

Index, the time remaining to maturity, dividend rates, and the creditworthiness of the issuer, Bear Stearns.¹³

Because Index Notes are linked to an index of equity securities, the Amex's existing equity floor trading rules will apply to the trading of Index Notes.¹⁴ First, pursuant to Amex Rule 411, the exchange will impose a duty of due diligence on its members and member firms to learn the essential facts relating to every customer prior to trading Index Notes.¹⁵ Second, consistent with Amex Rule 411, the Exchange will further require that a member or member firm specifically approve a customer's account for trading Index Notes prior to, or promptly after, the completion of the transaction.¹⁶ Third, Index Notes will be subject to the equity margin rules of the Exchange.¹⁷ Fourth, the Exchange will, prior to trading Index Notes, distribute a circular to the membership providing guidance with regard to member firm compliance responsibilities (including suitability recommendations) when handling transactions in Index Notes and highlighting the special risks and characteristics of the Index Notes.¹⁸

III. Commission Findings and Conclusions

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) of the Act.¹⁹ Specifically, the Commission believes that providing for exchange-trading of the Notes will offer a new and innovative means of participating in the market for securities identified by the issuer of the Notes as consolidation candidates.²⁰ In particular, the

Commission believes that the Notes will permit investors to gain equity exposure in such companies, while at the same time, limiting the downside risk of their original investment. For the reasons discussed in the Indexed Term Note Approval Orders, the Commission finds that the listing and trading of the Notes is consistent with the Act.²¹

As with the other indexed term notes approved for listing by the Exchange, the Notes are not leveraged instruments. Their price, however, will still be derived and based upon the underlying linked securities. Accordingly, the level of risk involved in the purchase or sale of Index Notes is similar to the risk involved in the purchase or sale of traditional common stock. Nonetheless, the Commission has several specific concerns with this type of products because the final rate or return of the Notes is derivatively priced, based on the performance of the underlying securities. The concerns include: (1) Investor protection concerns, (2) dependence on the credit of the issuer of the security, (3) systemic concerns regarding position exposure of issuers with partially hedged positions or dynamically hedged positions, and (4) the impact on the market for the underlying linked securities.²² The Commission believes the Amex has adequately addressed each of these issues such that the Commission's regulatory concerns are adequately minimized.²³ In particular, by imposing the listing standards, suitability, disclosure, and compliance requirements noted above, the Amex has adequately addressed the potential public customer concerns that could arise from the hybrid nature of the Notes.²⁴ Moreover, the Commission believes that the Exchange's existing surveillance procedures are adequate to detect and deter any attempts at manipulation of the Notes and the securities in the Index.

Further, the Commission believes that the listing standards and issuance restrictions discussed above, particularly, the objective standards for market capitalization, trading volume, and options eligibility, will ensure that at the time that the Notes are issued, the Index will be composed of highly capitalized, liquid securities. As a

result, the Commission believes that any concerns regarding the potential for manipulation of the Index or adverse market impact on the securities comprising the Index are adequately minimized.

The Commission realizes that Index Notes are dependent upon the individual credit of the issuer, Bear Stearns. To some extent this credit risk is minimized by the Exchange's listing standards in Section 107A of the Guide which provide that only issuers satisfying substantial asset and equity requirements may issue securities such as Index Notes.²⁵ In addition, the Exchange's hybrid listing standards further require that Index Notes have at least \$4 million in market value.²⁶ In any event, financial information regarding Bear Stearns, in addition to the information on the issuers of the securities comprising the Index, will be publicly available.²⁷

The Commission finds good cause for approving the proposed rule change and Amendment Nos. 1 and 2 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Specifically, the proposal, as amended, is substantively similar to other indexed term notes that the Commission has approved for listing by the Amex.²⁸ To the Commission's knowledge, these other issues of notes have traded on the Amex without any material problems occurring.²⁹ The only substantive differences between these Notes and those previously approved are the composition of the index of securities on which the values of the Notes will be based, the method for calculating the value to be received by holders upon maturity of the Notes, and the amount of participation by investors in the appreciation of the Index during the term of the Notes. With regard to the composition of the Index, as discussed above, the Commission believes that the objective eligibility standards for including a particular security in the Index minimize the potential for manipulation of the Notes and any possible adverse market impact on the securities contained in the Index.

The Commission also believes that the proposed method for calculating the amount to be paid to holders at maturity does not raise any significant regulatory concerns. The formula used here involves the averaging of 36 monthly

¹³ See Amendment No. 2, *supra* note 5.

¹⁴ *Id.*

¹⁵ *Id.* Amex Rule 411 requires that every member, member firm or member corporation use due diligence to learn the essential facts relative to every customer and to every order or account accepted.

¹⁶ See Amendment No. 2, *supra* note 5.

¹⁷ *Id.*

¹⁸ *Id.* The Commission notes that the circular should also highlight the formula for calculating the payment to holders at maturity as well as the participation rate in the appreciation of the Index, as described above.

¹⁹ 15 U.S.C. 78f(b)(2) (1988).

²⁰ The Commission notes that the Index Notes are very similar in structure to other indexed term notes recently approved by the Commission for listing on the Amex. See Securities Exchange Act Release Nos. 34820 (October 11, 1994), 59 FR 52571 (October 18, 1994) (approval for listing of indexed term notes linked to a portfolio of "basic" industry securities), 34723 (September 27, 1994), 59 FR 50631 (October 4, 1994) (approval for listing of indexed term notes linked to a portfolio of banking industry securities), and 33495 (January 19, 1994),

59 FR 3883 (January 27, 1994) (approval for listing of Telecommunications Basket Stock Upside Note Securities) (collectively, Indexed Term Note Approval Orders").

²¹ *Id.*

²² *Id.*

²³ *Id.*

²⁴ The Exchange will also distribute a circular to its membership calling attention to the specific risks associated with the Notes. See *supra* note 18.

²⁵ See *supra* note 8.

²⁶ See Amex Company Guide § 107A.

²⁷ The companies that comprise the Index are reporting companies under the Act.

²⁸ See Indexed Term Note Approval Orders, *supra* note 20.

²⁹ See June 20 Conversation, *supra* note 12.