

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41276; File No SR-Amex-99-09]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the American Stock Exchange LLC Relating to an Amendment to Amex Rule 901C

April 12, 1999.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 1, 1999, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend Amex Rule 901C to add modified equal-dollar weighting and modified capitalization weighting as acceptable weighting calculation methodologies for the construction of narrow-based index options.³ [Bracketing] indicates text to be deleted, and *italics* indicates text to be added. The text of the proposed rule change is as follows:

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Designation of Stock Index Options

Rule 901C. (a)-(c) No Change.

Commentary

.01 No change.

.02 No change.

(a) No change.

(b) Index Calculation—(i) The index will be calculated based on either the capitalization, [weighting,] *modified capitalization*, price, [weighting or] equal-dollar, [weighting] or *modified equal-dollar weighting* methodology. (ii) Indexes based upon the equal-dollar or *modified equal-dollar* weighting method will be rebalanced at least quarterly. (iii) If the index is maintained by a broker-dealer, the broker-dealer shall erect a "[chinese] firewall" around the personnel who have access to information concerning changes and

adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer. (iv) The current index value will be disseminated every 15 seconds over the Consolidated Tape Association's Network B.

(c) No change.

(d) No change.

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

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

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

1. Purpose

The Exchange proposes to amend Commentary .02 to Amex Rule 901C to include modified capitalization and modified equal-dollar weighting in the group of index calculation methodologies used for calculating stock industry index groups.⁴ Commentary .02 to Amex Rule 901C permits the Exchange to list options on stock industry index groups if the index meets certain criteria. Presently, the criteria require the index to be calculated using either the capitalization, price, or equal-dollar weighting methodologies. The Exchange proposes to include modified capitalization and modified equal-dollar weighting calculation methodologies in Commentary .02 to Amex Rule 901C to (i) better meet the needs of index option users; (ii) increase flexibility in index construction; and (iii) more accurately reflect the industry represented by the index.

Use of the capitalization weighting calculation methodology to determine an index value is accomplished by multiplying the primary exchange regular way last sale price of each component security by its number of shares outstanding, adding the products, and dividing by the current index divisor. Determining an index value for

modified capitalization weighted indexes is calculated in a similar manner. However, instead of using the number of shares outstanding, the methodology uses an adjusted number of shares outstanding in the multiplication (adding the products and then dividing by the current index divisor). The modified capitalization weighting methodology uses an adjusted number of shares outstanding to prevent components with relatively large market capitalizations from representing an excessive portion of an index's value. For example, inclusion of a large capitalization company in an index along with a number of smaller capitalization companies can result in the larger capitalization company's representation in the index exceeding 25% of the index's value, which violates the requirements of Amex Rule 901C, Commentary .02(a)(7). However, use of the modified capitalization index calculation methodology would permit a reduction in the large capitalization company's representation in the index to an amount less than 25% of the index's value, thereby permitting the index to satisfy the requirements of Commentary .02(a)(7). The Exchange represents that, as a part of their due diligence, the component weighting will be reviewed quarterly, and if necessary, adjusted to ensure the index continues to meet the weighting guidelines. Adjustments will be made on an intra-quarterly basis to reflect corporate actions, share issuances and repurchases, etc.

Use of the equal-dollar weighting calculation methodology to determine an index value initially is accomplished by establishing an initial dollar representation (for example \$100,000), determining the number of shares of each component representing this amount and then multiplying the primary exchange regular way last sale price of each component security by its predetermined fixed number of shares. The equal-dollar weighted methodology results in equal representation of each component in the index. The modified equal-dollar weighting methodology can be used to distinguish between larger and smaller capitalized companies, permitting larger capitalized companies to represent a larger portion of an index's value. This methodology can enhance an index's use as an accurate measure for a particular industry sector and thus its utility to market participants.

In effect, the modified equal-dollar weighting methodology is the mirror image of the modified capitalization weighting methodology. While the modified capitalization weighting

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange refers to narrow-based index options as "stock industry index options." See Amex Rule 900C(b)(1).

