 49 FR 2884 (January 24, 1984) (''Joint Policy Statement'').

[50] Amex Letter at 12. See also, Amex Letter at 18 (requesting that Commission provide a detailed list of materials that SROs would need to maintain in order to be in compliance with the amendment) and Phlx Letter at 2. The Phlx believes that ''the criteria outlined in the (Proposed Release) require an underlying index.'' Therefore, the Phlx believes that ''many other (new) derivative (securities) products, such as foreign currency options or unit investment trusts (referred to herein as PDRs), do not fall under the standards set forth in the Proposing Release. In addition, the CBOE believes that the Proposing Release does not indicate whether current surveillance procedures are adequate for purposes of Rule 19b–4(e) or whether there are unique issues presented by new derivative securities products that will require new surveillance procedures. CBOE Letter at 4 and 11.

[51] Amex Letter at 14–16. All comments regarding this issue were submitted by the Amex. See Section IV. B. *Information Sharing Agreements*, 1 infra, for a complete discussion of comprehensive ISAs.

[52] Amex Letter at 14.

[53] Amex Letter at 16.

eliminated in its entirety, to call for 50% coverage.'' [54]

Seventh several commenters raised issues regarding the Proposed Rule's interacdtion with the SEC's review of stock index futures products. The commenters suggested that the Commission ''develop an expedited procedure for reviewing applications of futures exchanges to trade stock index futures contracts.'' [55] Two comments were also concerned that a securities exchange could use its authority under the Proposed Rule to trade a futures contract. These commenters requested that the Proposed Rule ''be refined to make certain that no securities exchange could use the proposal to try to trade a futures contract under the guise of a new derivative securities product.'' [56] Additionally, several commenters sought clarification regarding the implications of a securities exchange categorizing an index as broad-based or narrow-based.[57] One commenter ''believe(d) that the SEC should make it clear that the classification decision made by the securities exchange is in no way binding on a later application from a futures exchange to trade futures contracts based on the same index.'' [58]

Eighth, several commenters asked about the public availability of Form 19b–4(e) filed by an SRO. One commenter noted that ''(w)hile the (Proposing) Release is silent on the issue, we assume that (any Form 19b–4(e) filed by an SRO) will be (a) public document.'' The same commenter suggests that ''the Commission could make (any Form 19b–4(e) filed by an SRO) available on its (w)eb site.'' [59] The CFTC requested that the SEC provide the CFTC ''with immediate notice of (new derivative securities products) listed pursuant to (Rule 19b–4(e) in order to permit the CFTC to monitor developments and to make a determination whether any action is necessary.'' [60]

Ninth, several commenters requested that the Commission take additional steps to enhance the timeliness of the rule filing process under section 19(b) of the Act. One commenter requested that ''the Commission make available a list of SRO rule filings from prior years that could have employed (the amendment to Rule) 19b–4.'' [61] One commenter ''recommend(ed) that the Commission consider exercising its authority under section 19(b((3)(A) to permit SRO (new) derivative securities products that do not otherwise qualify under Rule 19b–4(e) (of the Act) to become effective upon filing, subject to the Commission's authority to abrogate such rules pursuant to section 19(b)(3)(C) of the Act.'' [62] In addition, the commenters believed that ''the rule filing process, in general, could be shortened if SRO rules that are submitted to the Commission in proper form were published for notice and comment immediately, or within a set period of time, such as ten business days.'' [63] On a related issue, at least one commenter believed that amendments to existing derivative securities products, such as splitting an index or changing the exercise style should not require filing a proposed rule change pursuant to section 19(b)(2) of the Act. The same commenter ''believe[d] that any modifications to (new) derivative (securities) products should be effective upon filing [an amendment to Form] 19b–4(e).'' [64]

IV. Discussion

A. Definition of ''New Derivative Securities Product''

In the Proposing Release, the Commission proposed to define ''new derivative securities product,'' for purposes of section 19(b) of the Act and Rule 19b–4 thereunder, to be ''any type of option, warrant, hybrid securities product or any other security, the value of which is based upon the performance of an underlying instrument.''

As previously noted, at least one commenter requested clarification regarding specific terms used in the definition.[65] Use of such terms in other rules does not govern the terms used in Rule 19b–4(e). The definition of ''derivative securities'' in Rule 16a–1(c) under the Act ''shall apply solely to section 16 and the rules thereunder.'' [66] Similarly, Rule 12a–4(a) under the Act states that ''(w)hen used in this rule, the following terms shall have the meaning indicated.'' ''Warrant'' is then defined in Rule 12a–4(a)(1).[67] Finally, the term ''underlying instrument'' is defined in Rule 15c3–1 for use in computing a broker-dealer's net capital requirements. The Commission also notes that it proposed, and is adopting, the defined term ''new derivative securities product'' in the amendment to Rule 19b–4 solely for purposes of determining whether an SRO would be required to file a proposed rule change under Section 19(b) of the Act and Rule 19b–4 thereunder.

In response to the Amex's question,[68] the Commission did not intend to include traditional issuer warrants [69] and traditional convertible securities in the definition of new derivative securities product under the amendment to Rule 19b–4.[70] Therefore, SROs that have listing standards, trading rules and procedures approved by the Commission for traditional issuer warrants and traditional convertible securities are not required to submit Form 19b–4(e) when listing specific traditional issuer warrants and traditional convertible securities.

The Commission notes, however, that when CVRs were first developed, the SROs that sought to list them were required to submit for Commission approval CVR listing standards, trading

[54] Amex Letter at 16.

[55] CME Letter at 2. See also CBOT Letter at 2 and CFTC Letter at 2.

[56] CFTC Letter at 2. See also CME Letter at 2.

[57] For example, the Amex believes ''that once a determination is made as to the classification of an index as broad-based or narrow-based, the classification should remain unchanged given the important consequences that flow from the classification.'' Amex letter at 9.

[58] CME Letter at 3. See also CBOT Letter at 2 noting that the SEC should ''independently review a futures exchange's application, not *de facto* abdicate its statutory responsibility to the securities exchanges.''

[59] NYSE Letter at 2.

[60] CFTC Letter at 2.

[61] Amex Letter at 19.

[62] CBOE Letter at 12–13. See also Phlx Letter at 2 suggesting that ''combined notice and accelerated approval for new [derivative securities] products would further streamline the process by eliminating the time period between notice for comment and approval.''

[63] CBOE Letter at 13 and PCX Letter at 2.

[64] Phlx Letter at 2.

[65] See Amex Letter at 3–6, notes 33, 35 and 36, supra.

[66] 17 CFR 240.16a–1 The Commission notes that the definition of ''derivative securities'' found in Rule 16a–1 is for the purpose of requiring reports disclosing the beneficial ownership of directors, officers and principal stockholders of equity securities registered under 12 of the Act.

[67] Rule 12a–4(a)(1) defines the term ''warrant'' for purposes of determining whether a warrant is exempt from registration under section 12(a) of the Act.

[68] See Amex Letter at 4, supra note 33.

[69] The Commission believes that traditional issuer warrants do not include such things as third party warrants on individual securities.

[70] In addition, in response to the Amex's request that the Commission define the term ''hybrid securities product'' (see Amex Letter at 5, note 36, supra), the Commission is aware that the CFTC has issued statements regarding the term ''hybrid securities product'' for purposes of determining whether a particular product ''combines characteristics of futures contracts or commodity options with debt, depository or preferred equity interests.'' See ''Statutory Interpretation Concerning Certain Hybrid Instruments'' 55 FR 13582 (April 11, 1990). The Commission understands the Amex's desire to ''avoid possible market disruption or uncertainty'' (see Amex Letter at 5) when listing new derivative securities products pursuant to the new amendment. The Commission, however, believes that an attempt to establish specific criteria for ''hybrid securities products'' would unduly limit an SRO's ability to develop new derivative securities products. Rather, the Commission believes that it would be better able to address an SRO's concern regarding the status of a particular ''hybrid securities product'' if the SRO consulted with the Commission regarding a product's specific characteristics at the time the product is being developed.

rules and procedures.[71] Under the amendment, if an SRO does not have listing standards, trading rules and procedures for CVRs approved by the Commission, such SRO must submit a proposed rule change for Commission approval, under section 19(b), to establish listing standards, trading rules and procedures for the CVR product class, prior to listing CVRs.

The Commission also seeks to clarify that the term ''any type of option'' is not limited to any type of ''standardized option.'' [72] Rather, the term ''any type of option'' includes any type of new derivative securities product that is an option such as a third party warrant on an individual security. The Commission also notes that, with the exceptions discussed above, the qualifier ''any type of'' applies to the entire definition. In addition, the Commission clarifies that the term ''based upon'' means ''based in whole or in part.'' [73]

The Commission also is revising the proposed definition of new derivative securities product in order to clarify that if a product's value is based, in whole or in part, ''upon the interest in'' an underlying instrument, such product is included within the term ''new derivative securities product.'' In accordance with these clarifications, the Commission is adopting paragraph (e) of Rule 19b–4 to define ''new derivative securities product,'' for purposes of section 19(b) of the Act and Rule 19b–4 thereunder, to be ''any type of option, warrant, hybrid securities product or any other security, the value of which is based, in whole or in part, upon the interest in, or performance of, an underlying instrument.''

