expects the Amex to monitor compliance with these aspects of the stopping stock program through its special surveillance procedures.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[23] that the proposed rule change (SR–Amex–95–14) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[24]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 95–26573 Filed 10–25–95; 8:45 am]

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[Release No. 34–36390; International Series Release No. 872; File No. SR–CBOE–95–39]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to a Proposed Rule Change Relating to the Listing and Trading of Options and Long-Term Options on the CBOE Germany 25 Index and Long-Term Options on a Reduced-Value CBOE Germany 25 Index

October 18, 1995.

I. Introduction

On August 4, 1995, the Chicago Board Options Exchange, Inc. (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'' or ''SEC''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposal to list and trade on the Exchange cash-settled, European-style [3] stock index options on the Germany 25 Index. The Index is a capitalization-weighted index of 25 German blue-chip equities listed on the Frankfurt Stock Exchange (''FSE''). The proposed rule change was published for comment and appeared in the Federal Register on August 28, 1995.[4] The CBOE filed Amendment No. 1 to its proposal on October 13, 1995.[5] No comments were received regarding the CBOE's proposal.

II. Description of the Proposal

A. General

The purpose of the proposed rule change is to permit the Exchange to list and trade cash-settled, European-style stock index options on the Germany 25 Index. The Index is a capitalization-weighted index of 25 German blue-chip equities listed on the Frankfurt Stock Exchange (''FSE''). The Exchange represents that options on the Index will provide investors with a low-cost means of participating in the German economy and hedging against the risk of investing in that economy.

B. Index Design

The 25 stocks that comprise the Germany 25 Index were selected by the CBOE for their high market capitalization and high degree of liquidity. According to the Exchange, the Index stocks are drawn from a broad base of industries and are representative of the industrial composition of the German equity market. Specifically, the Index components are the top 25 German stocks by market capitalization excluding: (1) Stocks with an average daily volume of less than 50,000 shares per day over the past six months; and (2) preferred stock of an issuer if that issuer also has publicly-traded common stock. The Index will be reviewed annually by that CBOE at the end of May each year and any composition changes resulting from that review will be implemented after the June expiration in that year.

The Germany 25 Index is weighted by the capitalization (market value) of the component stocks. The capitalization of a particular stock in the Index is calculated by multiplying the listed shares (including common, preferred, and treasury shares) by the price of the stock.[6]

On June 30, 1995, the 25 stocks in the Index ranged in capitalization from DM 3.656 billion (US$2.648 billion) [7] to DM 51.642 billion (US$37.408 billion). The total capitalization of the stocks in the index on that date was DM 399.101 billion (US$289.099 billion); the mean capitalization was DM 15.964 billion (US$11.564 billion) and the median capitalization was DM 11.144 billion (US$8.072 billion). The largest stock by capitalization (Allianz AG Holdings) accounted for 12.94% of the total weighting of the Index, while the smallest (Kaufhof) accounted for 0.92%. The top five stocks accounted for 44.56% of the total weighting on that date.

For the period from January 1, 1995 through June 30, 1995, average daily volume in individual Germany 25 Index component stocks ranged from a low of approximately 87,629 shares to a high of 2.532 million shares traded per day, with a mean daily trading volume for all the stocks in the Index during that period of 523,501 shares traded per day.

The Exchange represents that the Index is composed of ten (10) broad industry groupings, including chemicals, automobile and insurance companies, among others, which reflect the industry composition of the German equity market.

C. Calculation

The CBOE states that the Germany 25 Index will reflect changes in the capitalization of the component stocks relative to the capitalization on a base date. The base date for the Index is June 30, 1995, at which time the Index was given a value of 200 by the CBOE. The Index value of 200 was reached by multiplying the price of each stock by the number of listed shares (including common, preferred, and treasury),[8] obtaining the sum of these values of all component stocks, and then dividing by a divisor determined to give the Index a value of 200. The CBOE states that it will calculate and disseminate the Germany 25 Idex, based on the most recent closing prices of the component stocks as reported by the FSE, each day prior to the opening of trading in the United States.[9] It is anticipated that at least several information vendors will make this information available throughout the CBOE trading day.

D. Maintenance

The Index will be maintained and calculated by to Exchange. To maintain continuity of the Index, the Exchange

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[23] 15 U.S.C. 78s(b)(2).

