

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43134; File No. SR-CBOE-00-23]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Listing Standards for Trust Issued Receipts

August 10, 2000.

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 June 12, 2000, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On June 30, 2000, the CBOE submitted Amendment No. 1 to the proposed rule change.³ On July 31, 2000, the CBOE submitted Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to grant accelerated approval to the proposed rule change.

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

The CBOE proposes to adopt listing standards to allow the Exchange to list and trade trust issued receipts. 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 III 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 CBOE is proposing to adopt new listing standards to allow the Exchange to list and trade trust issued receipts. Upon approval of the listing standards, the CBOE intends to trade, whether by listing or pursuant to unlisted trading privileges ("UTP"), Holding Company Depositary Receipts ("HOLDRs"), a type of trust issued receipt, that are currently listed and traded on other securities exchanges.

i. Trust Issued Receipts Generally

Trust issued receipts are negotiable receipts that are issued by a trust representing securities of issuers that have been deposited and are held on behalf of the holders of the trust issued receipts. Trust issued receipts are designed to allow investors to hold interests in a variety of companies throughout a particular industry in a single, exchange-listed and traded instrument that represents beneficial ownership in the deposited securities. Holders may cancel their trust issued receipts at any time to receive the deposited securities.

Beneficial owners of the receipts will have the same rights, privileges and obligations as they would have if they beneficially owned the deposited securities outside of the trust issued receipt program. Holders of the receipts have the right to instruct the trustee to vote the deposited securities evidenced by the receipts. They will receive reports, proxies, and other information distributed by the issuers of the deposited securities to their security holders and will receive dividends and other distributions declared and paid by the issuers of the deposited securities to the trustee.

Trust issued receipts will be issued by a trust created pursuant to a depository trust agreement. After the initial offering, the trust may issue additional receipts on a continuous basis when an investor deposits the requisite securities with the trust. An investor in trust issued receipts will be permitted to withdraw his or her deposited securities upon delivery to the trustee of one or

more round-lots of 100 trust issued receipts. Conversely, an investor may deposit the necessary securities and receive trust issued receipts in return.

ii. Criteria for Initial and Continued Listing

The Exchange believes that the listing criteria proposed in its new rule are generally consistent with the listing criteria currently used by the American Stock Exchange ("Amex"), the Chicago Stock Exchange ("CHX"), and the Boston Stock Exchange ("BSE").⁵

If trust issued receipts are to be listed on the CBOE, the Exchange will establish a minimum number of receipts that must be outstanding at the time trading commences on the Exchange, and such minimum number will be included in any required submission to the Commission. In connection with continued listing, the Exchange will consider the suspension of trading in, or removal from listing of, a series of trust issued receipts when any of the following circumstances arise: (1) the trust has more than 60 days remaining until termination and their have been fewer than 50 record and/or beneficial holders of the trust issued receipts for 30 or more consecutive trading days; (2) the trust has fewer than 50,000 receipts issued and outstanding; (3) the market value of all receipts issued and outstanding is less than \$1 million; or (4) such other event occurs or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. These flexible criteria will allow the Exchange to avoid delisting trust issued receipts (and possibly terminating the trust) due to relatively brief fluctuations in market conditions that may cause the number of holders to vary. However, these delisting criteria will not be applied for the initial 12-month period following formation of a trust and commencement of trading on the Exchange.

In addition, if the number of companies represented by the deposited securities drops to fewer than nine, and each time the number of companies is reduced thereafter, the Exchange will consult with the staff of the Division of Market Regulation to confirm the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the CBOE withdrew the portion of the proposed rule change that would have permitted the Exchange to trade trust issued receipts pursuant to Rule 19b-4(e). See Letter to Heather Traeger, Attorney, Division of Market Regulation ("Division"), SEC, from Angelo Evangelou, Attorney, Legal Division, CBOE, dated June 29, 2000 ("Amendment No. 1").