1. New Derivative Securities Product Must Be a ''Security'' as Defined in Section 3(a)(10) of the Act

Several commenters expressed concern that the amendment may be interpreted to permit SROs to trade futures contracts.[74] In response, the Commission reiterates its statement that SROs have the authority to list and trade ''securities'' as defined in section 3(a)(10) of the Exchange Act.[75] The proposed amendment does not provide SROs with any new authority to list a new derivative product that is not a ''security.'' If an SRO sought to trade a new derivative product that is not a ''security,'' such as a futures contract, it would be required to adhere to requirements of the Commodity Exchange Act (''CEA''),[76] or other applicable laws, and the rules and regulations thereunder.[77]

Furthermore, the proposal will only apply to securities SROs. It will not apply to entities that seek designation as contract markets for futures trading on an index or group of securities or to foreign boards of trade that seek to sell their futures contracts to U.S. persons. Under the amendments to the CEA effected by the Futures Trading Act of 1982,[78] section 2(a)(1)(B) of the CEA prohibits any person from offering or selling a futures contract based on ''any group or index of such securities or any interest therein based on the value thereof'' except as permitted under section 2(a)(1)(B)(ii) of the Act. In response to commenters' suggestions that the Commission develop an expedited procedure for reviewing applications of futures exchanges to trade stock index futures contracts, the Commission will make every effort to continue to review requests in a timely fashion.[79] The CEA requires the CFTC to seek the views of the SEC regarding each such application concerning a stock index and the SEC may object to the designation on the ground that any of the statutory criteria have not been met. Section 2(a)(1)(B) also sets forth a specific timetable for review of contract market designation for index futures by the SEC. These statutory procedures are not affected by the amendment to Rule 19b–4.

2. Scope of the Amendment

An SRO seeking to list a completely new class of derivative securities product must submit a proposed rule change pursuant to section 19(b)(2) of the Act in order to adopt appropriate trading rules, procedures and listing standards for such class. These requirements are intended to promote fair and orderly trading for the class of securities the SRO seeks to trade and protect investors.[80] In response to commenters' concerns that the term ''product class'' may be interpreted so narrowly that it would prevent effective use of the amendment,[81] the Commission intends that the term be interpreted flexibly. Examples of ''product classes'' include, but are not limited to: Broad-based index options; broad-based index warrants; narrow-based index options; narrow-based index warrants; foreign currency index options; foreign currency index warrants; PDRs; index fund shares; and ELNs.[82]

An SRO is not required to submit Form 19b–4(e) when listing Market Index Target Term Securities (''MITTS'') or Stock Upside Note Securities (''SUNS'') overlying an index for which the SRO previously has listed options or warrants pursuant to Rule 19b–4(e) or for which the SRO previously has

[71] See *e.g.* Securities Exchange Act Release No. 34759 (September 30, 1994) 59 FR 50939 (October 6, 1994) (order approving listing and trading of CVRs, among other things, on the CBOE).

[72] See Section IV. D. *Compliance With Other Federal Securities Laws,* infra, for a more detailed discussion of ''standardized options.''

[73] As previously stated, the Proposing Release stated that ''any other security, the value of which is based upon the performance of an underlying instrument'' would be defined to be a ''new derivative securities product.'' The Commission believes that inserting the term ''in whole or in part'' clarifies the scope of the amendment's coverage.

[74] See note 56, supra.

[75] 15 U.S.C. 78(c)(1)(j). The term ''security'' as defined in section 3(a)(10) of the Exchange Act, includes, among other instruments, ''any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to a foreign currency, or in general, any instrument commonly known as a 'security'.''

[76] 7 U.S.C. 1 *et seq.*

[77] In response to the CFTC's request that the Commission provide the CFTC with immediate notice of new derivative products listed pursuant to the amendment (see CFTC Letter at 2, supra note 60), the Commission notes, as it previously stated in the Proposing Release, that when an SRO submits trading rules, procedures and listing standards for a particular product class to the Commission for approval pursuant to section 19(b) of the Act, the Commission publishes notice of the proposed rule change and provides an opportunity for public comment. It is during this period that interested parties, including the CFTC and futures markets, may comment upon such issues as the characteristics of the specific product class, including whether or not they believe the product class has attributes of a futures contract. In addition, the Commission reminds commenters that it stated in the Paperwork Reduction Act section of the Proposing Release and the Instructions for Completing Form 19b–4(e) that the public has access to the information contained in Form 19b–4(e). The Commission now clarifies that upon being filed by an SRO, Form 19b–4(e) will be publicly available through the Commission's Public Reference Room. In addition, the Commission will endeavor to make the Forms available on the Commission's web site (see NYSE Letter at 2, supra note 59 and Proposing Release, supra note 1).

[78] 7 U.S.C. 2(a)(1)(B).

[79] See note 55, supra.

[80] The Commission notes that several exchanges have adopted listing standard categories termed ''other securities.'' These standards were adopted to allow the listing of securities that contain features borrowed from more than one category of currently listed securities, such as hybrid new derivative securities products that have characteristics of both common stock and debt securities. The Commission has clearly stated and reiterates its belief that such standards ''are not intended to accommodate the listing of securities that raise significant new regulatory issues, and, therefore, would require a separate filing with the Commission pursuant to Rule 19b–4 under the Act.'' Securities Exchange Act Release No. 28217 (July 18, 1990) 55 FR 30056 (July 24, 1990). Accordingly, an SRO could not avoid the requirement of adopting appropriate listing standards in order to rely on the amendment for a novel new derivative securities product by simply listing such product under the ''other security'' category.

[81] See note 39, supra.

[82] See notes 14, 15, 16, 17, and 18, supra.

received Commission approval under section 19(b) for option or warrant trading, provided that the SRO has received Commission approval under section 19(b) to establish listing standards for ''other securities.'' [83] The listing of MITTS or SUNS on such indices does not raise any new regulatory issues that the Commission had not previously considered. If, however, an SRO sought to list MITTS or SUNS overlying an index for which the SRO had not previously listed options or warrants pursuant to Rule 19b–4(e) or for which the SRO had not previously received Commission approval under section 19(b) for option or warrant trading, such SRO would be required to: Receive Commission approval for trading rules, procedures and listing standards for MITTS or SUNS product classes; or consult with the Commission, prior to listing an individual MITTS or SUNS, in order to determine whether such new individual MITTS [84] or SUNS [85] raised any new regulatory issues that would preclude the SRO from relying on its ''other securities'' listing standards and therefore require a proposed rule change pursuant to section 19(b).

Commenters sought guidance regarding the specific criteria that should be included in trading rules, procedures and listing standards.[86] The Commission, however, has determined not to specify criteria in this release. Rather, the Commission believes that it would be better able to provide assistance to an SRO in establishing specific criteria after an SRO has considered what trading rules, procedures and listing standards best suit its need and has submitted a proposed rule change under section 19(b) to the Commission for its review.[87]

In addition, several commenters raised concerns regarding how the term existing SRO ''trading rules, procedures, surveillance programs and listing standards'' should be interpreted. Trading rules, procedures, surveillance programs and listing standards for specific product classes should be flexible enough to permit innovation within a product class while maintaining compliance with section 6(b)(5) of the Act which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principals of trade, and in general, to protect investors and the public interest. For example, the Commission has approved trading rules, procedures and listing standards for generic narrow-based index options.[88] An SRO can use these trading rules, procedures and listing standards to list and trade narrow-based index options or it can submit new trading rules, procedures and listing standards for narrow-based index options to the Commission for approval pursuant to section 19(b).[89] With regard to product classes that currently do not have trading rules, procedures and listing standards, as one commenter suggests, the Commission generally would encourage SROs to establish ranges or formulas for position limits, margin requirements and other characteristics of new derivative securities products.[90]

Procedures include, but are not limited to, adequate procedures relating to sales practices (including suitability), margin and disclosure requirements. The SRO also must have a surveillance program adequate to monitor for abuses in the trading of the new derivative securities product, including trading in the underlying security or securities. Once an SRO has submitted, and the Commission has approved, a section 19(b)(2) proposal to establish an appropriate regulatory framework for a new class of new derivative securities product, the SRO would qualify under the amendment for further new derivative securities products under the same class. For example, if an exchange without any options rules sought to trade options, it would first need to file a rule change, pursuant to Rule 19b–4, to adopt appropriate trading rules, procedures and listing standards that apply to options. In addition, the amendment does not relieve an SRO from its obligation to submit a proposed rule change when amending existing listing standards for particular classes of securities.

B. Standards for All New Derivative Securities Products

The amendment is based upon the experience that the Commission has obtained through its review of new derivative securities product proposals by the SROs. Over the years, the Commission has identified the criteria it believes new derivative securities product proposals must meet in order to be consistent with the Act.[91] Two commenters were concerned that the standards discussed in the Proposing Release have always been obligations of the SROs generally, and should not be elevated to a special status under the amendment.[92] The Commission does not intend to revise standards that SROs currently are required to maintain, such as adequate systems capacity, to be

[83] See Amex Letter at 6.

[84] See *e.g.*, Securities Exchange Act Release No. 32840 (September 2, 1993) 58 FR 47485 (September 9, 1993) (order approving NYSE proposal to list and trade global telecommunications MITTS). See also, Section 703.19 of the NYSE Listed Company Manual.

[85] See *e.g.*, Securities Exchange Act Release No. 35886 (June 23, 1995) 60 FR 33884 (June 29, 1995) (order approving Amex proposal to list and trade SUNS on the Lehman Brothers European Stock Basket). See also, section 107 of the Amex Company Guide.

[86] See note 40, supra.

[87] The Commission does not believe, however, that the SROs that currently have the authority to list standardized options could list broad-based index options pursuant to Rule 19b–4(e) without first receiving Commission approval under section 19(b) for listing standards for a broad-based index option class. See, Section IV. C. 1. *Designation Of Index As Broad-Based Or Narrow-Based*, infra.

[88] See note 23, supra.

[89] The Commission notes that the Generic Narrow-Based Index Option Approval Order was drafted to require a filing under section 19(b)(3)(A) of the Act for Commission approval if an SRO sought to list and trade options that satisfied the criteria of the Generic Narrow-Based Index Option Approval Order. Therefore, in order to rely on the amendment adopted today and not submit filings pursuant to section 19(b)(3)(A) for options that satisfy the criteria of the Generic Narrow-Based Index Option Approval Order, and SRO could submit a proposed rule change for Commission approval to eliminate the section 19(b)(3)(A) rule filing requirement from its existing rules (see *e.g.* CBOE Rule 24.2). In the alternative, an SRO could submit a proposed rule change to the Commission for approval of completely new listing standards, trading rules and procedures in order to rely on the amendment to Rule 19b–4 for purposes of listing and trading narrow-based index options.