[24] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1) (1988).

[2] 17 CFR 240.19b–4 (1994).

[3] European-style options may only be exercised during a specified period before the options expire.

[4] *See* Securities Exchange Act Release No. 36125 (August 18, 1995), 60 FR 44526.

[5] Letter from Eileen Smith, Director, Product Development, Research Department, CBOE, to Michael Walinskas, Branch Chief, Office of Market Supervision, Division of Market Regulation, Commission, dated October 13, 1995 (''Amendment No. 1''). In Amendment No. 1, the CBOE provides information regarding the industries represented in the Index, IBIS average daily trading volume, and dissemination. Amendment No. 1 also states that if the weight of any one industry group exceeds 50% of the total weight of the Index, the Exchange will immediately notify Commission staff; and that the CBOE will not remove a component of the Index between annual reviews unless it becomes necessary (generally due to bankruptcy, delisting, takeover, or merger. *Id*.

[6] The Commission notes that this varies from the method used to calculate the values of domestic capitalization-weighted indexes, such as the S&P 100 Index. For such domestic indexes, values are determined based solely on the outstanding shares of common stock of each component in the indexes.

[7] The CBOE represents that the dollar values used herein are based on a German mark/U.S. dollar exchange rate of 1.3805 marks per U.S. dollar prevailing on June 30, 1995.

[8] *See supra* note 6 and accompanying text.

[9] Amendment No. 1, *supra* note 5.

will adjust the Index to reflect certain events relating to the component stocks. For example, the Exchange will adjust the Index divisor to reflect cash dividends paid on the component securities.The Exchange will make this adjustment because German companies usually pay their dividends only once a year (generally in May or June). In not adjusted, the annual dividend payment would result in a significant drop in the Index value at the time when the dividends are paid. The divisor will be adjusted immediately prior to each ex-dividend date so that the Index level will not be affected by the dividend payment. A similar adjustment will be made when a company issues new shares for which the shareholders have preemptive rights, or when other intra-year events such as mergers and spinoffs, occur.

Between annual reviews, CBOE will not remove a component of the Index unless it becomes necessary as a result of significant and fundamental changes to such Index component. Generally, such a change would include bankruptcy, delisting from the FSE, takeover, or merger.[10] In that case, the next eligible component will be added, *i.e.*, the German security with the highest market capitalization not then included in the Index that satisfies the criteria set forth above.

E. Index Option Trading

In addition to regular Index options, the Exchange may provide for the listing of long-term index option series (''LEAPS'') and reduced-value LEAPS on the Index (''Index LEAPS''). For reduced-value Index LEAPS, the underlying value will be computed at one-tenth of the Index level. The current and closing index value of reduced-value Index LEAPS will, after such initial computation, be rounded to the nearest one-hundredth.

The trading hours for options on the Index will be from 8:00 a.m. to 3:15 p.m., Chicago time. Currently, the trading hours of the Exchange and the FSE do not overlap.[11] The Exchange, therefore, will calculate and disseminate the value of the Index based on the most recent closing prices of the component stocks as reported by the FSE. After the close of the FSE, however, trading continues in the 25 stocks comprising the Index on the FSE's Integrated Stock Exchange Trading and Information System (''IBIS'').[12] The trading hours of IBIS and the Exchange currently overlap for the two hour period between 8 a.m. and 10 a.m., Chicago time. During this two hour period, the Exchange will continuously calculate and disseminate every 15 seconds an ''indicative'' Germany 25 Index level based on the most recent prices of the component stocks as reported by IBIS.[13] When Trading on IBIS has concluded (10 a.m. Chicago time), the Exchange will disseminate the last ''indicative'' Index level. To avoid any confusion, the ''indicative'' Index level will have a different ticker symbol from the actual Index level.

The option premium values will be quoted in U.S. dollars and trading accounts will be denominated in U.S. dollars. For strike prices under $200, the Exchange reserves the right to list series in 2½ point intervals.

