

the Index's total value and the five highest weighted securities in the Index accounted for 68.33% of the Index's value.

Fourth, the proposed maintenance criteria will serve to ensure that: (1) The Index remains composed substantially of liquid, highly capitalized securities; and (2) the Index is not dominated by any one security that does not satisfy the Exchange's options listing criteria. Specifically, in considering changes to the composition of the Index, 90% of the weight of the Index and 80% of the number of components in the Index must comply with the listing criteria for standardized options trading set forth in CBOE Rule 5.3 (for securities that are not then the subject of standardized options trading) and CBOE Rule 5.4 (for securities that are then the subject of standardized options trading).<sup>32</sup> Additionally, the CBOE is required to review the composition of the Index at least quarterly to ensure that the Index continues to meet this 90%/80% criterion.

The CBOE will promptly notify the Commission staff at any time that the CBOE determines that the Index fails to satisfy any of the above maintenance criteria. Further, in such an event, the Exchange will not open for trading any additional series of Index options or Index LEAPS unless the Exchange determines that such failure is not significant, and the Commission staff affirmatively concurs in that determination, or unless the Commission specifically approves the continued listing of that class of Index options or Index LEAPS pursuant to a proposal filed in accordance with Section 19(b) of the Act.

For the above reasons, the Commission believes that these criteria minimize the potential for manipulation of the Index and eliminate domination concerns.

#### 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 Automotive Index options, including full-value and reduced-value Automotive Index 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 index options currently traded on the CBOE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Automotive Index options and full-value and reduced-value Automotive Index LEAPS.

#### 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>33</sup> In this regard, the Commission notes that the NYSE, which currently is the primary market for all of the Index's component securities, is a member of the ISG.<sup>34</sup> The Commission believes that this arrangement ensures the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the Index options and full-value and reduced-value Index LEAPS less readily susceptible to manipulation.<sup>35</sup>

#### D. Market Impact

The Commission believes that the listing and trading on the CBOE of Automotive Index options, including full-value and reduced-value Index LEAPS, will not adversely impact the markets for the securities contained in the Index.<sup>36</sup> First, because of the

"modified equal-dollar-weighting" formula described above, no one security or group of securities represented in the Index will dominate the weight of the Index immediately following a quarterly re-balancing. Second, the maintenance criteria for the Index ensure that the Index will be substantially comprised of securities that satisfy the Exchange's listing standards for standardized options trading. Third, because the securities comprising the Index must be "reported securities" as defined in Rule 11Aa3-1 of the Act, the components of the Index generally will be actively-traded and highly-capitalized. Fourth, the 9,000 contract position and exercise limits applicable to Index options and Index LEAPS will serve to minimize potential manipulation and market impact concerns.

Lastly, the Commission believes that settling expiring Automotive Index options, including full-value and reduced-value Index LEAPS, based on the opening prices of the component securities is consistent with the Act.

The Commission finds good cause for approving Amendment No. 1 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Specifically, Amendment No. 1 provides objective maintenance criteria which, for the reasons stated above, minimize the potential for manipulation of the Index and the securities comprising the Index. Further, as discussed above, the Commission believes that these maintenance criteria significantly strengthen the customer protection and surveillance aspects of the proposal, as originally proposed.<sup>37</sup>

Based on the above, the Commission finds good cause for approving Amendment No. 1 to the proposed rule change on an accelerated basis and believes that the proposal, as amended, is consistent with sections 6(b)(5) and 19(b)(2) of the Act.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 1. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule

<sup>33</sup> See Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45849 (October 5, 1992).

<sup>34</sup> See *supra* note 28.

<sup>35</sup> See *e.g.*, Securities Exchange Act Release No. 31243 (September 28, 1992), 57 FR 45849 (October 5, 1992) (order approving the listing of index options and index LEAPS on the CBOE Biotech Index).

<sup>36</sup> In addition, the CBOE has represented that the CBOE 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 Memorandum from Joe Corrigan, Executive Director, OPRA, to William Speth, CBOE, dated August 30, 1995.

<sup>37</sup> See *supra* note III.A.

<sup>32</sup> Additionally, the securities contained in the Index must be "reported" securities and must be traded on the Amex or the NYSE or must be Nasdaq/NM securities. See also *supra* notes 9-15 and accompanying text discussing certain requirements involving changes in the Index.