[90] In response to commenters' request that SROs be permitted to submit proposed rule changes that are effective immediately upon filing, pursuant to section 19(b)(3)(A), in order to list and trade new derivative securities that do not satisfy the provisions of Rule 19b–4(e) (see CBOE Letter at 12–13 and Phlx Letter at 2, supra note 62), the Commission must consider investor protection when determining such a request. In order to utilize Rule 19b–4(e), an SRO must have in place adequate trading rules, procedures, surveillance programs and listing standards that pertain to the class of securities covering the new product. Because a proposed rule change submitted pursuant to section 19(b)(3)(A) is effective immediately upon filing and is not subject to Commission review and approval, the Commission is concerned that the approach suggested by commenters could be used as an attempt to list and trade new derivative products without developing adequate listing standards, trading rules and procedures for such products. As a result, the Commission believes that it would not be appropriate in the public interest to permit SROs to submit proposed rule changes that are effective immediately upon filing, pursuant to section 19(b)(3)(A), in order to list and trade new derivative securities that do not satisfy the provisions of Rule 19b–4(e).

[91] The Commission wishes to clarify, in response to commenters' concerns, that the criteria discussed in Section IV. B. *Standards For All New Derivative Securities Products* applies to all new derivative securities products including index based new derivative securities products. The criteria in Section IV. C. *Additional Standards For Index Based New Derivative Securities Products*, infra, applies only to index based new derivative securities products. See Phlx Letter at 2, supra note 50. Accordingly, an SRO can utilize the amendment for non-index based and index-based new derivative securities products provided that the applicable criteria are satisfied.

[92] See note 44, supra.

raised to a more important level under the amendment.

Additionally, these commenters noted that some requirements described in the Proposing Release, such as the functional separation between the trading desk of a broker-dealer and the research persons responsible for maintaining an index underlying a new derivative securities product, extend beyond the control of SROs.[93] As a result, these commenters believe that SROs should not be held to a higher standard than what they are currently held to, for the failure of unaffiliated entities to satisfy certain requirements of the amendment.[94] The Commission does not intend to impose new surveillance requirements on SROs through this amendment. Rather, the Commission believes that SROs should continue to obtain written representations, as they currently do, that the broker-dealer has procedures in place that provide for a functional separation between the trading desk and research department of the broker-dealer and that ensure compliance with the functional separation.

Therefore, in order to rely on the amendment, an SRO should determine, in a manner consistent with the standards that have been required of SROs in the past,[95] that each new derivative securities product meets the criteria for: Design and maintenance of the instruments or index underlying the new derivative securities product; customer protection rules; surveillance of the component securities; and the potential market impact of the new derivative securities product.[96] Specifically, an SRO should determine that it has adequate information sharing agreements, clearance and settlement procedures, systems capacity and transaction reporting procedures for underlying securities.

1. Information Sharing Agreements

In designing a new derivative securities product, the SRO should determine that it has adequate information sharing procedures to detect and deter potential trading abuses. It is essential that the SRO have the ability to obtain the information necessary to detect and deter market manipulation, illegal trading and other abuses involving the new derivative securities product. Specifically, there should be a comprehensive ISA that covers trading in the new derivative securities product and its underlying securities in place between the SRO listing or trading a derivative product and the markets trading the securities underlying the new derivative securities product.[97] Such agreements provide a necessary deterrent to manipulation because they facilitate the availability of information needed to fully investigate a manipulation if it were to occur.

For new derivative securities products based upon domestic securities, the SRO should determine that the markets upon which all of the U.S. component securities trade are members of the Intermarket Surveillance Group (''ISG'').[98] The ISG was formed to coordinate, among other things, effective surveillance and investigative information sharing arrangements in the stock and options markets.[99] For new derivative securities products based on securities from a foreign market, the SRO should have a comprehensive ISA with the market for the securities underlying the new derivative securities product. The SRO should determine that there are no blocking or secrecy laws in the foreign country that would prevent or interfere with the transfer of information under the comprehensive ISA.[100] If securing a comprehensive ISA is not possible, the SRO should contact the Commission prior to listing the new derivative securities product. In such instances, the Commission may determine that it is appropriate instead to rely on an between the Commission and the foreign regulator.[101]

For a new derivative securities product overlying an instrument with component securities from several countries, the Commission recognizes that it may not be practical in all instances to secure comprehensive ISAs with all of the relevant foreign markets. Foreign countries' securities or ADRs that are not subject to a comprehensive ISA should not represent a significant percentage of the weight of such an underlying instrument.[102] The Commission recognizes that commenters sought guidance regarding the percentage of comprehensive ISA coverage standard for index based new derivative securities products.[103] The Commission is not specifying thresholds for ISA coverage. Rather, the Commission will provide assistance to an SRO in formulating the appropriate percentage of comprehensive ISA coverage after an SRO has considered what standard best suits the needs of a specific product class and has submitted a proposed rule change for Commission approval in order to establish listing

[93] See note 43, supra. See also Section IV. C. 4. *Functional Separation Letter*, infra.

[94] The Proposing Release proposed that SROs ''ensure'' that the standards discussed below were satisfied in order to rely on the amendment.

[95] The Commission notes that an SRO currently must determine that a new derivative securities product satisfies the SRO's listing standards, trading rules and procedures, prior to listing such new derivative securities product. The Commission seeks to clarify that the standard for listing a new derivative securities product under new Rule 19b–4(e) is no different.

[96] As discussed in Section IV. G. *Compliance With The Proposed Amendment*, if an SRO has not complied with the standards, the SRO will not be permitted to rely on the new rule 19b–4(e).

[97] In response to the Amex's comments regarding an SRO's ability to obtain the identity of the *ultimate* purchasers and sellers of securities pursuant to a comprehensive ISA, (See Amex Letter at 14, supra note 52), the Commission believes that a comprehensive ISA should require that the parties provide each other, upon request, information about market trading, clearing activity and customer identity necessary to conduct an investigation.

[98] See ISG Agreement, dated July 14, 1983, amended January 20, 1990. The ISG members are: the Amex; the Boston Stock Exchange, Incorporated; the CBOE; the Chicago Stock Exchange, Inc.; the Cincinnati Stock Exchange, Incorporated; the NASD; the NYSE; the PCX; and the Phlx. The major stock index futures exchanges joined the ISG as affiliate members in 1990.

[99] The Commission anticipates that systems that currently are not national securities exchanges, or systems that have not yet been developed, may register as national securities exchanges, and therefore be regulated as an SRO, as a result of the companion release adopted today (see Securities Exchange Act Release No. 40760 (December 8, 1998), supra note 30). Therefore, if a new SRO trades component securities underlying a new derivative securities product and is not a member of the ISG, the SRO seeking to list and trade such new derivative securities product pursuant to Rule 19b–4(e) should enter into a comprehensive ISA with the non-ISG SRO. Conversely, if a new SRO seeks to list and trade a new derivative securities product pursuant to Rule 19b–4(e) and is not a member of the ISG, such SRO should enter into a comprehensive ISA with each SRO that trades securities underlying the new derivative securities product.

[100] The Commission believes that in order for an SRO to determine that a foreign country has no blocking or secrecy laws that would prevent or interfere with the transfer of information pursuant to a comprehensive ISA, an SRO can obtain written verification in the comprehensive ISA or in a separate letter.

[101] An MOU provides a framework for mutual assistance in investigatory and regulatory matters. Generally, the Commission has permitted an SRO to rely on an MOU in the absence of a comprehensive ISA only if the SRO receives an assurance from the Commission that such an MOU can be relied on for surveillance purposes and includes, at a minimum, the transaction, clearing and customer information necessary to conduct an investigation. See Securities Exchange Act Release No. 35184 (December 30, 1994) 60 FR 2616 (January 10, 1995) (order approving the listing and trading of warrants on the CBOE overlying the Nikkei Stock Index 300 where there was no comprehensive ISA between the CBOE and the underlying market, the Tokyo Stock Exchange but there was an MOU between the SEC and the Japanese Ministry of Finance). In addition, an SRO should endeavor to develop comprehensive ISAs with foreign exchanges that trade the underlying securities of an index even if the SRO receives prior Commission approval to rely on an MOU in place of a comprehensive ISA.

[102] If, however, a foreign security had more than 50% of its global trading volume in dollar value in U.S. markets, the Commission, in the past, has treated such security as a U.S. security.

[103] See Amex Letter at 16, supra note 54.

standards that includes the percentage of comprehensive ISA coverage.[104]

As previously stated, commenters sought clarification regarding the validity of comprehensive ISAs and MOUs with specific foreign countries in order not to contact the Commission prior to listing new derivative securities products.[105] The Commission notes that a current comprehensive ISA or MOU may not be valid in the future due to political or legal changes in a particular foreign country. Therefore, while the Commission understands the SROs' desire for certainty, it does not believe that it is prudent to provide a list of currently comprehensive ISAs and MOUs that may be invalid at the future time an SRO seeks to list a new derivative securities product.[106] An SRO may, however, contact the Commission, at any time, as it develops new derivative securities products to clarify that relevant comprehensive ISAs and MOUs are still valid and to inquire if any new comprehensive ISAs or MOUs have been determined to be valid. In addition, the Commission will continue to work with the SROs, as it has in the past, to develop MOUs with countries in which SROs are unable to sign comprehensive ISAs.

2. Clearance And Settlement

The calculation of the settlement value for the new derivative securities product should be clear, fixed and objective. In order to minimize market impact concerns, a new derivative securities product overlying an index of U.S. securities generally should be settled based on opening prices of the component stocks. If opening price settlement is not utilized, the settlement value should reflect the last available closing prices prior to settlement for the underlying securities or some alternative objective settlement measurement. If the new derivative securities product is settled in foreign currency, a recognized exchange rate should be used to convert the settlement value into U.S. dollars. In addition, the SRO should determine that adequate clearance procedures have been established for the new derivative securities product.