⁴ In Amendment No. 2, the CBOE added a description of how HOLDRs, a type of trust issued receipt, will trade on the CBOE as well as other salient characteristics of HOLDERS. See Letters to Heather Traeger, Attorney, Division, SEC, from Angelo Evangelou, Attorney, Legal Division, CBOE, dated July 28, 2000 ("Amendment No. 2").

⁵ See Securities Exchange Act Release No. 41892 (September 21, 1999) 64 FR 522559 (September 29, 1999) (approving listing and trading of trust issued receipts and Internet HOLDRs on the Amex); Securities Exchange Act Release No. 42056 (October 22, 1999), 64 FR 58870 (November 1, 1999) (approving listing and trading of trust issued receipts and Internet HOLDRs on the CHX pursuant to UTP); and Securities Exchange Act Release No. 42347 (January 18, 2000), 65 FR 4451 (January 27, 2000) (approving listing and trading of trust issued receipts and Internet HOLDRs on the BSE pursuant to UTP).

appropriateness of continued listing of the trust issued receipts.

iii. Exchange Rules Applicable to the Trading of Trust Issued Receipts

Trust issued receipts are considered "securities" under the Rules of the Exchange and are subject to all applicable trading rules, including the provisions of CBOE Rule 30.76 (Trade-Throughs), which prohibit Exchange members from initiating trade-throughs for ITS securities. The trust issued receipts are also subject to CBOE's rules governing equity margin, priority, parity and precedence of orders, market volatility related trading halt provisions, and responsibilities of Market-Makers and Designated Primary Market-Makers.⁶

Trust issued receipts are currently traded on the Amex, CHX and BSE at minimum variations of 1/16th of \$1.00 for trust issued receipts selling at or above \$.25 and 1/32nd of \$1.00 for those selling below \$.25. The CBOE is proposing the same minimum fractional increments for the trading of trust issued receipts on the Exchange, until decimal pricing is implemented for trust issued receipts.

The Exchange's surveillance procedure for trust issued receipts will be similar to the procedures used for index portfolio receipts ("IPRs") and other equity non-option products traded on the CBOE and will incorporate and rely upon existing CBOE surveillance systems.

Prior to the commencement of trading in trust issued receipts, the Exchange will issue a circular to members highlighting the characteristics of trust issued receipts, including that trust issued receipts are not individually redeemable. In addition, the circular will inform members of Exchange policies about trading halts in such securities. First, the circular will advise that trading will be halted in the event the market volatility trading halt parameters set forth in CBOE Rule 6.3B have been reached. Second, the circular will advise that, in addition to other factors that may be relevant, the Exchange may consider factors such as

those set forth in CBOE Rule 24.7 in exercising its discretion to halt or suspend trading. These factors would include: (1) whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value; or (2) whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

iv. Disclosure to Customers

The Exchange will require its members to provide all purchasers of newly issued trust issued receipts with a prospectus for that series of trust issued receipts.

v. Trading of HOLDRs

Upon approval of the CBOE's listing standards for trust issued receipts, the Exchange intends to begin trading the HOLDRs that are currently trading on other securities exchanges, pursuant to UTP. Specifically, the Exchange may seek to trade Biotech HOLDRs, Internet HOLDRs, Broadband HOLDRs, B2B Internet HOLDRs, Internet Architecture HOLDRs, Internet Infrastructure HOLDRs, Pharmaceutical HOLDRs, Semiconductor HOLDRs, and Telecom HOLDRs. The following section contains information about HOLDRs generally. This information is based upon descriptions included in the various HOLDRs prospectuses and depositary trust agreements, the Amex submissions relating to its trust issued receipt listing proposal and the Commission's order approving the Amex proposal.