⁴ A stock index industry group is defined in the Amex Rule as a group of stocks representing a particular industry or related industries. *Id.*

methodology prevents companies with the largest capitalization from skewing an index, the modified equal-dollar weighting methodology guards against the smaller capitalized companies doing so. Determining an initial index value for modified equal-dollar weighted indexes uses two or more fixed dollar values for different groups of the index components instead of using the same fixed dollar value for each component. In this way, the modified equal-dollar weighted method allows for similar component stocks to be weighted similarly, while differentiating among dissimilar groups (e.g., high capitalization stocks versus lower capitalization stocks). For example, given a ten stock index, five components with capitalizations of approximately \$1 billion (or \$5 billion in aggregate) and five with capitalizations of approximately \$500 million (or \$2.5 billion in aggregate), rather than each component accounting for 10% of the index (as would be the case in a pure equal-dollar weighted index), the modified equal-dollar weighting methodology would permit the larger capitalization components to account for twice the amount of the smaller capitalized companies. This permits a more accurate representation of the actual market capitalization composition of the industry for which the index is designed to measure.

The number of shares of each component security in an index calculated under the modified equal-dollar weighting methodology will be adjusted quarterly, so that the members of each weighting group are again set to the appropriate index weight. The number of shares of each component stock in the index portfolio will remain fixed between quarterly reviews, except in the event of certain types of corporate actions (such as the payment of a dividend other than an ordinary cash dividend, stock distribution, reorganization, recapitalization, or similar event with respect to the component stocks). In a merger or consolidation of an issuer of a component stock, if the stock remains in the index, the number of shares of that security in the portfolio may be adjusted to the nearest whole share, to maintain the component's relative weight in the index at the level immediately prior to the corporate action. In the event of a stock addition or replacement, the average dollar value of the remaining components in the same weighting group will be calculated, and that amount invested in the stock of the new component to the nearest whole share.

In all cases, the divisor will be adjusted, if necessary, to ensure index continuity.

The Exchange notes that the Inter@ctive Week Internet Index, the Nasdaq-100 Index, and the Amex Eurotop 100 Index are currently calculated using modified capitalization weighting methodologies, and have been approved as indexes that may underlie index options. Additionally, the Amex Mexico Index and the Amex Networking Index currently use modified equal-dollar weighting index calculation methodologies, and have been approved as indexes that may underlie index options.

Increasingly, the Exchange receives requests to construct new stock industry indexes using the modified capitalization or modified equal-dollar weighting methodologies, in many cases to enable the proposed indexes to meet the generic criteria for narrow-based indexes, or to provide for the timely trading of options on the newly proposed indexes. As a result, the Exchange proposes to add the modified capitalization and modified equal-dollar weighted calculation methodologies to the existing narrow-based criteria set forth in Amex Rule 901C that are currently subject to filing pursuant to Rule 19b-4(e) under the Act.⁵ In doing so, use of the modified capitalization and modified equal-dollar weighted calculation methodologies will be limited to those narrow-based indexes meeting the generic index criteria set forth in Commentary .02 to Amex Rule 901C. In the event a proposed index does not meet the criteria set forth in Commentary .02, the Exchange will submit the terms of the proposed index to the Commission for review pursuant to section 19(b)(2) of the Act.⁶

The Exchange represents that the terms of any modified capitalization or modified equal-dollar weighting calculation methodology will be clearly defined, and consist of objective standards that will permit any newly developed narrow-based index initially to meet, and subsequently, to continue to be maintained, in accordance with the generic criteria set forth in Commentary .02 to Amex Rule 901C. Further, the Exchange represents that these terms will be discussed in marketing materials describing the index and in the Information Circulars distributed to members upon the launch of the new index options.

2. Statutory Basis

The Amex believes that the proposed rule change is consistent with Section

6(b) of the Act⁷ in general, and furthers the objectives of section 6(b)(5) of the Act⁸ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to, and perfect the mechanisms of, a free and open market and a national market system.

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

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

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

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

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

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

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

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

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the

⁵ 17 CFR 240.19b-4(e).

⁶ 15 U.S.C. 78s(b)(2).

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to file number SR-Amex-99-09 and should be submitted by May 11, 1999.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.⁹

Jonathan G. Katz,
Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41270; File No. SR-CBOE-99-08]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Exchange Fees

April 9, 1999.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934¹ ("Act"), and Rule 19b-4 thereunder,² notice is hereby given that on February 25, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 26, 1999, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange is proposing to amend certain fees,⁴ and to amend its

Prospective Fee Reduction Program and Customer "Large" Trade Discount Program. The text of the proposed rule change is available at the Office of the Secretary, CBOE, and at the Commission.