3. Systems Capacity For New Derivative Securities Products

It is essential that the SRO and the applicable authority responsible for collecting last sale data have adequate systems processing capacity to accommodate the listing and trading of a new derivative securities product. The SRO should, prior to listing a new derivative securities product, determine that it has adequate systems processing capacity to accommodate the new listing and obtain a representation from the applicable authority responsible for collecting ''last sale data'' that such authority also has adequate systems processing capacity.[107]

In addition, in most circumstances, when the new derivative securities product is index based, an index value should be disseminated frequently and, if based on U.S. equities only, should reflect last-sale prices. If an index is composed of both U.S. and foreign securities, prices for all securities that trade on markets that are open during U.S. trading hours should be disseminated promptly, and if practicable, at least every 15 seconds. Dissemination of an index value based in whole or in part on closing prices of component securities should occur only for those component securities where the underlying markets are closed during U.S. trading hours (the disseminated index value may still be adjusted for currency fluctuations) or the underlying component value itself is not calculated real-time (*e.g.*, indices of open-end mutual funds that report net asset value at the close of trading).[108] Certain indices may use quotes (*e.g.*, a bond index) if last sale prices are unavailable and the quotes are reliable and spread across multiple dealers.

4. Transaction Reporting of Underlying Instruments

In order to prevent manipulation and ensure liquidity of instruments underlying a new derivative securities product, underlying equity securities should be listed on a national securities exchange or traded through the facilities of a national securities association or otherwise subject to real-time public transaction reporting.[109] For securities that are not subject to transaction reporting (*e.g.*, municipal securities), there should be an objective means of capturing price information through disseminated quotations.[110]

In response to the Amex's request for clarification regarding the reporting requirements of underlying instruments, the Commission believes that, in order to prevent fraudulent and manipulative acts and practices and to protect investors and the public interest, underlying foreign securities also should be subject to real-time transaction reporting for an SRO to avail itself of Rule 19b–4(e). For individual foreign securities underlying a new derivative securities product, an SRO should determine that such securities satisfy and maintain all criteria described in this release including the transaction reporting requirement. In the case of multiple foreign securities underlying a new derivative securities product, the Commission believes that no more than a *de minimis* percentage of the weight of the underlying foreign securities should be non-real-time reported. In the case of underlying instruments that are not securities, such as foreign currencies, the Commission believes that the same investor protection concerns are applicable and therefore the SROs should endeavor to satisfy the standards set forth above.[111]

[104] See *e.g.*, Securities Exchange Act Release No. 40157 (July 1, 1998) 63 FR 37426 (July 10, 1998) (order approving the listing and trading of options on PDRs and index fund shares on the Amex) for a discussion of an appropriate percentage of comprehensive ISA coverage for the specific product class of options on PDRs and index fund shares.

[105] See Amex Letter at 16, supra note 53.

[106] In addition, the Commission seeks to clarify that if an SRO lists a new derivative securities product involving a comprehensive ISA that is valid at the time the SRO relies on Rule 19b–4(e) but subsequently becomes invalid due to political or legal changes in the foreign country, the SRO should contact the Commission to determine what actions should be taken.

[107] The Commission notes that the language in the Proposing Release required SROs to obtain representations regarding systems capacity from applicable price reporting authorities. The Commission has revised the language to require an SRO to obtain a representation from the applicable authority responsible for collecting ''last sale data,'' as that term is defined in Rule 11Aa3–1 under the Act. Based on comments received in response to the Proposing Release (see Amex Letter at 10, supra note 47), the Commission believes that the previous language could be interpreted to be limited only to standardized index options. As a result, the Commission believes that this revision is appropriate in order to encompass all new derivative securities products that an SRO may list and under the amendment to Rule 19b–4.

[108] Securities Exchange Act Release No. 39244 (October 15, 1997) 62 FR 55289 (October 23, 1997).

[109] The Commission notes that this section in the Proposing Release generally referred to underlying securities. Based on comments received, the Commission has revised this section to include all underlying instruments, such as foreign currencies underlying a new derivative securities product (see Amex Letter 10, supra note 48).

[110] In the case of securities that are not subject to real-time transaction reporting (*e.g.*, municipal securities), bids and offers disseminated by dealers through electronic means, provided that services are generally used by industry participants and contain a reasonable number of bids and offers entered with reasonable frequency, may be used as an objective means of capturing price information through disseminated quotations (see Amex Letter at 10, supra note 48). See generally, Securities Exchange Act Release No. 39495 (December 29, 1997) 63 FR 585 (January 6, 1998).

[111] See Amex Letter at 10, supra note 48. See also, BEMI Latin America Index Order, supra note 15.

C. Additional Standards for Index Based New Derivative Securities Products

In addition to the items discussed above, in order to rely on Rule 19b–4(e), SROs should determine that if a new derivative securities product is index based: The index is classified properly as broad-based or narrow-based; the index is constructed according to established criteria for initial inclusion of new component securities; the index is maintained so that it measures the same segment of the market as originally intended; the index value is disseminated frequently; component securities that fail to meet the maintenance criteria are replaced according to established policies and procedures; and when the index is maintained by a broker-dealer, a functional separation exists between the broker-dealer's trading desk and research department.

1. Designation of an Index as Broad-Based or Narrow-Based

An SRO should first classify the underlying index as narrow-based (*i.e.*, containing securities from a specific industry sector or comprising a small group of securities) or broad-based (*i.e.*, a larger group of securities that is representative of the entire market or a substantial portion of the entire market).[112] In order to make a determination that an index is broad-based, the SRO should identify how the index represents the overall stock market or a substantial portion thereof. The SRO should undertake an analysis of the basis for such a determination. A mere conclusion by the SRO that an index has been designated as broad-based is not determinative of the status of the index.

For example, SROs need listing standards for broad-based index option classes even if they have been approved previously for a specific broad-based index option. Listing standards for specific broad-based index options have been determined on a case-by-case basis when such an SRO submits a section 19(b) rule filing and the Commission approves such filing.[113] In order for an SRO to avail itself of new Rule 19b–4(e) to trade broad-based index options, an SRO would need to propose general criteria for Commission review and approval for classifying indices as broad-based under Section 19(b) of the Act.[114]

As previously stated, commenters have concerns regarding the implications on the futures markets of a securities exchange categorizing an index as broad-based or narrow-based.[115] The Commission is required, under section 2(a)(1)(B) of the CEA, to analyze the composition of an index underlying a stock future in order to determine whether such index is broad-based. By its own terms, the CEA does not apply to index based derivative securities products that trade on securities SROs. Accordingly, when an SRO utilizes new Rule 19b–4(e) to list an index based new derivative securities product, the CEA will not be applicable. When the Commission reviews proposed listing standards for index based derivative securities products, it must find that such standards are consistent with the Exchange Act. The Commission also notes that, when it reviews a stock index for futures trading, the Commission is not bound by the determination of an SRO regarding the classification of an index as broad-based or narrow-based.

2. Initial Inclusion Standards and Maintenance Criteria for Index Components

The index underlying a new derivative securities product should be constructed according to established criteria for initial inclusion of new component securities. SROs seeking to rely on the proposed amendment should employ objective index construction standards that include a minimum number of component securities and a fixed and objective weighting methodology (*e.g.*, capitalization weighted, price weighted, equal-dollar weighted or modified equal-dollar weighted).[116] In addition, SROs must determine that the index construction standards applied to the underlying securities provide sufficient liquidity to reduce the potential for manipulation of the index's component securities. For example, the index construction criteria should include, among other things, a minimum price, available capitalization, average daily trading volume and value of each component security and establish a maximum relative weight for the top component and the five largest components. Maintenance criteria should be designed to provide that an index that has derivative products overlying it continues to measure the same segment or sector of the market as originally intended, remains composed of liquid securities, and does not become dominated by one (or a few) component(s).[117]

The Commission recognizes that commenters to the Proposing Release sought detailed information regarding the initial inclusion and maintenance of component securities and quantifiable standards regarding the number, weight, and liquidity of component securities that an index should maintain.[118] The Commission, however, has determined not to impose specific criteria on SROs regarding derivative securities products discussed in this release. The specific criteria should be based on the trading rules, procedures and listing standards that best suit the needs of a particular class of new derivative securities products and discussed with the Commission when a proposed rule change is submitted to the Commission for its review.[119]

3. Component Changes

SRO listing standards should provide that component securities that fail to meet the index maintenance standards

[112] Such a classification is necessary because regulatory requirements such as position limits and margin levels are different for narrow-based and broad-based index options. See *e.g.*, CBOE Rules 24.4, 24.4A and 24.11.

[113] The Commission deos not believe, for example, that, absent a Commission approval order under Section 19(b) establishing specific criteria for a particular index, CBOE Rule 24.2 regarding ''Designation of an Index'' provides adequate listing standards for a broad-based index option class. CBOE Rule 24.2 states that ''the component securities of an index option contract need not meet the requirements of Rule 5.3 (Criteria for Underlying Securities). The listing of a class of index options on a new underlying index will be treated by the (CBOE) as a proposed rule change subject to filing with and approval by the (SEC) under section 19(b) of the Act.'' Similarly, the Commission does not believe that, absent a Commission approval order under section 19(b) establishing specific criteria for a particular index, Amex Rule 901(C) regarding ''Designation of Stock Index Options'' provides adequate listing standards for a broad-based index option class.

[114] The Commission does not believe that it is ''reasonable and appropriate for SROs to employ'' the criteria discussed in the Joint Policy Statement (Amex Letter at 6–10, supra note 49) for purposes of classifying an index as broad-based. Rather, the Commission believes that an SRO should develop specific listing standards, trading rules and procedures that the SRO believes adequately address the needs of a particular class of new derivative securities and submit such listing standards, trading rules and procedures as a proposed rule change for Commission review under section 19(b) of the Act. Supra note 87.