Each of the companies represented by the securities in the portfolios underlying the aforementioned HOLDRs trusts were required to meet the following minimum criteria when they were selected: (1) each company's common stock was registered under Section 12 of the Exchange Act;⁷ (2) the minimum public float of each company included in the portfolio was at least \$150 million; (3) each security was either listed on a national securities exchange or traded on Nasdaq and was a reported national market system security; (4) the average daily trading volume for each security was at least 100,000 shares during the preceding sixty-day trading period; and (5) the average daily dollar value of the shares traded during the preceding sixty-day trading period was at least \$1 million. The initial weighting of each security in the portfolio was based on its market capitalization; however, if on the date

such weighting was determined, a security represented more than 20% of the overall value of the receipt, then the amount of such security was to be reduced to no more than 20% of the receipt value.

vi. Trading Issues for HOLDRs

A round lot of any of the above trust issued receipts represents a holder's individual and undivided beneficial ownership interest in the whole number of securities represented by the receipt. The amount of deposited securities for each round lot of 100 trust issued receipts will be determined at the beginning of the marketing period and will be disclosed in the prospectus to investors. Because trust issued receipts may be acquired, held or transferred only in round lots of 100 receipts or round lot multiples, orders for less than a round lot will be rejected, while orders for greater than a round lot, but not a round lot multiple, will be executed to the extent of the largest round lot multiple, rejecting the remaining odd lot.⁸

The CBOE believes that trust issued receipts will not trade at a material discount or premium to the assets held by the issuing trust, because the arbitrage process should promote correlative pricing between the trust issued receipts and the deposited securities. If the price of the trust issued receipt deviates enough from the portfolio of deposited securities to create a material discount or premium, an arbitrage opportunity would be created, allowing the arbitrageur either: (1) to buy the trust issued receipts at a discount, exchanging them for shares of the underlying securities and selling those shares at a profit; or (2) to sell the trust issued receipts short at a premium, buying the securities underlying the trust issued receipts, depositing them in exchange for the trust issued receipts, and delivering against the short position. In both instances, the arbitrageur locks in a profit and the markets move back into line.

vii. Maintenance of HOLDRs Portfolio

Except when a reconstitution even occurs, as described below, the securities represented by a trust issued receipt will not change. According to the prospectuses of the HOLDRs product, under no circumstances will a new company be added to the group of issuers of the underlying securities, and weightings of component securities will

⁶ However, the Exchange's rules relating to odd lot executions will not apply, because trust issued receipts are traded only in round lots or round lot multiples. Additionally, the Exchange understands that the Commission has provided an exemption from the short sale rule, Rule 10a-1 under the Act, 17 CFR 240.10a-1, for transactions in securities issued under the HOLDRs program. The CBOE will issue a notice to its members detailing the terms of the exemption. See Letter to Claire P. McGrath, Vice President and Special Counsel Derivative Securities, Amex, from James A. Brigagliano, Assistant Director, Division, SEC, dated November 3, 1999.

⁷ 15 U.S.C. 781.

⁸ For example, an order for 50 trust issued receipts will be rejected, while an order for 1,050 trust issued receipts, will be executed in part (1,000) and rejected in part (50).

not be adjusted after they are initially set.⁹

viii. Reconstitution Events of HOLDRs

As described in the aforementioned HOLDRs prospectuses, the securities underlying the trust issued receipts will be automatically distributed to the beneficial owners of the receipts in four circumstances:

(1) If the issuer of the underlying securities no longer has a class of common stock registered under Section 12 of the Act,¹⁰ then its securities will no longer be an underlying security and the trustee will distribute the securities of that company to the owners of the trust issued receipts;

(2) If the Commission finds that an issuer of underlying securities should be registered as an investment company under the Investment Company Act of 1940, and the trustee has actual knowledge of the Commission's finding, then the trustee will distribute the shares of that company to the owners of the trust issued receipts;

(3) If the underlying securities of an issuer cease to be outstanding as a result of a merger, consolidation or other corporate combination, the trustee will distribute the consideration paid by and received from the acquiring company to the beneficial owners of the trust issued receipts, unless the acquiring company's securities are already included in the trust issued receipt as deposited securities, in which case such additional securities will be deposited into the trust; and

(4) If an issuer's underlying securities are delisted from trading on a national securities exchange or Nasdaq and are not listed for trading on another national securities exchange or through Nasdaq within five business days from the date the deposited securities are delisted.