F. Surveillance

The Exchange expects to apply its existing index options surveillance procedures to Index options. In addition, the CBOE states that the German legislature recently adopted new laws regarding insider trading that also provide for the creation of an independent regulatory authority.[14] The Exchange understands that these developments will facilitate the effective coordination between the Commission and the appropriate German regulatory authority of option trading on the Germany 25 Index because they will enhance the surveillance of trading in the stocks comprising the Index. In addition, the Exchange will continue to pursue its own independent agreement with the Deutsche Börse AG (the holding company that owns the FSE) and/or the FSE.[15]

G. Exercise and Settlement

The proposed options on the Index will expire on the Saturday following the third Friday of the expiration month. The Exchange intends to list up to three near-term calendar months and three additional months at three month intervals.[16] Trading in the expiring contract month will normally cease at 3:15 p.m. (Chicago time) on the immediately preceding Thursday, unless a holiday occurs. The exercise settlement value of the Index at option expiration will be calculated by the Exchange on the day following the last day of trading in the expiring contracts. The exercise settlement value of Index options at expiration will be determined at the close of the regular Friday trading sessions at the FSE in Germany, ordinarily at 1:30 p.m., Frankfurt time (6:30 a.m., Chicago time), *i.e.*, values of component stocks disseminated through IBIS will not be used in calculating the settlement values for Index options or Index LEAPS.[17] If an Index stock does not open for trading at the FSE, the last available price on the FSE of the stock will be used in the calculation of the value of the Index. When expirations are moved in accordance with Exchange holidays, such as when the CBOE is closed on the Friday before expiration, the last trading day for expiring options will be Wednesday and the exercise settlement value of Index options at expiration will be determined at the close of the regular Thursday trading sessions at the FSE in Germany even if the FSE is open on Friday. If the FSE will be closed on the Friday before expiration but the CBOE will not, the last trading day for expiring Index options and Index LEAPS will be Wednesday.[18]

H. Position Limits

The Exchange proposes to establish position limits for options on the Index of 50,000 contracts on either side of the market, with no more than 30,000 contracts in the series with the nearest expiration month. The Exchange represents that these limits are roughly equivalent, in dollar terms, to the limits applicable to options on other approved broad-based indexes. For purposes of determining whether given position in full-value and reduced-value Index LEAPS comply with applicable position and exercise limits, positions in full-value and reduced-value Index LEAPS

[10] Amendment No. 1, *supra* note 5.

[11] The FSE's trading hours are from 10:30 a.m. to 1:30 p.m., Frankfurt time (3:30 a.m. to 6:30 a.m., Chicago time).

[12] According to the Exchange, the Deutsche Börse AG, the holding company for the FSE, states that IBIS is a screen-based trading and information system that is available for trading from 8:30 a.m. to 5:00 p.m., Frankfurt time (1:30 a.m. to 10:00 a.m., Chicago time). The CBOE represents that IBIS, as part of the FSE, is subject to the same rules and regulations as floor trading on the FSE. According to the Exchange, IBIS began operating in April, 1991.

[13] Amendment No. 1, *supra* note 5. The Exchange intends to calculate the ''indicative'' Index with the same method of calculation as described above for the actual Index.

[14] The Commission notes that this new regulatory body, the Bundesaufsichtsamt fur den Wertpapierhandel, was established in January 1995.

[15] Telephone conversation between Eileen Smith, Director, Product Development, Research Department, CBOE, and Brad Ritter, Senior Counsel, Office of Market Supervision, Division, Commission, on August 8, 1995.

[16] Telephone Conversation between Scott Lyden, Senior Research Analyst, CBOE, and Francois Mazur, Attorney, Office of market Supervision, Division of Market Regulation, Commission, on October 17, 1995 (''October 17 Telephone Conversation'').

[17] *Id.*

[18] In this circumstance, the CBOE will issue a notice to members informing them that the last trading day for Index options and Index LEAPS will be on Wednesday even though the CBOE will be open on expiration Friday. *Id.*

will be aggregated with positions in the regular Index options. For these purposes, ten reduced-value contracts will equal one full-value contract.

I. Exchange Rules Applicable

Except as modified herein, the rules in Chapter XXIV of the CBOE's rules applicable to other broad-based index options will be applicable to Germany 25 Index options, including Index LEAPS for purposes of trading rotations, halts and suspensions, and margin treatment.