[115] See CME Letter at 3, supra note 58 and Amex Letter at 9, supra note 57.

[116] *See* Generic Narrow-Based Index Option Approval Order, supra note 23 and Generic Narrow-Based Index Warrant Approval Orders, supra note 24.

[117] Id.

[118] *See* Amex Letter at 11, supra note 49 and Amex Letter at 12, supra note 50.

[119] If an SRO wanted to ensure that amendments to existing and new derivative securities products, such as splitting an index or changing the exercise style (see Phlx Letter at 2, supra note 64), would not be considered to be proposed rule changes, such SRO could, for example, include such types of amendments as part of its Rule 19b–4 filing for Commission review and approval of the listing standards, trading rules and procedures for the relevant class of derivative securities products. In this way, an SRO could notify the Commission of such changes by submitting Form 19b–4(e).

be replaced within the index according to established policies and procedures for reviewing and replacing such component securities. Automatic rebalancing of index components also should occur according to established policies and procedures *(e.g.*, annually, semi-annually or quarterly). Notice of component changes should be disseminated to news vendors and the public. SROs also should determine that components are replaced promptly in the event of specified circumstances such as corporate mergers or spin-offs.

4. Functional Separation Letter

When the index is maintained by a broker-dealer or an affiliate of a broker-dealer, the SRO's listing standard should include a requirement that the SRO obtain a letter from the broker dealer representing that, prior to the listing of a new derivative securities product, there will be a functional separation, such as a firewall, between the trading desk of the broker-dealer and the research persons responsible for maintaining the index. In addition, the broker-dealer should represent that it has in place procedures to ensure compliance with the functional separation. A fire wall is a mechanism by which employees responsible for constructing and maintaining the index are separated from employees involved in the sale and trading of securities. The persons responsible for maintaining an index should be subject to certain procedures limiting the dissemination of index information within the broker-dealer and particularly should be prohibited from relaying any information concerning a potential change to the components of the index to anyone not responsible for maintaining the index, including employees of the sales and trading department.[120]

D. Compliance With Other Federal Securities Laws

The Commission notes that the amendment does not relieve SROs from any obligation under the federal securities laws, or rules or regulations thereunder, except the requirement of filing a proposed rule change pursuant to section 19(b) of the Act and Rule 19b–4 thereunder. For example, Form S–20 [121] under the Securities Act of 1933, as amended (''Securities Act''),[122] and Rule 9b–1 [123] under the Exchange Act establish a disclosure framework specifically tailored to the informational needs of investors in ''standardized options'' [124] that are traded on an ''options market''.[125] Under Rule 9b–1, broker-dealers must provide an updated copy of the options disclosure document (''ODD'') [126] to each customer at or prior to the approval of the customer's account for trading in standardized options.[127] Accordingly, when trading a new standardized option, an SRO must determine if it should change the ODD to reflect specific characteristics and risks associated with the new derivative securities product not currently set forth in the ODD and submit such changes to the Commission. In addition, a particular new derivative securities product may need to be designated as a standardized option under Rule 9b–1 in order to use the ODD.[128] If the proposing SRO and the issuer of the new derivative securities product determine that such steps are necessary, they are required to submit proposals to the Commission, under Rule 9b–1, prior to listing the new derivative securities product.

The Commission notes that the amendment to Rule 19b–4 may still be available if an SRO determines that the above steps are necessary. So long as all conditions to the amendment are met, including the existence of appropriate current listing standards for the new product, the SRO may immediately list the new derivative securities product without a Section 19(b) rule filing after the Commission designates the particular new product as a ''standardized option'' and approves the Rule 19b–1 filing of amendments to the ODD.

In addition to Form S–20 and Rule 9b–1, the Commission notes that other federal securities laws must be complied with even when an SRO relies on the amendment to Rule 19b–4. For example, issuers of new derivative securities products must continue to comply with, among other things, the registration requirements of the Securities Act and in addition, if a product is an investment company [129] regulated under the Investment Company Act of 1940, as amended (''ICA''),[130] the product must comply with the ICA.

E. Existing Trading Rules, Procedures, Surveillance Programs and Listing Standards

An SRO wishing to list a new derivatives securities product should have in place trading rules, procedures, a surveillance program and listing standards that pertain to the class of securities covering the new product.[131] The Amex, CBOE, NYSE,[132] PCX, and Phlx are the only SROs that currently have in place trading rules, position limits, margin requirements and internal surveillance programs that pertain to the listing and trading of narrow-based stock index options.[133] Should another exchange desire to trade narrow-based index options, it would first have to submit a proposed rule change to the Commission adding relevant trading rules, procedures and listing standards to its rules. Procedures include, but are not limited to, adequate procedures relating to sales practices (including suitability), margin and disclosure requirements. Otherwise, the SRO would be in violation of sections 6(b) and 19(b) of the Act which are intended to ensure fair and orderly trading markets. The SRO also must have a surveillance program adequate to monitor for abuses in the trading of the new derivative securities product,

[120] Supra notes 43 and 93. See also, Section IV. B. *Standards For All New Derivative Securities Products*, supra.

[121] 17 CFR 239.20. Form S–20 is used to register classes of options under the Securities Act.

[122] 15 U.S.C. 77a *et seq.*

[123] 17 CFR 240.9b–1.

[124] ''Standardized options'' are options contracts trading on a national securities exchange, an automated quotation system of a registered securities association or a foreign securities exchange which relate to options classes the terms of which are limited to specific expiration dates and exercise prices or such other securities as the Commission may, by order, designate. 17 CFR 240.9b–1(a)(4).

[125] ''Options market'' means a national securities exchange, an automated quotation system of a registered securities association or a foreign securities exchange on which standardized options are traded. 17 CFR 240.9b–1(a)(1).

[126] The ODD identifies the issuer and describes the uses, mechanics and risks of options trading and other matters in language that can be easily understood by the general investing public

[127] The ODD may be used as a substitute for the traditional prospectus.

[128] See Securities Exchange Act Release No. 31920 (February 24, 1993) 58 FR 12280 (March 3, 1993) (order approving CBOE proposal to list and trade FLEX Options based on the S&P's 500 and 100 Stock Indices).

[129] See *e.g.*, Investment Company Act Release No. 21979 (December 30, 1997) (exemptive order under the ICA permitting the trading of a PDR on the Amex based on the Dow Jones Industrial Average known as DIAMONDS SM Trust).

[130] 15 U.S.C. 80a *et seq.*

[131] The Commission notes that in the companion release adopted today (supra note 30), SROs are permitted to operate pilot trading systems, subject to certain conditions, for up to two years, without submitting a Rule 19b–4 filing to establish, among other things, trading rules and procedures for the pilot trading system. The Commission believes that it would not be appropriate in the public interest to permit an SRO to list and trade new derivative securities products that either have not been approved under section 19(b) of the Act or do not meet the criteria of Rule 19b–4(e).

[132] Although the NYSE transferred its options business to the CBOE, supra note 23, the NYSE still has listing standards for narrow-based index options in its rules. See also note 89, supra.

[133] See *e.g.*, Amex Rules 900c through 980C; CBOE Rules 24.1 through 24.8; and PCX Rules 7.1 through 7.18.

including trading in the underlying security or securities.[134]

SROs that have the appropriate regulatory framework in place for a specific class of new derivative securities product could immediately list such class of new derivative securities product, provided the particular SRO satisfies the conditions of Rule 19b–4(e).[135] In response to Proposing Release comments, if an SRO sought to alter position limits, margin requirements, or any other rules or procedures for a new derivative securities product class, however, it would be required to submit a section 19(b)(2) rule filing for Commission review.[136] The SRO could apply such proposed rule changes to a new product only after the Commission has reviewed and approved the proposal pursuant to section 19(b). This framework would not prevent an SRO from using the amendment to immediately list a new derivative securities product under its existing rules, and then, after the Commission has approved a section 19(b) rule filing proposing new position limits or margin requirements for the relevant product class, impose new position limits or margin requirements for the new derivative securities product.[137]

Commenters suggest that amendments to existing derivative securities products, or amendments to new derivative securities products that are listed pursuant to the amendment to Rule 19b–4, such as splitting an index or changing the exercise style, should not require a proposed rule change pursuant to section 19b(2) of the Act.[138] The Commission believes that if the trading rules, procedures and listing standards for the product class include criteria regarding splitting an index, changing the exercise style or changing the composition of the index, such changes would be permitted without being considered a material change to the derivative securities product and a proposed rule change pursuant to Section 19(b) would not be required.

F. Form of Notification to the SEC of New Derivative Securities Product Listing Pursuant to the Amendment

In order for the Commission to maintain an accurate record of all new derivative securities products traded on the SROs, it is adopting a new form, Form 19b–4(e), to be filed by an SRO in order to notify the Commission when an SRO begins to trade a new derivative securities product that is not required to be submitted as a proposed rule change to the Commission for approval. Proposed Form 19b–4(e) should be submitted within five business days after an SRO begins trading a new derivative securities product that is not the subject of a proposed rule change.[139]

G. Compliance With the Proposed Amendment

The Commission will review SRO compliance with the proposed amendment through its routine inspections of the SROs. In order for the Commission to determine whether an SRO has properly availed itself of the proposed amendment, the SRO must maintain, on-site, relevant records and information pertaining to each new derivative securities product for which the SRO relied on the proposed amendment. Such records should be maintained for a period of not less than five years, the first two years in an easily accessible place, according to the recordkeeping requirements set forth in Rule 17a–1 under the Act.[140]

Such records available for Commission review for each new derivative securities product would include, but are not limited to, a copy of proposed Form 19b–4(e) under the Act, the information circular distributed to members and the product description distributed to investors (if such documents were distributed) and documentation of the factual and numerical information regarding the new derivative securities product's characteristics that meet the conditions of the proposed amendment. The SRO should be able to provide the listing standard under which the new derivative securities product falls as well as, but not limited to, such other things as the details of its surveillance program, records of adequate information sharing procedures and index construction and maintenance standards.[141] In short, the Commission believes that when an SRO relies on the amendment, such SRO should determine that its regulatory framework adequately supports the listing and trading of any new derivative securities product. Failure to comply with this requirement could mean that the SRO may be in violation of the Act.[142] If so, appropriate measures would be taken, including, but not limited to, ordering

[134] In response to comments from the Proposing Release (CBOE Letter at 11, supra note 50), the Commission believes that current surveillance programs are appropriate for existing classes of new derivative securities products. New classes of derivative securities products, however, may present unique issues that would require different or additional surveillance programs. The Commission does not believe that it would be appropriate to establish such standards before the classes of derivative securities products have been developed. Rather, the Commission believes that an SRO should consult with the Commission when new classes of derivative securities products are developed in order to formulate appropriate surveillance programs.

