#### D. Surveillance

The Exchanges will use their existing surveillance procedures to monitor trading in Index warrants. The Exchanges represent that they are currently negotiating to enter into separate surveillance sharing agreements with the FSE.

Both the Amex and the CBOE have submitted to Commission approval a proposed rule change governing, among other things, customer protection and margin requirements for stock index warrants, currency index warrants, and currency warrants. <sup>14</sup> DAX Index warrants issued subsequent to approval of those proposals will be subject to these new rules.

#### **III. Comment Letters**

Three comment letters were received by the Commission—one discussing the CBOE proposal, one discussing the Amex proposal, and one follow-up letter discussing both proposals. All three comment letters were submitted on behalf of the Deutsche Börse AG, DTB, and FSE. The first two letters received raised the same issues concerning the respective proposals. 15 The commenters assert that the FSE has a proprietary interest in the DAX Index which vests the FSE with the exclusive right to license its use for trading index products based on the DAX Index. According to the commenters, even if the Amex and CBOE had any rights to use the DAX Index or the "DAX" name, those rights either lapsed or were terminated by the Deutsche Börse AG. 16 As a result, the commenters argue that the proposals raise issues concerning intellectual property rights which should be resolved prior to Commission approval of the proposals.

Similarly, the commenters also assert that all surveillance agreements between the FSE and each of the Exchanges have either lapsed or been terminated by the Deutsche Börse AG.<sup>17</sup> As a result, the commenters conclude that it would be impossible for the Commission to find that the proposed DAX Index warrants would not be susceptible to manipulation. The commenters, however, have informed the

Commission that the Deutsche Börse AG is currently negotiating with the CBOE and the Amex for purposes of entering into market surveillance agreements with each Exchange. 18

Based on these arguments, the commenters conclude that it would be inappropriate for the Commission to approve the proposed rule changes until these issues are resolved.<sup>19</sup>

## **IV. Commission Findings**

The Commission finds that the proposed rule changes are 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.<sup>20</sup> Specifically, the Commission believes that the trading of warrants based on the DAX Index will serve to protect investors, promote the public interest, and help to remove impediments to a free and open securities market by providing investors with a means to hedge exposure to market risk associated with the German equity market and provide a surrogate instrument for trading in the German securities market.<sup>21</sup> The trading of warrants based on the DAX Index should provide investors with a valuable hedging vehicle that should reflect accurately the overall movement of the German equity market.

In addition, the Commission believes, for the reasons discussed below, that the Amex and the CBOE have adequately addressed issues related to customer protection, index design, surveillance, and market impact of DAX Index warrants.

# A. Customer Protection

Due to the derivative nature of index warrants, the Commission believes that DAX Index warrants should only be sold to investors capable of evaluating and bearing the risks associated with trading in such instruments and that adequate risk disclosure be made to investors. In this regard, the Commission notes that the rules and procedures of the Exchanges that address the special concerns attendant

to the secondary market trading of index warrants will be applicable to DAX Index warrants. In particular, by imposing the special suitability, account approval, disclosure, and compliance requirements noted above, the Amex and the CBOE have adequately addressed potential public customer problems that could arise from the derivative nature of DAX Index warrants. Moreover, the Amex and the CBOE plan to distribute circulars to their members identifying the specific risks associated with warrants on the DAX Index. Finally, pursuant to the Exchanges' listing guidelines, only substantial companies capable of meeting their warrant obligations will be eligible to issue DAX Index warrants.

# B. Index Design and Structure

The Commission finds that it is appropriate and consistent with the Act to classify the Index as a broad-based index. Specifically, the Commission believes the Index is broad-based because it reflects a substantial segment of the German equity market. First, the Index consists of 30 actively traded stocks listed by the FSE. Second, the market capitalizations of the stocks comprising the Index are very large. Specifically, the total capitalization of the Index, as of December 2, 1994, was approximately U.S. \$299.55 billion, with the market capitalizations of the individual stocks in the Index ranging from a high of \$36.40 billion to a low of \$841.73 million, with a mean value of \$9.99 billion.22 Third, no one particular stock or group of stocks dominates the weight of the Index. Specifically, as of December 2, 1994, no single stock accounted for more than 12.15% of the Index's total value, and the percentage weighting of the five largest issues in the Index accounted for 43.69% of the Index's value. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based.

## C. Surveillance

As a general matter, the Commission believes that comprehensive surveillance sharing agreements between the relevant foreign and domestic exchanges are important where an index derivative product based on foreign securities is to be traded in the United States.<sup>23</sup> In most

Continued

 <sup>&</sup>lt;sup>14</sup> See Securities Exchange Act Release Nos.
35086 (December 12, 1994), 59 FR 65561 (December 20, 1994) (notice of File No. SR-Amex-94-38), and
35178 (December 29, 1994), 60 FR 2409 (January 9, 1994) (notice of File No. SR-CBOE-94-34).

<sup>15</sup> See Comment Letters. supra note 4

<sup>&</sup>lt;sup>16</sup> *Id.* The commenters, however, have informed the Commission that the Deutsche Börse AG is currently negotiating with the CBOE and the Amex for purposes of licensing the DAX Index and the DAX name to the Exchanges for purposes of listing DAX Index warrants. *See* July 19 Letter, *supra* note 4.

<sup>17</sup> See Comment Letters, supra note 4.

 $<sup>^{18}\,</sup>See\,July$ 19 Letter, supra note 4.

 $<sup>^{19}\,</sup>See$  Comment Letters, supra note 4.

<sup>20 15</sup> U.S.C. § 78f(b)(5) (1988).

<sup>&</sup>lt;sup>21</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new securities product upon a finding that the introduction of such product is in the public interest. Such a finding would be difficult with respect to a warrant that served no hedging or other economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

<sup>&</sup>lt;sup>22</sup> These figures are based on the German mark values as of December 2, 1994, but converted to dollars using the current exchange rate of approximately DM 1.39/U.S. \$1.00.

<sup>&</sup>lt;sup>23</sup> A comprehensive surveillance sharing agreement would allow the parties to the agreement to obtain relevant surveillance information,