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

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

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

The purpose of this proposed rule change is to make certain fee changes and to amend the Exchange's Prospective Fee Reduction Program and Customer "Large" Trade Discount Program. The foregoing fee changes are being implemented by the Exchange pursuant to CBOE Rule 2.22 and took effect on March 1, 1999.

The Exchange is amending the following fees: (1) Equity Customer Transaction Fees are reduced from \$.15/.30 to a flat \$.09 per contract side,⁵ Trade Match and Floor Brokerage Fees will remain at \$.05 and \$.03, respectively; (2) Marketable Equity Customer orders of thirty contracts or less will not be billed the reduced customer transaction fee noted above if those orders reach CBOE's trading posts through the automated Order Routing System ("ORS"); (3) Equity Order Book Official ("OBO") Execution Fees are reduced from \$.45 per contract with free execution at the opening, to \$.20 for all contracts, regardless of when they are executed; (4) Equity Market Maker Fees are increased to \$.19 per contract side from \$.05 per contract side; (5) OEX Market Maker Fees are increased to \$.15 per contract side from \$.05 per contract side; (6) SPX Market Maker Fees are

exclusively to member fees, this proposed rule change is properly filed under section 19(b)(3)(A)(ii) of the Act. 15 U.S.C. 78s(b)(3)(A)(ii). Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, CBOE, and Joseph P. Morra, Attorney, Division, Commission, on March 3, 1999.

⁵ A rate differential will no longer exist based on the dollar amount of the premium paid.

increased to \$.15 per contract side from \$.07 per contract side; (7) Equity Member Firm Proprietary Fees are increased from \$.06 to \$.19 per contract side to match market maker rates; (8) OEX Member Firm Proprietary Fees are increased from \$.06 to \$.15 per contract side to match Index market maker rates; and (9) Member Firm Proprietary Fees for SPX, DJX and all other Indexes are increased from \$.10 to \$.15 per contract side to match Index market maker rates. Trade Match fees remain at \$.05 per contract side. Member Firm proprietary rates remain unchanged when the firm is facilitating its own customer order. Index Customer Transaction Fees are unchanged.

Previously, it has been CBOE's policy to assign the customer rate to option orders from broker-dealers. Under the revised fee schedule, broker-dealer marketable equity option orders of thirty contracts or less that are routed through ORS will not be assessed any transaction fee. However, non-marketable broker-dealer equity option orders for more than thirty contracts will be charged the new higher market maker/firm rate of \$.19 instead of the new lower customer rate of \$.09.

The Exchange's Prospective Fee Reduction Program for Trade Match Fees and Member Dues currently provides that if at the end of any quarter of the Exchange's fiscal year, the Exchange's average contract volume per day on a fiscal year-to-date basis exceeds one of certain predetermined volume thresholds, the Exchange's Trade Match Fees and Member Dues will be reduced in the following fiscal quarter in accordance with a fee reduction schedule. Effective March 1, 1999 the Program proposed to be is suspended for the remainder of Fiscal Year 1999 ("FY99").⁶

The Exchange's Customer "Large" Trade Discount Program currently provides for discounts on the transaction fees that CBOE customers are assessed with respect to public customer orders for 500 or more contracts. Specifically, for any month during which the Exchange's average contract volume per day exceeds one of certain predetermined volume thresholds, the transaction fees that are assessed by the Exchange in that month with respect to public customer orders for 500 or more contracts are subject to a discount in accordance with a discount schedule. The Program is proposed to be suspended for equity option orders only for the remainder of FY99, effective March 1, 1999.

⁶ CBOE's FY99 terminates on June 30, 1999.

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Debora E. Barnes, Senior Attorney, CBOE, to David Sieradzki, Special Counsel, Division of Market Regulation ("Division"), Commission, dated March 25, 1999 ("Amendment No. 1"). Amendment No. 1 is a technical amendment to add the Exchange's statement on burden on competition, which was inadvertently omitted.

⁴ The Exchange represents that, although some of the fees in this filing are referred to as customer fees, they are charged to members. As a result, the Commission notes that, as this filing relates