[135] The Commission notes that if an SRO does not have an appropriate regulatory framework in place for a specific class of new derivative securities product, the SRO would have to submit a section 19(b)(2) rule filing. In response to commenters' request for publication of a rule filing within 10 days of its submission to the Commission if it is in proper form (see CBOE Letter at 13 and PXC Letter at 2, supra note 63), the Commission will endeavor to continue to review rule filings in a timely fashion.

[136] See CBOE Letter at 7 and PCX Letter at 2, supra note 38.

[137] The Commission does not anticipate that every proposed change in an SRO's existing trading rules to accommodate a new derivatives securities product will require a section 19(b)(2) rule filing. An SRO will not be required to submit a rule filing for a stated policy, practice or interpretation of the SRO that is reasonably or fairly implied by an existing rule of the SRO or its concerned solely with the administration of the SRO and is not a stated policy, practice or interpretation with respect to the meaning, administration or enforcement of an existing rule of the SRO. 17 CFR 240.19b–4(c), supra note 7. For example, if an SRO has rules that merely delineate each new derivative securities product covered by a particular existing trading rule, the SRO need not submit a rule filing pursuant to section 19(b) of the Act and Rule 19b–4 thereunder merely because it is adding a new derivative securities product to the list. See *e.g.*, CBOE Rule 24.9(a)(3) and (4).

[138] Supra note 64.

[139] The Commission seeks to clarify that, upon being filed by an SRO, Form 19b–4(e) will be publicly available through the Commission's Public Reference Room. In addition, the Commission will endeavor to make the Forms available on the Commission's web site, supra note 77. See also, NYSE Letter at 2, supra note 59.

[140] 17 CFR 240.17a–1. SROs may also destroy or otherwise dispose of such records at the end of five years according to Rule 17a–6 under the Act, 17 CFR 240.17a–6.

[141] SROs have had over twenty years of experience undergoing Commission inspections that have included examination of derivative securities products. As such, the Commission believes that SROs are familiar with the types of materials that should be available during a Commission inspection. See Amex Letter at 18, supra note 50. If an SRO desired to establish a list of the specific information it would provide to the Commission upon inspection, the SRO may submit such list for Commission review as part of its proposed rule change under section 19(b) of the Act to establish listing standards, trading rules and procedures for each product class.

[142] The Commission notes that the amendment should eliminate approximately 45 SRO rule filings each year. The Commission believes that the determination as to whether or not a specific previous SRO rule filing for a derivative securities product would have satisfied the conditions of the amendment is based upon the listing standards, trading rules and procedures that an SRO may develop in response to the adoption of the amendment (see Amex Letter at 19, supra note 34). The Commission reiterates that examples of classes of new derivative securities products are: Broad-based index options; broad-based index warrants; narrow-based index options; narrow-based index warrants; foreign currency index options; foreign currency index warrants; PDRs; index fund shares; and ELNs. Supra notes 14, 15, 16, 17 and 18. Some classes may not currently satisfy the requirements of new Rule 19b–4(e). Supra Section IV. C. 1. *Designation Of Index As Broad-Based Or Narrow-Based*.

the SRO to remediate the deficiency or prohibiting opening transactions in or discontinuing the listing of new derivative securities products.[143]

V. Technical Changes

Because the Commission is adopting a new paragraph (e) to Rule 19b–4 under the Act, Form 19b–4 under the Act[144] is amended by revising the phrase ''subparagraph (e) of Rule 19b–4'' to read ''subparagraph (f) of Rule 19b–4'' and the phrase ''subparagraph (e) of Securities Exchange Act Rule 19b–4'' to read ''subparagraph (f) of Securities Exchange Act Rule 19b–4'' in Exhibit 1, III. (B); and is amended by revising the first sentence in Exhibit 1, IV to read ''Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Exchange Act.''

VI. Conclusion

For the reasons discussed above, the Commission believes that amending Rule 19b–4 under the Act will reduce signficantly the SROs' regulatory burden and help SROs maintain their competitive balance with the overseas and OTC derivatives markets. The amendment to Rule 19b–4 provides guidelines for SROs seeking to rely on it but removes the need for Commission review, notice and approval prior to an SRO trading a new derivative securities product pursuant to existing SRO trading rules, procedures, surveillance programs and listing standards.[145] Furthermore, the Commission will maintain regulatory oversight over the SROs' new derivative securities product listing, trading and surveillance through its routine inspection process. Thus, while the amendment reduces the recordkeeping and reporting obligations of the SROs, investor protection is maintained through regular inspection oversight.

The Commission believes that the amendment offers benefits for investors. The amendment will facilitate the listing and trading of new derivative securities products by permitting SROs to bring such products to market quickly to provide investors with tailored products that directly meet their evolving investment needs. The Commission believes that the amendment will not result in any additional costs for U.S. investors or others. The amendment should reduce the cost of offering new derivative securities products to investors because it will foster innovation and create a streamlined process for SROs to list and trade such new derivative securities products subject to existing trading rules, procedures, surveillance programs and listing standards. Thus, the Commission has considered the amendment's impact on efficiency, competition and capital formation and believes that it would promote these three objectives.[146] Finally, the Commission believes that the SROs will spend significantly less time filling out the form to be used under the amendment than they do now when submitting a complete proposed rule change for Commission review, notice and approval pursuant to Rule 19b–4 under the Act.[147]

VII. Costs and Benefits of the Amendment

A. Benefits

To assist the Commission in its evaluation of the costs and benefits that may result from the amendment, commenters were requested to provide analysis and data, if possible, relating to costs and benefits associated with the proposal herein. No comments were received regarding this request. The Commission believes that the amendment will reduce SRO compliance burdens under Rule 19b–4. The amendment should reduce significantly the SROs' regulatory burden and help SROs maintain their competitive balance with the overseas and OTC derivative markets. Moreover, the Commission believes that the amendment will foster innovation and create a streamlined procedure for SROs to list promptly new derivative securities products subject to appropriate listing standards.

The Commission believes that the amendment would be considered a ''major'' rule because it is anticipated to result in an annual beneficial effect on the economy of $100 million or more. The Commission estimates that because SROs will, on average, list and trade 45 new derivative securities products per year 90 days sooner under the amendment, broker-dealers and investors will, on average, have 90 additional days per new derivative securities product to derive significant financial benefits. The Commission has collected data on the first 90 days of trading activity, including share volume and dollar volume, from several currently trading SRO new derivative securities products that could have relied on new Rule 19b–4(e), had the amendment been in effect when the SRO sought to list and trade such new derivative securities products.[148] Based on an analysis of this data, the Commission believes that increased transaction volumes from new derivative securities products could exceed $100 million each year.

B. Costs

The Commission notes that the amendment provides an alternative approach for SROs to list and trade new derivative securities products. The Commission is not requiring SROs to incur any additional costs as a result of the amendment. An SRO may continue to operate under the current regulatory framework and submit a proposed rule change under section 19(b) of the Act to list and trade every new derivative securities products. If an SRO chooses to avail itself of the amendment, the Commission notes that most SROs already have in place appropriate listing standards, trading rules, procedures and surveillance programs for certain product classes such as PDRs and index fund shares and therefore would not incur any costs by relying on the

[143] See section 19(h) of the Act, 15 U.S.C. 78s(h). The Commission could also use its inspection authority to review whether an SRO has established appropriate procedures.

[144] 17 CFR 249.819.

[145] As previously stated, the Commission anticipates that the amendment will eliminate approximately 45 SRO filings each year pursuant to Rule 19b–4 and Form 19b–4, supra note 142. In addition, the Commission believes that the amendment reduces the recordkeeping and reporting requirements, pursuant to Rule 19b–4 and Form 19b–4, on the SROs by permitting them to submit a one page summary form after they list a new derivative securities product instead of filing a complete proposed rule change for Commission review prior to listing such new derivative securities product.

[146] Section 3(f) of the Act, 15 U.S.C. 78c(f), requires the Commission, when it is engaged in rulemaking and is required to consider or determine whether an action is necessary or appropriate in the public interest, to also consider, in addition to the protection of investors, whether the action will promote efficiency, competition and capital formation.

[147] Because the amendment constitutes a ''major rule'' within the meaning of the Small Business Regulatory Enforcement Fairness Act of 1996, 5 U.S.C. 801 *et seq.*, the amendment will take effect 60 days after the date of publication in the **Federal Register**.