The Exchange states that it has the necessary systems capacity to support new series that would result from the introduction of Germany 25 Index options. The CBOE also states that it has been informed that the Options Price Reporting Authority (''OPRA'') has the capacity to support such new series.[19]

III. 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) of the Act.[20] The Commission finds that the trading of options on the Index will permit investors to participate in the price movements of the 25 German equity securities on which the Index is based. The Commission also believes that the trading of options on the Index will allow investors holding positions in some or all of the securities underlying the Index to hedge the risks associated with their portfolios. Accordingly, the Commission believes that Germany 25 Index options will provide investors with an important trading and hedging mechanism that should reflect accurately the overall movement of German equity securities. By broadening the hedging and investment opportunities of investors, the Commission believes that the trading of Index options will serve to protect investors, promote the public interest, and contribute to the maintenance of fair and orderly markets.[21]

The trading of Germany 25 Index options, however, raises several issues, including issues related to index design, customer protection, surveillance, and market impact. For the reasons discussed below, the Commission believes that the CBOE has adequately addressed these issues.

A. Index Design and Structure

The Commission finds that it is appropriate and consistent with the Act to classify the Index as broad-based, and therefore to permit Exchange rules applicable to the trading of broad-based index options to apply to Index options.[22] First, the Index consists of 25 actively traded German securities. Second, the total capitalization of the Index, as of June 30, 1995, was US$399.101 billion, with the market values of the individual stocks in the Index ranging from a high of US$37.408 billion to a low of US$2.648 billion, with a median value of US$8.072 billion. Third, the Index reflects the various sectors of the German equities market, and includes stocks of companies from a broad range of industries, and no industry segment comprises more than 20% of the Index's total value.[23] Fourth, as of June 30, 1995, no single stock comprised more than 12.94% of the Index's total value, and the percentage weighting of the five largest issues in the Index accounted for only 44.56% of the Index. Fifth, the Index selection and maintenance criteria will serve to ensure that the Index continues to reflect the 25 most highly capitalized German stocks. Accordingly, the Commission believes it is appropriate to classify the Index as broad-based.

The Commission believes that the general broad diversification of the Index component stocks, as well as their high capitalizations and liquid markets, significantly minimize the potential for manipulation of the Index. First, as discussed above, the Index represents a broad cross-section of highly capitalized German stocks, with no single industry group or stock dominating the Index. Second, the stocks that comprise the Index are actively traded.[24] Third, the Commission believes that the Index selection and maintenance criteria will serve to ensure that the Index continues to represent stocks with high capitalizations and trading volumes. Fourth, the Exchange has proposed position and exercise limits for the Index options that are consistent with other broad-based index options. Accordingly, the Commission believes it is unlikely that attempted manipulations of the prices of the Index components would affect significantly the Index's value.

In addition, because only one of the Index component stocks is traded in the United States as a National Market System security,[25] and the primary market for component stocks is closed throughout the CBOE's trading day, the Commission believes it is reasonable and appropriate for the Exchange to begin trading Index options at 8 a.m. (Chicago Time).

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 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 risk 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 traded on the CBOE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Index options and Index LEAPS.

C. Surveillance

As a general matter, the Commission believes that comprehensive surveillance sharing agreements between the relevant foreign and

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[19] *See* Letter from Joe Corrigan, Executive Director, OPRA, to Eileen Smith, Director, Product Development, Research Department, CBOE, dated November 21, 1994 (''OPRA Letter'').

[20] 15 U.S.C. 78f(b)(5) (1988).

[21] Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new option or warrant 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 options or warrants on the Index will provide investors with a hedging vehicle that should reflect the overall movement of the German equity market. The Commission also believes that these options will provide investors with a means by which to make investment decisions in the German equity market, allowing them to establish positions or increase existing positions in German stocks in a cost effective manner.

[22] In addition, the basic character of the reduced-value Germany 25 Index, which is comprised of the same component securities as the Germany 25 Index, and calculated by dividing the Germany 25 Index by ten, is essentially identical to the Germany 25 Index.

[23] *See supra* Section II.B. The Exchange has stated that if at any time the weight of any one industry group exceeds 50% of the total weight of the Index, it will notify Commission staff immediately. Amendment No. 1, *supra* note 5.

[24] *See supra* Section II.B.

