

clearing agency registration on three prior occasions.¹³ In those cases, the applicants requesting exemption from clearing agency registration were required to meet standards substantially similar to those required of registrants under Section 17A in order to assure that the fundamental goals of that section were furthered (*i.e.*, safety and soundness of the national clearance and settlement system).

In the Matching Release, we stated that an entity that limited its clearing agency functions to providing matching services might not have to be subject to the full range of clearing agency regulation. In addition, we stated that an entity seeking an exemption from clearing agency registration for matching would be required to: (1) provide us with information on its matching services and notice of material changes to its matching services; (2) establish an electronic link to a registered clearing agency that provides for the settlement of its matched trades; (3) allow us to inspect its facilities and records; and (4) make periodic disclosures to us regarding its operations.

TFTS's matching service would be the only clearing agency function that it would perform under an exemptive order. While we believe that TFTS's matching services could have a significant impact on the national clearance and settlement system, we do not believe that TFTS's matching services raise all of the concerns raised by an entity that performs a wider range of clearing agency functions. TFTS represents in its Form CA-1 that as a condition of its exemption it will comply with the conditions suggested by the Commission in the Matching Release. Therefore, we believe that it may not be necessary to require TFTS to satisfy all of the standards required of registrants under Section 17A.¹⁴

We anticipate that in addition to considering the public interest and the

protection of investors, the primary factor in our consideration of TFTS's Application will be whether TFTS is so organized and has the capacity to be able to facilitate prompt and accurate matching services subject to the specific conditions that it has proposed.¹⁵ In particular, TFTS has represented that, among other things, it will provide us with (1) an independent audit report that addresses all the areas discussed in the Commission's ARPs prior to beginning commercial operations and annually thereafter, (2) on-site inspection rights, and (3) a current balance sheet and income statement prior to beginning operations.¹⁶

We expect that any exemption from clearing agency registration for TFTS would contain all of the conditions that TFTS has proposed in its Form CA-1. We request comment on whether these conditions are sufficient to promote the purposes of Section 17A and to allow us to adequately monitor the effects of TFTS's proposed activities on the national system for the clearance and settlement of securities transactions. In addition, we invite commenters to address whether granting TFTS an exemption from clearing agency registration would impose any burden on competition that is not necessary or appropriate in furtherance of the Exchange Act.

IV. Solicitation of Comments

Comments are due by March 8, 1999. These comments will be considered in deciding whether to grant TFTS's application for exemption from registration as a clearing agency. Six copies of the comments should be filed with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Comments also may be submitted electronically at the following E-mail address: rule-comments@sec.gov. All comment letters should refer to File No. 600-31; this file number should be used on the subject line if E-mail is used. Copies of the application and all written comments will be available for inspection and copying at the Commission's Public Reference Room, 450 Fifth Street, N.W., Washington, D.C. 20549.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40995; File No. SR-CBOE-99-05]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Listing of Options on the Dow Jones E*Commerce Index

January 28, 1999.

Pursuant to Section 19(b)(1) of the Securities Act of 1934,¹ notice is hereby given that on January 28, 1999, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") hereby proposes to amend certain of its rules to provide for the listing and trading on the Exchange of options on the Dow Jones E*Commerce Index ("E*Commerce Index" or "Index"), a narrow-based Index designed by Dow Jones & Company, Inc. ("Dow Jones™").² The E*Commerce Index is a modified capitalization-weighted, cash-settled index with European-style exercise.

The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

¹⁷ 17 CFR 200.30-3(a)(16).

¹⁵ 15 U.S.C. 78s(b)(1).

² Dow Jones & Company, Inc. ("Dow Jones") has licensed "Dow Jones™," and "Dow Jones E*Commerce Index" for use for certain purposes to the Chicago Board Options Exchange, Incorporated. CBOE's options based on the Dow Jones E*Commerce Index are not sponsored, endorsed, sold or promoted by Dow Jones, and Dow Jones makes no representation regarding the advisability of investing in such products.

¹³ Securities Exchange Act Release Nos. 36573 (December 12, 1995 60 FR 65076 (order approving application for exemption from clearing agency registration for the Clearing Corporation for Options and Securities); 38328 (February 24, 1997), 62 FR 9225 (order approving application for exemption from clearing agency registration for Cedel Bank); and 39643 (February 11, 1998), 63 FR 8232 (order approving application for exemption from clearing agency registration by Morgan Guaranty Trust Company of New York, Brussels Office, as operator of the Euroclear System).