[148] For example, during the fist 90 days of trading, DIAMONDS℠ Trust (supra note 129) (Securities Exchange Release No. 39525 (January 8, 1998) 63 FR 2438 (January 15, 1998)) traded a total of 52,672,500 shares valued at $4,452,065,077 or an average of 741,866 shares per day valued at an average of $62,705,142 per day. During the first 90 days of trading, SPDRs (supra note 16) traded a total of 12,138,900 shares valued at $540,575,938 or an average of 183,923 shares per day valued at an average of $8,190,545 per day. In addition, the Commission analyzed data on: Market Index Target Term Securities on the S&P 500 Index trading on the Amex; Lehman Brothers European Stock Basket Stock Upside Note Securities trading on the Amex (supra note 85); and options on The Tobacco Index trading on the Amex (Securities Exchange Act Release No. 38693 (May 29, 1997) 62 FR 30914 (June 5, 1997)).

amendment for these products. The Commission believes that an SRO could use its past experience with listing and trading new derivative securities products in order to establish listing standards, trading rules, procedures and surveillance programs for product classes that currently would not be covered by the amendment, such as broad-based index options. Consequently, the Commission believes that an SRO would incur nominal costs associated with developing and receiving Commission approval for listing standards, trading rules, procedures and surveillance programs for product classes that currently would not be covered by the amendment.

VIII. Effects on Competition, Efficiency and Capital Formation

Section 23(a)(2)[149] of the Act requires that the Commission, when promulgating rules under the Exchange Act, to consider the impact any rule would have on competition and to not adopt any rule that would impose a burden on competition that is not necessary or appropriate in the public interest. In the Proposing Release, the Commission solicited comments on the effects on competition, efficiency and capital formation of the amendment, in general, and the potential competitive effects across markets, in particular. Specifically, the Commission requested commenters to address whether the proposed amendment would generate the anticipated benefits or impose any costs on U.S. investors or others. The Commission received no comments regarding these issues. The Commission has considered the amendment in light of the standards cited in section 23(a)(2) of the Act and believes that it would not impose any burden on competition not necessary or appropriate in furtherance of the Exchange Act.

Securities SROs potentially compete with futures markets when a securities SRO seeks to list and trade a broad-based index option and a futures market seeks contract market designation for a futures contract overlying the same broad-based index. This constitutes only a small portion of the new derivative securities products that Rule 19b–4(e) will cover. While utilizing Rule 19b–4(e) may result in the securities SROs providing broad-based index options to investors more quickly than they currently do, it is not certain whether the effect of Rule 19b–4(e) would result in the securities SROs listing broad-based index options sooner than the futures markets listing similar broad-based index futures. Nevertheless, to the extent that it could be argued that this may be a possible effect of Rule 19b–4(e) in a particular case, the Commission notes that its jurisdiction over stock index futures is limited to reviewing such products under the criteria set forth in section 2(a)(1)(B) of the CEA. Stock index futures must be approved by the CFTC, not the Commission. To the extent that the Commission does review such products under the requirements of the CEA, the Commission must adhere to the 45 day time period set forth in the statute. Despite the Commission's lack of jurisdiction in actually approving such products for trading on a futures market, the Commission has committed to be sensitive to the time involved in its review and has stated in this release that it will make every effort to continue to review requests in a timely fashion. As a result, the Commission believes that the ability of a securities SRO to use the new regulatory framework of Rule 19b–4(e) will not impose a burden on competition but will instead promote competition because securities SROs can choose to provide new derivative securities products to investors more quickly than under the current regulatory framework. This will allow securities SROs to list and trade new derivative securities products, on average, 90 days earlier than under the current regulatory framework.

The Commission also notes that generally OTC derivatives can begin trading sooner than exchange traded new derivative securities products because there is no prior Commission approval required for OTC derivatives as there is for exchange traded new derivative securities products under section 19(b) of the Act. The Commission believes that because OTC derivatives are highly customized among individual parties, exchange traded new derivative securities products do not always compete with OTC derivatives. Nonetheless, Rule 19b–4(e) may potentially have a competitive impact in this area because an SRO will be able to list a new derivative securities product, pursuant to Rule 19b–4(e), more quickly than under the existing regulatory framework. The Commission believes that the ability of an SRO to use the new regulatory framework of Rule 19b–4(e) will not impose a burden on competition but will instead promote competition because SROs could provide new derivative securities products to investors more quickly than under the current regulatory framework. This will allow securities SROs to compete more equally with the OTC market.

Finally, the Commission believes that the amendment will reduce SRO compliance costs and will enable SROs to compete more effectively with overseas derivative markets. The Commission believes that SROs should be able to bring new derivative securities products to market more quickly to provide investors with tailored products that directly meet their evolving investment needs.[150] SROs have had over 20 years of experience with Commission review of new derivative securities product proposals. SROs that have sought approval from the Commission to list and trade such new derivative securities products should be familiar with the factors discussed in this release that the Commission believes must be considered when listing and trading such new derivative securities products. Thus, the Commission believes that there is less need for its review, notice and approval prior to an SRO listing and trading a particular new derivative securities product pursuant to existing SRO trading rules, procedures, surveillance programs and listing standards. Furthermore, the Commission believes that the procedures discussed in this release will enable the Commission to continue effectively protect investors and promote the public interest.

IX. Summary of Final Regulatory Flexibility Act Analysis

In the Proposing Release, the Commission prepared an Initial Regulatory Flexibility Act Analysis (''IRFA'') an accordance with 5 U.S.C. 605(b) regarding the amendment to Rule 19b–4 and Form 19b–4(e) under the Exchange Act. No comments were received in response to the IRFA. In addition, the Commission notes that Form 19b–4(e) is being adopted without any changes and Rule 19b–4(e) is being adopted in substantially the same format that it was proposed.[151] As a result, the Commission has prepared a Final Regulatory Flexibility Analysis (''FRFA'') in substantially the same form as the IRFA. The following summarizes the FRFA.

The FRFA sets forth the statutory authority for the proposed amendment

[149] See 15 U.S.C. 78w(a)(2).

[150] The Commission also believes that the amendment will benefit broker-dealers. See IX. *Summary of Final Regulatory Flexibility Act Analysis,* infra.

[151] See IV.A. *Definition of ''New Derivative Securities Product''*, supra, for a complete discussion of the technical changes to the definition of new derivative securities product in response to commenters' requests for clarification.

to Rule 19b–4. The FRFA also discusses the effect of the proposed amendment on broker-dealers that are small entities as defined in Rule 0–10 under the Exchange Act.[152] A broker-dealer that has total capital of less than $500,000 on the date in the prior fiscal year as of which its audited financial statements were prepared, or, if not required to prepare such statements, a broker-dealer that had total capital of less than $500,000 on the last business day of the preceding fiscal year is deemed to be a small entity for purposes of the FRFA.[153] The FRFA states that the proposed amendment would enable broker-dealers that are small entities (such as certain options market makers and options specialists) to trade new derivative securities products pursuant to existing trading rules, procedures, surveillance programs and listing standards approximately 90 days earlier, on average, because the proposed amendment will permit SROs to immediately list these new derivative securities product without prior Commission approval.[154] As a result, broker-dealers will have additional days to earn income through trading such new derivative securities products. As of December 31, 1997, the Commission estimated that there were over 870 options market makers and specialists that may be considered small entities.[155]

As previously stated, the Commission estimates that new Rule 19b–4(e) will eliminate approximately 45 SRO filings each year pursuant to Rule 19b–4 and Form 19b–4. The Commission has collected data on the first 90 days of trading activity, including share volume and dollar volume, from several currently trading SRO new derivative securities products that could have relied on new Rule 19b–4(e), had the amendment been in effect when the SROs sought to list and trade such new derivative securities products.[156] Based on this data, the Commission believes that broker-dealer small entities will benefit substantially from new Rule 19b–4(e).

The FRFA states that the amendment would not impose any new reporting, recordkeeping or compliance requirements on broker-dealer small entities. Any new reporting, recordkeeping or compliance burdens will rest with the SROs, not broker-dealer small entities.

The FRFA discusses the various alternatives considered by the Commission in connection with the amendment that might minimize the effect on small entities, including: (a) The establishment of differing compliance or reporting requirements or timetables that take into account the resources of small entities; (b) the clarification, consolidation or simplification of compliance and reporting requirements under the rule for small entities; (c) the use of performance rather than design standards; and (d) an exemption from coverage of the proposed rule amendment, or any part thereof, for small entities. The Commission believes that different compliance or reporting requirements for small entities are not necessary because the amendment does not establish any new reporting, recordkeeping or compliance requirements for small entities. In addition, the Commission has concluded that it is not feasible to further clarify, consolidate or simplify the amendment for small entities. The Commission also believes that it would be inconsistent with the purposes of the Exchange Act to use performance standards to specify different requirements for small entities or to exempt broker-dealer small entities from being able to trade new derivative securities products that are covered by the proposed rule amendments.

The FRFA includes quantifiable information concerning the number of small entities that would be affected by the proposed rule amendment. A copy of the FRFA may be obtained by contacting Marianne H. Duffy, Special Counsel, (202) 942–4163 at Office of Market Supervision, Division of Market Regulation, SEC, Mail Stop 10–1, 450 Fifth Street, NW, Washington, DC 20549.

X. Paperwork Reduction Act

The amendment contains a ''collection of information'' requirements within the meaning of the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). Accordingly, the Commission submitted the collection of information requirements contained in the amendment to the Office of Management and Budget (''OMB'') for review and were approved by OMB which assigned Form 19b–4(e) control number 3235–0504. The collection of information is in accordance with Section 3507 of the PRA.[157]

The collection of information obligations imposed by the amendment is mandatory. The information filed pursuant to the amendments will not be kept confidential and therefore will be available to the public. An agency may not conduct or sponsor, and a person is not required to comply with, a collection of information unless it displays a currently valid OMB control number.

The collection of information is necessary for persons to obtain certain benefits or to comply with certain requirements. The amendment to which the collection of information relates is necessary as a means for the Commission to maintain accurate records of new derivative securities products that are traded. The Commission solicited public comment on the collection of information requirements contained in the Proposing Release. The Commission received no comments that addressed the PRA portion of the release.

The title for the collection of information is: ''Form 19b–4(e) Under the Securities Exchange Act of 1934.'' The collection of information requires SROs to prepare a one-page summary sheet of nine questions that requests factual information regarding the characteristics of the new derivative securities product and the underlying securities. Such questions do not require any analysis or exhibits. The amendment may be used by any SRO. currently, there are ten such SROs for which it is estimated that the proposed amendment would be used, in the aggregate, approximately 45 times a year.