[25] Currently, Daimler-Benz AG is traded in the United States as an American Depositary Receipt. October 17 Telephone Conversation, *supra* note 16.

domestic exchanges are important where an index derivative product comprised of foreign securities is to be traded in the United States.[26] In most cases, in the absence of such a comprehensive surveillance sharing agreement, the Commission believes that it would not be possible to conclude that a derivative product, such as a Germany 25 Index option, was not readily susceptible to manipulation.

With regard to the CBOE proposal, the Commission understands that the CBOE has been attempting to secure such a surveillance sharing agreement with the relevant German market.[27] The Commission would prefer that a comprehensive surveillance agreement be in place, and believes that such agreements play a particularly important role in ensuring the integrity of global securities markets. Even in the absence of an agreement, however, the Commission does not believe that the Exchange's proposal should continue to be detained pending the conclusion of negotiations when an alternative with respect to obtaining surveillance information exists for the Germany 25 Index products. Specifically, the U.S. Department of State and the German Foreign Office have exchanged Diplomatic Notes that provide a framework for mutual assistance in investigatory and regulatory matters (''Diplomatic Notes'').[28] The Diplomatic Notes confirm that the Commission is qualified to obtain assistance through the German Ministry of Justice under German law. Based on the existence of the Diplomatic Notes, the Commission believes that the German governmental authorities are committed to assistance in addressing cross-border fraud. In addition, the Commission could obtain from the German Ministry of Justice (and vice versa) information similar to that which would be available in the event that a comprehensive surveillance sharing agreement were executed between the FSE and the CBOE with respect to transactions in FSE-traded stocks related to Germany 25 Index options transactions on the CBOE.[29] While this arrangement would certainly be enhanced by the existence of comprehensive surveillance sharing agreements, it is nonetheless consistent with other instances where the Commission has explored alternatives to direct exchange-to-exchange surveillance sharing agreements where the relevant foreign exchange was unwilling or unable to enter into a comprehensive surveillance sharing agreement.[30]

In addition, the Commission notes that there are factors relating to the computation of the Germany 25 Index that further support reliance on arrangements other than direct exchange-to-exchange surveillance agreements. Specifically, the size of the market for the securities underlying the Germany 25 Index makes it less likely that the proposed Index warrants are readily susceptible to manipulation.[31] For example, as of June 30, 1995, the market capitalization of the securities in the Index ranged from a low of approximately U.S. $2.648 billion to a high of approximately U.S. $37.408 billion, and the average trading volume for individual Index component securities during the period from January 1995 to June 1995 ranged from a low of 87,629 shares per day to a high of over 2.5 million shares per day.

The Commission continues to believe strongly that the existence of comprehensive surveillance sharing agreements between the appropriate German entity(ies) and the Exchange would be important measures to deter and detect potential manipulations or other improper or illegal trading involving Index options. Accordingly, the Commission urges the Exchange and the appropriate German entity(ies) to seek formal comprehensive surveillance sharing agreements as soon as practicable.

D. Market Impact

The Commission believes that the listing and trading of Germany 25 Index options on the CBOE will not adversely affect the underlying securities markets.[32] First, as described above, the Index is broad-based and comprised of 25 stocks with no one stock or industry group dominating the Index. Second, as noted above, the stocks contained in the Index all have large capitalizations and are actively traded. Third, existing CBOE stock index options rules and surveillance procedures will apply to Germany 25 Index options. Fourth, the position limits of 50,000 contracts on either side of the market, with no more than 30,000 of such contracts in a series in the nearest month expiration month, will serve to minimize potential manipulation and market impact concerns. Fifth, the risk to investors of contra-party non-performance will be minimized because the Index options will be issued and guaranteed by The Options Clearing Corporation just like any other standardized option traded in the United States.

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Specifically, Amendment No. 1 states that the CBOE will notify Commission staff if the weight of one industry group exceeds 50% of the total weight of the Index. Amendment No. 1 also provides additional information regarding the composition, calculation, and dissemination of the Index. Finally, Amendment No. 1 clarifies when an Index component may be removed between annual reviews. The Commission believes that Amendment No. 1 serves to strengthen and clarify the Exchange's original proposal, but does not represent a material change that raises regulatory concerns not already addressed by the original proposal. Accordingly, the Commission believes it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 1 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and

[26] A comprehensive surveillance sharing agreement would allow the parties to the agreement to obtain relevant surveillance information, including, among other things, the identity of the purchasers and sellers of securities underlying the derivative product.