¹⁴ For example, TFTS's Form CA-1 (1) represents that TFTS will not handle funds or securities and (2) states that TFTS will not impose prohibitions or limit access to its service by potential customers but that it might terminate a subscription for failure to pay fees. In addition, TFTS will provide us with a current balance sheet and income statement before beginning operations which will enable us to assess TFTS's financial capability.

¹⁵ See Section 17A(b)(3)(A) of the Exchange Act, 15 U.S.C. 78q-1(b)(3)(A).

¹⁶ See Section III.A, *supra*.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

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 Dow Jones E*Commerce Index. The Index is a modified capitalization-weighted index of 15 of the largest, most liquid U.S. Internet commerce stocks. Internet commerce companies are involved in providing a good or service through an open network such as the Internet.

1. Purpose

Index Design

The E*Commerce Index has been designed to measure the performance of certain Internet commerce stocks. All of the stocks in the Index are U.S. securities and currently trade through the facilities of the National Association of Securities Dealers Automated Quotation System and are reported national market system securities. In addition, all of the stocks are "reported securities" as defined in Rule 11Aa3-1 under the Exchange Act.

The Exchange represents that in all but one respect, options on the E*Commerce Index meet the generic listing criteria for options on narrow-based indexes which may be filed with the Commission under Exchange Rule 24.2(b) as a stated policy, practice, or interpretation within the meaning of paragraph (3)(A) of subsection 19(b) of the Exchange Act. The only variation is that the Index is calculated using a modified capitalization-weighting methodology.

Each of the stocks in the E*Commerce Index has a market capitalization in excess of \$75 million. Specifically, the stocks comprising the Index range in capitalization from \$378.9 million to \$26.15 billion as of January 21, 1999. The total capitalization as of that date was \$76.50 billion. The mean

capitalization was \$5.10 billion. The median capitalization was \$1.94 billion.

The CBOE indicates that all but two of the component stocks meet the trading volume criteria set forth in paragraph (b)(3) of CBOE Rule 24.2. E-Bay, Inc. does not meet the criteria of CBOE Rule 24.2(b)(e) because it was the subject of an initial public offering on September 24, 1998. Since that time, E-Bay, Inc. has average 1.24 million shares per day and it is expected that the company will exceed the trading volume criteria in early February 1999. Additionally, Ticketmaster On-line CitySearch does not meet the volume criteria because it was the subject of a spin-off on December 3, 1998. However, the Exchange represents that the company currently satisfies the requirements of CBOE Rule 5.3 applicable to individual underlying securities and is the subject of options trading. Furthermore, since the company was spun off, it has averaged 1.5 million shares per day. The Exchange represents that each of the component stocks in the E*Commerce Index has had monthly trading volume in excess of one million shares over the six month period through January 1999. The average monthly volume over the six-month period for the stocks in the Index ranged from a low of 8.3 million shares to a high of 292.5 million shares.

Currently, two of the fifteen stocks in the Index are not eligible for options trading. However, the CBOE represents that Cyberian Outpost, Inc. will be eligible on January 28, 1999 and Geocities will be eligible on February 8, 1999. Therefore, each stock in the Index will be eligible for options trading before the anticipated start of options trading.

As the initial re-balancing on January 4, 1999, the largest stock accounted for 10.00% of the total weight of the Index, while the smallest accounted for 1.43%. The top five stocks in the Index accounted for 50.00% of the total weight of the Index. Accordingly, the Exchange's generic listing standards for narrow based indexes are more than met with respect to the criteria of market capitalization, weighting constraints and trading volume.

Calculation and Dissemination of Index Value

The E*Commerce Index is calculated on a "modified capitalization-weighted" method. This method is a hybrid between equal weighting (which may pose liquidity concerns for smaller-cap stocks) and normal-cap weighting (which may result in two or three stocks dominating the index's performance). Under this method, the maximum

weight for any stock in the Index will be set to 10%, or "capped," on the quarterly rebalancing date. The weight of all the remaining stocks shall be market capitalization weighted. Thus, the weights of these remaining stocks are not "capped."

For stocks which are not "capped," index shares will equal the company's outstanding common shares. For stocks that are "capped," index shares will equal its maximum weight, multiplied by the adjusted total market capitalization of the Index, divided by the stock's closing price on the rebalancing date. The index's adjusted total market capitalization is the total outstanding market capitalization adjusted to reflect the combined weight of all of the "capped" stocks.

