replacements and unusual divisor adjustments caused by the occurrence of extraordinary events, such as dissolution, merger, bankruptcy, nonroutine spinoffs, or extraordinary dividends, will be made by Exchange staff in consultation with Morgan Stanley, Amex alone ultimately will select the actual replacement stock from the Replacement List without Morgan Stanley's assistance. Such replacements will be announced publicly at least 10 business days in advance of the effective change by the Amex through the dissemination of an information circular, whenever practicable. Fourth, each Replacement List submitted to the Amex by Morgan Stanley will be published by the Amex and securities cannot be selected from a Replacement List for three months after receipt by the Amex. Fifth, the Commission believes that the procedures Morgan Stanley has established to detect and prevent material non-public information concerning the Index from being improperly used by the person or persons responsible for compiling the Replacement Lists, as well as other persons within Morgan Stanley, as discussed above,<sup>40</sup> adequately serve to minimize the susceptibility to manipulation of the Index, the securities in the Index, and securities added to and deleted from any Replacement List. Finally the Exchange's existing surveillance procedures for stock index options will apply to the options on the Index and should provide the Amex with adequate information to detect and deter trading abuses that may occur. In summary, the Commission believes that the procedures outlined above help to ensure that Morgan Stanley will not have any informational advantages concerning modifications to the composition of the Index due to its limited role in consulting with Amex on the maintenance of the Index under certain circumstances.

## B. Customer Protection

The Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as Index options (including full-value and reduced-value LEAPS), can commence on a national securities exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) The special risks of options are disclosed to public customers; (2) only investors capable of evaluating and

bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. Accordingly, because the Index options and Index LEAPS will be subject to the same regulatory regime as the other standardized options currently traded on the Amex, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Tech 35 Index options and full-value or reduced value Index LEAPS. Finally, the Amex has stated that it will distribute information circulars to members following rebalancings and prior to component changes to notify members of changes in the composition of the Index. Additionally, the Amex will publicly disseminate each Replacement List by means of information circulars. The Commission believes this should help to protect investors and avoid investor confusion.

## C. Surveillance

The Commission believes that a surveillance sharing agreement between an exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. Such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation.<sup>41</sup> In this regard, the Amex, NYSE, and National Association of Securities Dealers, Inc. are all members of the ISG, which provides for the exchange of all necessary surveillance information.42

## D. Market Impact

The Commission believes that the listing and trading of Index options, including full-value and reduced-value Index LEAPS on the Amex will not adversely impact the underlying securities markets.<sup>43</sup> First, as described

above, due to the "equal dollarweighting" method, no one stock or group of stocks dominates the Index. Second, because at each quarterly review and each rebalancing of the Index, at least 90% of the weight of the Index must be accounted for by stocks that meet the Amex's options listing standards, the component stocks generally will be actively-traded, highlycapitalized stocks. Third, the currently applicable 10,500 contract position and exercise limits will serve to minimize potential manipulation and market impact concerns. Fourth, the risk to investors of contra-party nonperformance will be minimized because the Index options and Index LEAPS will be issued and guaranteed by the Options Clearing Corporation just like any other standardized option traded in the United States.

Lastly, the Commission believes that settling expiring Tech 35 Index options (including full-value and reduced-value Index LEAPS) based on the opening prices of component securities is reasonable and consistent with the Act. As noted in other contexts, valuing options for exercise settlement on expiration based on opening prices rather than closing prices may help reduce adverse effects on markets for stocks underlying options on he Index.<sup>44</sup>

The Commission finds good cause for approving Amendment Nos. 1, 3,45 and 4 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Specifically, as discussed above, the Commission believes that Amendment Nos. 1, 3, and 4 serve to minimize the susceptibility of the Index to manipulation by, among other things, requiring more restrictive maintenance standards than those originally proposed by the Exchange, and, in certain circumstances, requiring rebalancing of the Index more frequently than on an annual basis. Additionally, the Amex's original proposal was published in the Federal Register for the full 21-day comment period without any comments being received by the Commission. Finally, the Commission notes that except for the proposed rebalancing requirements, the proposal, as amended, satisfies the Exchange's generic narrow-based index option listing standards contained in Amex Rule 901C, Commentary .02. As

<sup>&</sup>lt;sup>40</sup> See Morgan Stanley Letter, supra note 18.

<sup>&</sup>lt;sup>41</sup> See Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45829 (October 5, 1992).

<sup>&</sup>lt;sup>42</sup> See supra note 29.

<sup>&</sup>lt;sup>43</sup> In addition, the Amex has represented that the Amex and the OPRA have the necessary systems capacity to support those new series of index options that would result from the introduction of Index options and Index LEAPS. *See* Letter from Charles Faurot, Managing Director, Market Data Services, Amex, to Michael Walinskas, Branch Chief, OMS, Division, Commission, dated August 10, 1995; Letter from Edward Cook, Jr., Managing Director, Information Technology, Amex, to Michael Walinskas, Branch Chief, OMS, Division, Commission, dated August 15, 1995; and Letter from Joe Corrigan, Executive Director, OPRA, to

Michael Walinskas, Branch Chief, OMS, DIvision, Comission, dated August 14, 1995.

<sup>&</sup>lt;sup>44</sup> Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992).

<sup>&</sup>lt;sup>45</sup> As noted above, Amendment No. 2 has been superseded by Amendment No. 3. *See supra* note