In order for the Commission to maintain an accurate record of all new derivative securities products traded on the SROs and to determine whether an SRO has properly relied on the proposed amendment, however, it is necessary that the SRO file proposed Form 19b–4(e) with the Commission when such SRO begins trading a new derivative securities product pursuant to the proposed amendment. In addition, an SRO must maintain, on-site, a copy of proposed Form 19b–4(e). The SROs are required to retain records of the collection of information for a period of not less than five years, the first two years in an easily accessible place, according to the current

[152] 17 CFR 240.0–10(c). The Commission notes that SROs and most issuers listed on a national securities exchange or The Nasdaq Stock Market would not be considered ''small entities'' under Rule 0–10.

[153] The Commission recently amended its small business definition for broker-dealers. See Securities Exchange Act Release No. 40122 (June 24, 1998) 63 FR 35508 (June 30, 1998) at note 32. Because the IRFA for this proposal relied on the old definition, which is broader, the FRFA also relies on the old definition.

[154] See note 148, supra.

[155] The Commission bases its estimate on the information provided in Form X–17A–5—Financial and Operational Combined Uniform Single Reports pursuant to Section 17 of the Act and rule 17a–5 thereunder.

[156] See note 148, supra.

[157] 44 U.S.C. 3507.

recordkeeping requirements set forth in Rule 17a–1 under the Act.[158]

XI. Statutory Basis

The amendment to Rule 19b–4(e) under the Exchange Act is being adopted pursuant to 15 U.S.C. 78a *et seq.*, particularly sections 3(a)(27), 3(b), 19(b), 23(a) and 36(a) of the Act, unless otherwise noted.

Text of the Final Rule

List of Subjects 17 CFR Parts 240 and 249

Reporting and recordkeeping requirements, Securities.

In accordance with the foregoing, Title 17, Chapter II of the Code of Federal Regulations is amended as follows:

PART 240—GENERAL RULES AND REGULATIONS SECURITIES EXCHANGE ACT OF 1934

1. The authority citation for part 240 continues to read, in part, as follows:

Authority: 15 U.S.C. 77c, 77d, 77g, 77j, 77s, 77z–2, 77eee, 77ggg, 77nnn, 77sss, 77ttt, 78c, 78d, 78f, 78i, 78j, 78j–1, 78k, 78k–1, 78*l*, 78m, 78n, 78o, 78p, 78q, 78s, 78u–5, 78w, 78x, 78*ll*(d), 78mm, 79q, 79t, 80a–20, 80a–23, 80a–29, 80a–37, 80b–3, 80b–4 and 80b–11, unless otherwise noted.

* * * * *

2. Section 240.19b–4 is amended by redesignating paragraphs (e), (f), (g), and (h) as paragraphs (f), (g), (h) and (i) and adding new paragraph (e) to read as follows:

[158] SROs may also destroy or otherwise dispose of such records at the end of five years according to Rule 17a–6 under the Act, supra note 140.

§ 240.19b-4 Filings with respect to proposed rule changes by self-regulatory organizations.

* * * * *

(e) For the purposes of this paragraph, *new derivative securities product* means any type of option, warrant, hybrid securities product or any other security whose value is based, in whole or in part, upon the performance of, or interest in, an underlying instrument.

(1) The listing and trading of a new derivative securities product by a self-regulatory organization shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of this section, if the Commission has approved, pursuant to section 19(b) of the Act (15 U.S.C. 78s(b)), the self-regulatory organization's trading rules, procedures and listing standards for the product class that would include the new derivative securities product and the self-regulatory organization has a surveillance program for the product class.

(2) Recordkeeping and reporting:

(i) Self-regulatory organizations shall retain at their principal place of business a file, available to Commission staff for inspection, of all relevant records and information pertaining to each new derivative securities product traded pursuant to this paragraph (e) for a period of not less than five years, the first two years in an easily accessible place, as prescribed in § 240.17a–1.

(ii) When relying on this paragraph (e), a self-regulatory organization shall submit Form 19b–4(e) (17 CFR 249.820) to the Commission within five business days after commencement of trading a new derivative securities product.

* * * * *

PART 249—FORMS, SECURITIES EXCHANGE ACT OF 1934

3. The authority citation for part 249 continues to read in part as follows:

Authority: 15 U.S.C. 78a, *et seq.*, unless otherwise noted;

* * * * *

4. Form 19b–4 (referenced in § 249.819) is amended by revising the phrase ''subparagraph (e) of Rule 19b–4'' to read ''subparagraph (f) of Rule 19b–4'' and the phrase ''subparagraph (e) of Securities Exchange Act Rule 19b–4'' to read ''subparagraph (f) of Securities Exchange Act Rule 19b–4'' in Exhibit 1, III. (B); and in Exhibit 1, IV. revise the first sentence to read ''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.''

5. Section 249.820 and Form 19b–4(e) are added to read as follows:

§ 249.820 Form 19b–4(e) for the listing and trading of new derivative securities products by self-regulatory organizations that are not deemed proposed rule changes pursuant to Rule 19b–4(e) (§ 240.19b–4(e)).

This form shall be used by all self-regulatory organizations, as defined in section 3(a)(26) of the Act, to notify the Commission of a self-regulatory organization's listing and trading of a new derivative securities product that is not deemed a proposed rule change, pursuant to Rule 19b–4(e) under the Act (17 CFR 240.19b–4(e)).

BILLING CODE 8010–01–M

[Note: Form 19b-4(e) will not appear in the Code of Federal Regulations.]

For Internal Use Only Sec File No. 91 -	Submit 1 Original And 9 Copies	OMB Approval No.: 3235 - 0504 Expires: 07/31/2001 Estimated average burden hours per response: 2.00

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 19b-4(e)

Information Required of a Self-Regulatory Organization Listing and Trading a New Derivative Securities Product Pursuant to Rule 19b-4(e) Under the Securities Exchange Act of 1934

READ ALL INSTRUCTIONS PRIOR TO COMPLETING FORM

Part I **Initial Listing Report**

1. Name of Self-Regulatory Organization Listing New Derivative Securities Product:

2. Type of Issuer of New Derivative Securities Product (e.g., clearinghouse, broker-dealer, corporation, etc.):

3. Class of New Derivative Securities Product:

4. Name of Underlying Instrument:

5. If Underlying Instrument is an Index, State Whether it is Broad-Based or Narrow-Based:

6. Ticker Symbol(s) of New Derivative Securities Product:

7. Market or Markets Upon Which Securities Comprising Underlying Instrument Trades:

8. Settlement Methodology of New Derivative Securities Product:

9. Position Limits of New Derivative Securities Product (if applicable):

Part II **Execution**

The undersigned represents that the governing body of the above-referenced Self-Regulatory Organization has duly approved, or has duly delegated its approval to the undersigned for, the listing and trading of the above-referenced new derivative securities product according to its relevant trading rules, procedures, surveillance programs and listing standards.

Name of Official Responsible for Form:

Title:

Telephone Number:

Manual Signature of Official Responsible for Form:

Date:

Instructions for Completing Form 19b-4(e)

I. Terms. Unless the context clearly indicates otherwise, terms used in this Form have the meaning ascribed to them in the Securities Exchange Act of 1934, as amended, and Rule 19b-4 thereunder.

II. Who Must File; When to File. Rule 19b-4(e) requires every self-regulatory organization (SRO) seeking to rely on Rule 19b-4(e) to file Form 19b-4(e) with the Securities and Exchange Commission (SEC) at least 5 business days after commencement of trading a new derivative securities product that is not deemed to be a proposed rule change. Each time an SRO files Form 19b-4(e), the execution page must be completed.

III. Number of Copies; How and Where to File. File an original and 9 copies of each Form 19b-4(e) with the SEC, 450 Fifth Street, N.W., Washington, D.C. 20549. The SRO must keep an exact copy of the filing for its records. All copies must be legible. The filing date of Form 19b-4(e) is the date of actual receipt by the SEC, provided that the filing complies with applicable requirements.

IV. Format of Filing. An SRO may use the printed Form 19b-4(e) or a reproduction of it.

V. Paperwork Reduction Act Disclosure.

Form 19b-4(e) requires an SRO filing the Form to provide the SEC with certain information concerning the nature of the new derivative securities product it intends to list and/or trade.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a currently valid control number. Sections 3(a)(26), 3(a)(27), 3(a)(28), 3(b), 19(b), 23(a) and 36(a) of the Securities Exchange Act of 1934 authorize the SEC to collect information on Form 19b-4(e) from SROs. See 15 U.S.C. §§78c(a)(26), 78c(a)(27), 78c(a)(28), 78c(b), 78s(b), 78w(a), 78mm(a).

Any member of the public may direct to the SEC any comments concerning the accuracy of the burden estimate on the facing page of Form 19b-4(e) and any suggestions for reducing this burden.

The principal purpose of Form 19b-4(e) is to enable the SEC to maintain an accurate record of all new derivative securities products on the SROs not deemed to be proposed rule changes pursuant to Rule 19b-4(e).

It is estimated SROs will spend approximately 2 hours completing each Form 19b-4(e).

It is mandatory that an SRO file Form 19b-4(e) with the SEC at least 5 business days after commencement of trading a new derivative securities product that is not deemed to be a proposed rule change.

No assurance of confidentiality is given by the SEC with respect to the responses made in the Form. The public has access to the information contained in the Form.

This collection of information has been reviewed by the Office of Management and Budget in accordance with the clearance requirements of 44 U.S.C. 3507. The applicable Privacy Act system of records is SEC-2 and the routine uses of records are set forth at 40 FR 39255 (August 27, 1975) and 41 FR 5318 (February 5, 1976).

By the Commission.

Dated: December 8, 1998.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 98–33300 Filed 12–21–98; 8:45 am]

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