requirements of Section 6(b)(5).<sup>33</sup> Specifically, the Commission finds that the trading of Asian Markets Index options, including full-value and reduced-value Index LEAPs, will serve to promote the public interest and help to remove impediments to a free and open securities market by providing investors with a means of hedging exposure to market risk associated with emerging Asian market securities.<sup>34</sup>

The trading of options on the Asian Markets Index, including full-value and reduced-value Index LEAPS, however, raises several issues related to index design, customer protection, surveillance, and market impact. The Commission believes, for the reasons discussed below, that the CBOE has adequately addressed these issues.

## A. Index Design and Structure

The Commission finds that it is appropriate to treat the Asian Markets Index as a narrow-based index under CBOE rules for purposes of applicable position and exercise limits, trading halt and suspension procedures, and margin treatment. Although the closed-end funds represented in the Index. in aggregate, hold in excess of 180 individual Asian market securities,35 the Asian Markets Index is composed of securities representing only 15 closedend mutual funds.<sup>36</sup> Accordingly, in light of the limited number of closedend fund securities contained in the Index, the Commission believes it is proper to treat the Asian Markets Index as narrow-based for the regulatory purposes noted above.

The Commission also finds that the large capitalizations, liquid markets, and relative weightings of the closed-end fund securities comprising the Index significantly minimizes the potential for manipulation of the Index.

First, the overwhelming majority of the closed-end fund securities comprising the Index are actively traded, with an average daily trading volume for all such mutual fund shares for the period from July 1, 1994 through December 31, 1994, of approximately 53,568 shares per day. Second, the market capitalizations of the closed-end fund securities in the Index are large, ranging from a high of \$628.65 million to a low of \$46.36 million as of January 4, 1995, with the mean and median being \$205.05 million and \$172.65 million, respectively. Third, although the Index is composed of securities representing only 15 closed-end mutual funds, no particular security or group of closedend fund securities dominates the Index. Specifically, as of January 4, 1995, no closed-end fund security contained in the Index accounted for more than 12.51% of the Index's total value and the percentage weighting of the five largest closed-end fund securities in the Index accounted for 48.80% of the Index's value.

Fourth, the proposed maintenance criteria will serve to ensure that: (1) the Index remains comprised substantially of closed-end mutual funds that are highly capitalized and that have liquid markets for their issued securities; and (2) the Index is not dominated by any one mutual fund security that does not satisfy the Exchange's options listing criteria, any one security held by one or more of the mutual funds represented in the Index, or securities from any one country held by one or more of the mutual funds represented in the Index. Specifically, in considering changes to the composition of the Index, 75% of the weight of the Index and 75% of the number of closed-end mutual funds represented in the Index must comply with the listing criteria for standardized options trading set forth in CBOE Rule 5.3, Interpretation and Policy .01 (for mutual fund securities that are not then the subject of standardized options trading) and CBOE Rule 5.4, Interpretation and Policy .01 (for mutual fund securities that are then the subject of standardized options trading).37 Additionally, the CBOE is required to review the composition of the Index at least semiannually to ensure that the Index continues to meet these "75%' requirements.

Further, at least semiannually, based on the most recent Commission filings

by the closed-end funds represented in the Index, the CBOE will review the holdings of each closed-end fund and will promptly notify the Commission if: (1) any security held by one or more of the closed-end funds represented in the Index, in aggregate, accounts for more than 5% of the weight of the Index; or (2) securities from any one country held by one or more of the closed-end funds represented in the Index, in aggregate, account for more than 25% of the weight of the Index. Similarly, the CBOE will promptly notify the Commission staff at any time that it determines that the shares of a closedend fund contained in the Index account for more than 15% of the weight of the Index if the shares of the mutual fund do not satisfy the listing eligibility requirements in CBOE's rules.38

Finally, the CBOE will promptly notify the Commission staff at any time that it determines that either the Index or the shares of one or more of the closed-end funds comprising the Index fail to satisfy any of the above maintenance criteria. In such an event, the Exchange will not open for trading any additional series of Index options or 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)(2) 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 Asian Markets Index options, including fullvalue and reduced-value Asian Markets 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

<sup>33 15</sup> U.S.C. 78f(b)(5)(1988).

<sup>34</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new option proposal upon a finding that the introduction of such new 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. In this regard, the trading of listed Index options and full-value and reducedvalue Index LEAPS will provide investors with a hedging vehicle that should reflect the overall movement of Asian market securities, excluding Japanese securities, represented through the holdings of closed-end mutual funds traded in the

<sup>35</sup> See August 16, Letter, supra note 12.

<sup>36</sup> The reduced-value Asian Markets Index, which consists of the same component mutual fund components as the Index and is calculated by dividing the Index value by ten, is identical to the Asian Markets Index.

<sup>&</sup>lt;sup>37</sup> Additionally, mutual fund 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. The CBOE is also limited in the number of mutual funds that can be represented in the Index without having to obtain Commission approval. *See supra* notes 14 and 15.

<sup>38</sup> See supra notes 16 and 17.