[27] *See* Securities Exchange Act Release No. 36070 (August 9, 1995), 60 FR 42205.

[28] *See* International Series Release No. 691, 1994 SEC LEXIS 2324 (July 22, 1994).

[29] It is the Commission's expectation that this information would include transaction, clearing, and customer information necessary to conduct an investigation relating to trading of Index options or components of the Index.

[30] *See, e.g.,* Letter to David R. Merrill, Deputy General Counsel, CFTC, from Brandon Becker, Director, Division, Commission, dated April 20, 1994 (Commission comment letter to the CFTC regarding the offer by the Osaka Securities Exchange of futures contracts based on the Nikkei 300 Index to U.S. persons), and letter to Joanne T. Medero, General Counsel, CFTC, from William H. Heyman, Director, Division, Commission, dated January 16, 1992 (Commission comment letter to the CFTC regarding the offers by the Osaka Stock Exchange and the Tokyo Stock Exchange of futures contracts based on the Nikkei 225 and TOPIX Indexes to U.S. persons).

[31] In evaluating the manipulative potential of a proposed index derivative product, as it relates to the securities that comprise the index and the index product itself, the Commission has considered several factors, including, among others, (1) the number of securities contained in the index or group, (2) the capitalizations of those securities, (3) the depth and liquidity of the group or index, (4) the diversification of the group or index, (5) the manner in which the index or group is weighted, and (6) the ability to conduct surveillance on the product. *See* Securities Exchange Act Release No. 31016 (August 11, 1992), 57 FR 37012 (August 17, 1992).

[32] The CBOE has stated that it has the necessary systems capacity to support new series that would result from the introduction of Germany 25 Index options. In addition, OPRA has represented that additional traffic generated by options and LEAPS on the Index is within OPRA's capacity. OPRA Letter, *supra note 19.*

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 change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR–CBOE–95–39 and should be submitted by November 16, 1995.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 6 of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[33] that the proposed rule change (File No. SR–CBOE–95–39), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[34]

Margaret H. McFarland,

Deputy Secretary.

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[33] 15 U.S.C. 78s(b)(2) (1988).

[34] 17 CFR 200.30–3(a)(12) (1994).

[Release No. 34–36401; File No. SR–CHX–95–10]

Self-Regulatory Organizations; Chicago Stock Exchange, Incorporated; Order Granting Approval to Proposed Rule Change Relating to Permanent Approval of the Pilot Program for Stopped Orders in Minimum Variation Markets

October 20, 1995.

I. Introduction

On March 23, 1995, the Chicago Stock Exchange, Incorporated (''CHX'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to approve permanently its stopping stock program in minimum variation markets.

The proposed rule change was published for comment in Securities Exchange Act Release No. 35910 (June 28, 1995), 60 FR 34563 (July 3, 1995). No comments were received on the proposal.[3] For the reasons discussed below, the Commission has decided to approve the CHX's proposal.

II. Description of Proposal

Prior to 1992, CHX Rule 37, Article XX, required specialists, upon request, to grant a stop for Dual Trading System issues [4] if an out of range [5] execution would result, regardless of the spread. Under this stopping stock policy, the specialists were required to execute stopped stock based on the next primary market sale. The Exchange's purpose for stopping stock generally was to prevent orders from being executed outside the primary market range for the day (*i.e.*, from establishing a new high or new low).[6]

This general stopping stock policy, however, produced an anomalous result in minimum variation markets.[7] In a minimum variation market because the stopped market order did not have time or price priority, its execution triggered the requirement for the Exchange specialist to execute all pre-existing orders based on the Exchange's rules of priority and precedence.[8] Therefore, the specialists were required to execute the preexisting orders even if such orders were not otherwise entitled to be filled.[9]

In January 1992, the Commission approved on a pilot basis the Exchange's revised procedures for stopping orders in minimum variation markets that would prevent the anomalous consequence of requiring the execution of pre-existing orders that are not yet due a fill.[10] The Commission subsequently extended the Exchange's pilot program without modification.[11] The most recent extension of the pilot program is scheduled to expire on October 21, 1995.

