Thursday, as well as on the valuation date.

Third, the Comment Letter recommended creating a special category of "warrant eligible" customers (separate and distinct from options eligibility criteria), who are authorized to trade warrants even if not approved to trade options. The Firms believe it is inappropriate to apply an options regulatory regime to warrants and that doing so may prevent institutional customers who are not permitted to purchase options products, yet who nevertheless meet all of the options eligibility criteria, from purchasing warrants. In this regard, the Firms propose to create a "warrant eligible" category with standards mimicking those currently required for options approved accounts. As such, "warrantapproved" accounts could purchase warrants, however, they could not purchase options or other products requiring options account approval. The CBOE did not amend its filing in response to this comment.

Fourth, the Comment Letter urges the adoption of a rule permitting firms to approve for warrant trading those accounts managed by an investment adviser ("IA") based upon the IA's representation concerning the eligibility status of its customers to engage in warrant trading, even if the underlying documentation relating to the managed accounts is not provided to the brokerage firms. The CBOE has amended its proposal to allow member firms to accept the representation of an investment adviser registered under the Investment Advisers Act of 1940 concerning the eligibility status of its customers to engage in warrant trading, even if the underlying documentation relating to the managed account is not provided to the member firm, where the managed account is for an institutional customer or the investment advisor account represents the collective investment of a number of persons. The CBOE states that this will conform the handling of warrant accounts to the current practice with respect to listed options accounts.30

Finally, the Comment Letter addressed the proposed position limits applicable to warrants. Specifically, the Comment Letter noted that position limits for warrants would be set at levels that are approximately 75% of that allowed for similar broad-based indexes. The Comment Letter recommended establishing position limits for warrants that were equivalent to those established for listed options, allowing a hedge exemption similar to listed

## IV. Discussion

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).31 Specifically, the Commission finds that the Exchange's proposal to establish uniform listing standards for broadbased stock index, currency and currency index warrants strikes a reasonable balance between the Commission's mandates under Section 6(b)(5) to remove impediments to and perfect the mechanism of a free and open market and a national market system, while protecting investors and the public interest. In addition, the CBOE's proposed listing standards for warrants are consistent with the Section 6(b)(5) requirements that rules of an exchange be designed to prevent fraudulent and manipulative acts, to promote just and equitable principles of trade, and are not designed to permit unfair discrimination among issuers.

The CBOE's proposed generic listing standards for broad-based stock index warrants, currency and currency indexes set forth a regulatory framework for the listing of such products.32 Generally, listing standards serve as a means for an exchange to screen issuers and to provide listed status only to bona fide issuances that will have sufficient public float, investor base, and trading interest to ensure that the market has the depth and liquidity necessary to maintain fair and orderly markets. Adequate standards are especially important for warrant issuances given the leverage and contingent liability they represent. Once a security has been approved for initial listing, maintenance criteria allow an exchange to monitor the status and trading characteristics of that issue to ensure that it continues to meet the exchange's standards for market depth and liquidity so that fair and orderly markets can be maintained.

In reviewing listing standards for derivative-based products, the Commission also must ensure that the

regulatory requirements provide for adequate trading rules, sales practice requirements, margin requirements, position and exercise limits and surveillance procedures. These rules minimize the potential for manipulation and help to ensure that derivativelypriced products will not have a negative market impact. In addition, these standards should address the special risks to consumers arising from the derivative products.<sup>33</sup> For the reasons discussed below, the Commission believes the CBOE's proposal will provide it with significant flexibility to list index, currency and currency index warrants, without compromising the effectiveness of the Exchange's listing standards or regulatory program for such products.34

## A. Issuer Listing Standards and Product Design

As a general matter, the Commission believes that the trading of warrants on a stock index, currency or currency index permits investors to participate in the price movements of the underlying assets, and allows investors holding positions in some or all of such assets

option procedures and providing a mechanism for specific waivers or exemptions of warrant position limits for hedgers, market-makers and broker-dealers comparable to the procedures in place for listed options. The CBOE did not amend its filing in response to this comment.

 $<sup>^{31}\,15</sup>$  U.S.C. 78f(b)(5) (1982).

<sup>&</sup>lt;sup>32</sup> The Commission notes that warrants issued prior to this approval order will continue to be governed by the rules applicable to them at the time of their listing.

<sup>33</sup> Pursuant to Section 6(b)(5) of the Act, the Commission is required to find, among other things, that trading in warrants will serve to protect investors and contribute to the maintenance of fair and orderly markets. In this regard, the Commission must predicate approval of any new derivative product upon a finding that the introduction of such derivative instrument is in the public interest. Such a finding would be difficult for a derivative instrument 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. As discussed below, the Commission believes warrants will serve an economic purpose by providing an alternative product that will allow investors to participate in the price movements of the underlying securities in addition to allowing investors holding positions in some or all of such securities to hedge the risk associated with their

<sup>&</sup>lt;sup>34</sup> Issuances of warrants overlying a single currency may currently be listed for trading without a rule filing provided that the underlying currence is one of the original seven foreign currencies approved for options trading: the Australian Dollar, British Pound, Canadian Dollar, French France German Mark, Japanese Yen, Swiss Franc and the European Currency Unit. Issuances of currency warrants overlying any other foreign currency would require a rule filing pursuant to Section 19(b) of the Act. The Commission notes that currency index warrants may only be established without a further rule filing upon an index that has been previously approved by the Commission pursuant to a Section 19(b) filing. To date, the only currency index approved pursuant to Section 19(b) is an equal-weighted index comprised of the British Pound, Japanese Yen and German Deutsche Mark. See Securities Exchange Act Release No. 31627 (Dec. 21, 1992), 57 FR 62399 (Dec. 30, 1992). Accordingly, any other currency index (as well as a broad-based stock index) not previously approved by the Commission would require approval pursuant to Section 19(b).

<sup>30</sup> See Amendment No. 1.