As described in the prospectus, if a reconstitution event occurs, the trustee will deliver the deposited security to the investor as promptly as practicable after the date that the trustee has knowledge of the occurrence of a reconstitution event.

ix. Issuance and Cancellation of HOLDRs

The trust will issue and cancel—and an investor may obtain, hold, trade or surrender—HOLDRs only in round lots

⁹ However, the number of each security represented in a receipt may change due to certain corporate events such as stock splits or reverse stock splits on the deposited securities, and the relative weightings among the deposited securities may change based on the current market price of the deposited securities.

¹⁰ 15 U.S.C. 781.

of 100 or in round lot multiples. While investors will be able to acquire, hold, transfer and surrender a round lot of 100 trust issued receipts, the bid and asked prices will be quoted on a per receipt basis. The trust will issue additional receipts on a continuous basis when an investor deposits the required securities with the trust.

An investor may obtain trust issued receipts by either purchasing them on an exchange or by delivering to the trustee the underlying securities evidencing a round lot of trust issued receipts. The trustee will charge an issuance and cancellation fee of up to \$10.00 per 100 trust issued receipts. Lower charges may be assigned for bulk issuances and cancellations. An investor may cancel trust issued receipts and withdraw the deposited securities by delivering a round lot or round lot multiple of the trust issued receipts to the trustee, during normal business hours. According to the prospectus, the trustee expects that, in most cases, it will deliver the deposited securities within one business day of the withdrawal request.

x. Termination of a HOLDRs Trust

The trust shall terminate upon the earlier of: (1) the removal of the receipts from listing on a national securities exchange of Nasdaq if they are not listed for trading on another national securities exchange or Nasdaq within five business days from the date the receipts are delisted; (2) the trustee resigns and no successor trustee is appointed within 60 days from the date the trustee provides notice to the initial depositor of its intent to resign; (3) 75% of the beneficial owners of outstanding trust issued receipts (other than Merrill Lynch, Pierce, Fenner & Smith Incorporated) vote to dissolve and liquidate the trust; or (4) December 31, 2039. If a termination event occurs, the trustee will distribute the underlying securities to the beneficial owners as promptly as practicable after the termination event.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b)(5)¹¹ of the Act in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

¹¹ 15 U.S.C. 78f(b)(5).

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

The Exchange does not believe that the proposed rule will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

No written comments were either solicited or received.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-00-23 and should be submitted by September 7, 2000.

IV. Commission's Findings and Order Granting Accelerated Approval of proposed Rule Change

A. Generally

The Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act¹² and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the Commission finds, as it did in the previous orders approving the listing and trading of trust issued receipts,¹³ that CBOE's proposal establishing listing standards for trust issued receipts will provide investors with a convenient and less expensive way of participating in the securities markets. The proposal should advance the public interest by

¹² 15 U.S.C. 78f(b)(5).

¹³ See *supra* note 5.

providing investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day. Accordingly, the Commission finds that the proposal will facilitate transactions in securities, removed impediments to and perfect the mechanism of a free and open market system, and, in general, to protect investors and the public interest. Moreover, the proposal is not designated to permit unfair discrimination between customers, issuers, brokers, or dealers.¹⁴

Although trust issued receipts are not leveraged instruments, and, therefore, do not possess any of the attributes of stock index options, their prices will be derived and based upon the securities held in their respective trusts. Accordingly, the level of risk involved in the purchase or sale of trust issued receipts is similar to the risk involved in the purchase or sale of traditional common stock, with the exception that the pricing mechanism for trust issued receipts is based on a basket of securities.¹⁵ Nevertheless, the Commission believes that the unique nature of trust issued receipts raises certain product design, disclosure, trading and other issues.

