rules and requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6(b)(5) of the Act.[16] Specifically, the Commission finds that the Exchange's proposal to list and trade S&P MidCap SPDRs will provide investors with a convenient way of participating in the securities markets.[17] In particular, the Commission believes that the Exchange's proposal will provide investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a low cost security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.[18]

The Commission believes that listing and trading products, such as MidCap 400 SPDRs, based on a broad portfolio of stocks may benefit the securities markets by reducing volatility, such as that experienced during the October 1987 and 1989 Market Breaks.[19] Creating a product where actual portfolios of stocks and instruments representing portfolios of stock trade at a single location in an auction market environmental may alter the dynamics of program trading,[20] because the availability of such single transaction portfolio trading could promote more traditional block trading techniques.

The 1987 Market Break Report noted the potential benefits of providing institutional investors and member firms with the ability to trade a portfolio of stocks at posts in a single transaction. The trading crowd at a single post can allow a single transaction in a portfolio of securities to take the place of numerous transactions in individual stocks. Trading MidCap SPDRs should also provide an easy and inexpensive method to clear and settle a portfolio of stocks.

An individual MidCap SPDR recently would have had a value of approximately $34, which should make it attractive to individual retail investors who wish to hold a security replicating the performance of a broad portfolio of medium capitalization stocks. Moreover, the Commission believes that MidCap SPDRs will provide investors with several advantages over standard open-end mutual funds specializing in medium capitalization stocks. In particular, investors will be able to trade MidCap SPDRs continuously throughout the business day in secondary market transactions at negotiated prices.[21] In contrast, Investment Company Act Rule 22c–1 [22] limits holders and prospective holders of open-end mutual fund shares to purchasing or redeeming securities of the fund based on the net asset value of the securities held by the fund as designated by the board of directors. Accordingly, MidCap SPDRs will allow investors to (1) respond quickly to market changes; (2) trade at a known price; (3) engage in hedging strategies not currently available to retail investors; and (4) reduce transaction costs for trading a portfolio of securities.

Although the value of MidCap SPDRs is based on the value of the securities held in the Trust, MidCap SPDRs are not leveraged instruments. In essence, MidCap SPDRs are equity securities that are priced off a portfolio of stocks based on the S&P MidCap 400 Index.[23] Accordingly, the level of risk involved in the purchase or sale of a MidCap SPDR is similar to the risk involved in the purchase or sale of equity securities, except that the value of a MidCap SPDR is based on a basket of stocks. Nevertheless, the Commission believes that MidCap SPDRs raise disclosure, market impact, and secondary market trading issues that must be addressed.

A. Disclosure

Existing Amex rules regarding PDRs are applicable to MidCap SPDRs, ensuring that investors are aware of the terms, characteristics, and risks of trading MidCap SPDRs.[24] Accordingly, Amex members must provide their customers trading MidCap SPDRs with a written explanation, prepared by the Amex, describing any special characteristics and risks attendant to trading MidCap SPDRs.[25] Members and member organizations also must include this written product description with any sales material relating to MidCap SPDRs that is provided to customers or the public. Finally, any other written materials provided by a member or member organization to customers or the public that refer to MidCap SPDRs as an investment vehicle must include a statement, in a form specified by the Amex, that a circular and prospectus are available from a broker upon request. A member or member organization carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of MidCap SPDRs for such omnibus account will be deemed to constitute agreement by the non-member to make the written product description available to its customers on the same terms as member firms.[26]

The Amex's proposal contains no special account opening or customer suitability rules applicable to the

[16] 15 U.S.C. 78f(b)(5) (1988).

[17] The Commission approved Amex rules to accommodate trading on the Exchange of PDRs in Securities Exchange Act Release No. 31591, *supra* note 5. Because the analysis contained in that release is applicable to the Amex's current proposal to list and trade MidCap SPDRs, the Commission is incorporating it by reference.

[18] In originally approving PDRs, the Commission noted that PDRs will benefit investors by allowing them to trade securities based on Trusts in secondary market transactions.

The Commission notes that unlike open-end funds where investors have the right to redeem their fund shares on a daily basis, investors could only redeem MidCap SPDRs in 25,000 share units. Nevertheless, MidCap SPDRs will have the added benefit of liquidity from the secondary market.

[19] See Division of Market Regulation (''Division''), SEC, The October 1987 Market Break (February, 1988) (''1987 Market Break Report'') and Division, SEC, Market Analysis of October 13, and 16, 1989 (December 1990).

[20] Program trading is defined as index arbitrage or any trading strategy involving the related purchase or sale of a ''basket'' or group of 15 or more stocks having a total market value of $1 million or more.

[21] Because of potential arbitrage opportunities, the Commission believes that MidCap SPDRs will not trade at a material discount or premium in relation to their net asset value. The mere potential for arbitrage should keep the market price of a SPDR comparable to its net asset value, and therefore, arbitrage activity likely will be minimal. In addition, the Trust will redeem only in-kind, thereby enabling the Trust to invest virtually all of its assets in securities comprising the MidCap 400 Index.

[22] 17 CFR 270.22c–1 (1994). Investment Company Rule 22c–1 generally requires that a registered investment company issuing a redeemable security, its principal underwriter, and dealers in that security may sell, redeem, or repurchase the security only at a price based on the net asset value next computed after receipt of an investor's request to purchase, redeem or resell. The net asset value of a mutual fund generally is computed once daily Monday through Friday as designated by the investment company's board of directors. The Commission granted MidCap SPDRs an exemption from this provision to allow them to trade in the secondary market at negotiated prices. See Investment Company Act Release No. 20844 (January 18, 1995).

[23] Because SPDRs will trade like equity securities, the margin requirements for MidCap SPDRs, as with other PDRs, will be 150% of current market value for short sales, and 50% of current market value for long positions. These are the usual Regulation T, 12 CFR 220 (1994), requirements for equity margin stocks. Accordingly, the Exchange has stated its intention to obtain margin offset treatment with respect to Regulation T customer margin, both for offsetting positions of MidCap SPDRs and an equivalent amount of their component securities, and for ''cover'' in accordance with the provisions contained in Section 220.5(c)(3) governing options. The Exchange also intend to seek similar margin offset treatment with respect to market maker charges under Exchange Act Rule 15c3–1(c)(2)(x), 17 CFR 240.15c3–1(c)(2)(x) (1994). Telephone Conversation with Michael Cavalier, *supra* note 11.

[24] See Amex Rule 1000, Commentary .01.

[25] The Amex submitted a MidCap SPDR product description as an exhibit to its filing. Among other things, the product description states that MidCap SPDRs possess risks similar to those that exist when investing in a broadly based portfolio of common stocks, including the risk that the general level of stock prices may decline.

[26] See Amex Rule 1000, Commentary .01.