The pilot program adds interpretation and policy .03 to Rule 37, Article XX, to permit a specialist to delay execution of stopped stock in minimum variation markets until a volume equal to the pre-

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] The Commission has received three comment letters opposing the New York Stock Exchange's proposal for permanent approval of the NYSE's procedures for stopping stock in minimum variation markets, two of which were from the same commenter (Junius Peake). *See* letter from Junius W. Peake, Monfort Professor of Finance, University of Northern Colorado, to Secretary, SEC, dated March 1, 1995; letter from Junius W. Peake, Monfort Professor of Finance, University of Northern Colorado, to Secretary, SEC, dated July 21, 1995; letter from Morris Mendelson, Professor Emeritus of Finance, the Wharton School of the University of Pennsylvania to Jonathan Katz, Secretary, SEC, dated August 2, 1995. Although the NYSE's procedures differ from those of CHX, certain issues raised in the comment letters apply equally to the CHX proposal. The comment letters and the NYSE's response thereto are summarized in the Commission's order. In addition, the Commission's discussion in the NYSE order is applicable to this order. *See* Securities Exchange Act Release No. 36399 (Oct. 20, 1995) (permanently approving NYSE's pilot program for stopping stock in minimum variation markets); *see also* letter from James Buck, Senior Vice President and Secretary, NYSE, to Jonathan Katz, Secretary, SEC, dated July 17, 1995.

[4] The Dual Trading System of the Exchange allows the execution of both round-lot and odd-lot orders in certain issues assigned to specialists on the Exchange and listed on either the New York Stock Exchange or the American Stock Exchange.

[5] ''Out of range'' means either higher or lower than the range in which the security traded on the primary market during a particular trading day.

[6] For example, assume the market in ABC stock is 20–20⅛; 50×50 and that a buy order at ⅛ would be higher than the range in which the security traded on the primary market during the trading day. A customer places an order with the Exchange specialist to buy 100 shares of ABC at the market and a stop is effected. The order is stopped at 20⅛ and the Exchange specialist includes the order in his quote by bidding the 100 shares at 20. If the next sale on the primary market is for 100 shares at 20, the Exchange's existing general policy regarding stopping stock would require the specialist to execute the stopped market order at 10.

[7] CHX Rule 22, Article XX sets forth the minimum variations for stocks traded on the Exchange. The rule provides that bids or offers in stocks above $1.00 per share shall not be made at a less variation than ⅛ of $1.00 per share; in stocks below $1.00 but above $.50 per share, at a less fraction than /1/16 of $1.00 per share; in stocks below $.50 per share, at a less variation than 1⁄32 of $1.00 per share; provided that the Committee on Floor Procedure may fix variations of less than the above for bids and offers in specific securities or classes of securities.

[8] *See* CHX Rule 16, Article XX (Precedence of Bids at Same Price).

[9] Under CHX Rule 37(a)(3), Article XX, the Exchange specialists are required to fill orders at the limit price only if: (1) The bid or offering at the limit price has been exhausted in the primary market; (2) there has been a price penetration of the limit in the primary market; or (3) the issue is trading at the limit price on the primary market unless it can be demonstrated that such order would not have been executed if it had been transmitted to the primary market or the broker and specialist agree to a specific volume related or other criteria for requiring a fill.

[10] *See* Securities Exchange Act Release No. 30189 (Jan. 14, 1992), 57 FR 2621 (Jan. 22, 1992) (File No. SR–MSE–91–10) (order approving MSE pilot program for stopped orders in minimum variation markets) (''1992 Approval Order'').

[11] *See* Securities Exchange Act Release Nos. 31975, (Mar. 10, 1993), 58 FR 14230 (Mar. 16, 1993) (File No. SR–MSE–93–04) (''March 1993 Approval Order''); 32457 (June 11, 1993), 58 FR 33681 (June 18, 1993) (File No. SR–MSE–93–14) (''June 1993 Approval Order''); 33790 (Mar. 21, 1994), 59 FR 14434 (Mar. 28, 1994) (File No. SR–MSE–93–30) (''1994 Approval Order''); 35431 (Mar. 1, 1995), 60 FR 12796 (Mar. 8, 1995) (File No. SR–CHX–95–04) (''March 1995 Approval Order''); 36011 (July 21, 1995), 60 FR 38874 (July 28, 1995) (''July 1995 Approval Order'').