B. Trading of Trust Issued Receipts—Listing and UTP

The Commission finds that the CBOE's proposal contains adequate rules and procedures to govern the trading of trust issued receipts whether by listing or pursuant to UTP and meets all of the specific criteria and listing standards that the Commission approved in earlier orders.¹⁶ This finding specifically extends to the CBOE's intention to trade certain of the HOLDRs type of trust issued receipt, currently limited to Biotech HOLDRs, Internet HOLDRs, Broadband HOLDRs, B2B Internet HOLDRs, Internet Architecture HOLDRs, Internet Infrastructure HOLDRs, Pharmaceutical HOLDRs, Semiconductor HOLDRs, and

¹⁴ In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁵ The Commission has concerns about continued trading of the trust issued receipts whether listed or pursuant to UTP, if the number of component securities falls to a level below nine securities, because the receipts may not longer adequately reflect a cross section of the selected industry. Accordingly, the CBOE has agreed to consult the Commission concerning continued trading, once the trust has fewer than nine component securities, and for each loss of a security thereafter.

¹⁶ See *supra* note 5.

Telecom HOLDRs.¹⁷ Trust issued receipts are equity securities that will be subject to the full panoply of CBOE rules governing the trading of equity securities on the CBOE, including, among others, rules governing margin, the priority, parity and precedence of orders, responsibilities of the specialist, and operational and regulatory trading halts.¹⁸

Moreover, in approving this proposal, the Commission notes the CBOE's representation that trust issued receipts will not trade at a material discount or premium in relation to the overall value of the trusts' assets because of potential arbitrage opportunities. The CBOE represents that the potential for arbitrage should keep the market price of a trust issued receipt comparable to the overall value of the deposited securities.

Finally, the CBOE will apply surveillance procedures for trust issued receipts that incorporate and rely upon existing CBOE surveillance procedures governing equities. The Commission believes that these surveillance procedures will provide adequate safeguards to prevent manipulative acts and practices and to protect investors and the public interest.

C. Disclosure and Dissemination of Information

The Commission believes that the CBOE's proposal will ensure that investors have sufficient information to be adequately apprised of the terms, characteristics, and risks of trading trust issued receipts. The CBOE will require its members to provide all purchasers of newly issued trust issued receipts with a prospectus for that series of trust issued receipt. The Commission also notes that upon the initial listing of any trust issued receipts, the CBOE will issue a circular to its members highlighting the characteristics of trust issued receipts, including that trust issued receipts are not individually redeemable.

D. Accelerated Approval

CBOE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**. As noted above, the Commission has approved the listing and trading of trust issued receipts, including the aforementioned series of HOLDRs which the CBOE intends to

¹⁷ See *infra* note 20.

¹⁸ Trading rules pertaining to the availability of odd lot trading do not apply because trust issued receipts only can be traded in round lots.

trade pursuant to UTP, on other exchanges, under rules that are substantially similar to those in CBOE's proposal. The Commission published those rules in the **Federal Register** for the full notice and comment period. No comments were received on the proposed rules, and the Commission found them consistent with the Act.¹⁹ The Commission believes that trading of this product raises no novel regulatory issues that were not addressed in the previous filings. Accordingly, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**.²⁰

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²¹ that the proposed rule change (SR-CBOE-00-23), is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²²

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43144; File No. SR-CBOE-00-24]

Self-Regulatory Organization; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Exchange Fees

August 10, 2000.

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 June 22, 2000, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission

¹⁹ See *supra*, note 5.

²⁰ However, the Commission notes that, notwithstanding approval of the listing standards for trust issued receipts and, specifically, Biotech HOLDRs, Internet HOLDRs, Broadband HOLDRs, B2B Internet HOLDRs, Internet Architecture HOLDRs, Internet Infrastructure HOLDRs, Pharmaceutical HOLDRs, Semiconductor HOLDRs, and Telecom HOLDRs, other similarly structured products; including trust issued receipts based on other industries, will require review by the Commission prior to being traded on the Exchange. In addition, the CBOE may be required to submit a rule filing prior to trading a new issue or series on the Exchange.

²¹ 15 U.S.C. 78s(b)(2).

²² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(1).

² CFR 240.19b-4.