The level of the Index reflects the adjusted total capitalization of the component stocks divided by the Index Divisor. The Index divisor was initially calculated to yield a benchmark level of 200.00 at the close of trading on January 4, 1999. The Index divisor will be adjusted as needed to ensure continuity whenever there are additions or deletions from an index, share changes, or adjustments to a component's price to reflect rights offerings, spinoffs, special cash dividends, etc.

The values of the Index will be calculated by Dow Jones or its designee and will be disseminated to market information vendors at 15-second intervals during regular CBOE trading hours via the Options Price Reporting Authority or the Consolidated Tape Association. If a component stock is not currently being traded, the most recent price at which the stock traded will be used in the Index calculation. The Index had a closing level of 259.43 on January 21, 1999.

Index Maintenance

The CBOE represents that Dow Jones is responsible for maintenance of the E*Commerce Index. Index maintenance generally includes monitoring and completing the adjustments for company additions and deletions, stock splits, stock dividends (other than an ordinary cash dividend), and stock price adjustments due to company restructuring or spinoffs. If required, the Index Divisor will be adjusted to account for any of the above changes.

The Exchange represents that the Index will satisfy the maintenance criteria set forth in CBOE Rule 24.2(c). The Index will be re-balanced at the close of business on expiration Friday on the March quarterly cycle. In addition, the number of Index components will not increase to more than 20 nor decrease to fewer than 10.

Component changes will be made such that 90% of the Index by weight and 80% of the total number of stocks in the index are eligible for options trading under CBOE Rule 5.3.

If the Index fails at any time to satisfy the maintenance criteria, the CBOE will immediately notify the Commission and will not open for trading any additional series of options on the Index, unless the continued listing of options has been approved by the Commission under Section 19(b)(2) of the Securities Exchange Act.

Index Options Trading

In addition to regular Index options, the Exchange may provide for the listing of long-term index option shares ("LEAPS[®]") and reduced-value LEAPS on the Index. For reduced-value LEAPS, the underlying value would be computed at one-tenth of the Index level. The current and closing index value of any such reduced-value LEAP will, after such initial computation, be rounded to the nearest one-hundredth. Exhibit C presents proposed contract specifications for the E*Commerce Index options.

Strike prices will be set to bracket the index in a minimum of 2½ point increments for strikes below 200 and 5 point increments above 200. The minimum tick size for series trading below \$3 will be ¼¢ and for series trading above \$3 the minimum tick will be ⅛¢. The trading hours for options on the Index will be from 8:30 a.m. to 3:02 p.m. Chicago time.

Exercise and Settlement

The CBOE proposes that options on the Index will expire on the Saturday following the third Friday of the expiration month. Trading in the expiring contract month will normally cease at 3:02 p.m. (Chicago time) on the business day preceding the last day of trading in the component securities of the Index (ordinarily the Thursday before expiration Saturday, unless there is an intervening holiday). The exercise settlement value of the Index at option expiration will be calculated by Dow Jones or its designee based on the opening prices of the component securities on the business day prior to expiration. If a stock fails to open for trading, the last available price on the stock will be used in the calculation of the index, as is done for currently listed indexes. When the last trading day is moved because of Exchange holidays (such as when 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 opening of regular Thursday trading.

Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other index options to monitor trading in Index options and Index LEAPS.

Position Limits

Options on the E*Commerce Index would be subject to the position limits for industry index options set forth in CBOE Rule 24.4A.

Exchange Rules Applicable

The Rules of Chapter XXIV will be applicable to options on the E*Commerce Index. Narrow-based margin rules will apply to the Index as set forth in CBOE Rule 24.11.

Capacity

CBOE believes it has the necessary systems capacity to support new series that would result from the introduction of options on the E*Commerce Index. CBOE has also been informed that the Options Price Reporting Authority also has the capacity to support the new series.

2. Basis

The proposed rule change is consistent with Section 6(b)³ of the Act in general and furthers the objectives of Section 6(b)(5)⁴ in particular in that it will permit trading in options based on the E*Commerce Index pursuant to rules designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade, and thereby will provide investors with the ability to invest in options based on an additional index.

B. Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any inappropriate burden on competition.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

³ 17 CFR 200.30-3(a)(12).

⁴ The Exchange initially filed this proposal on

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or as to which the self-regulatory organization consents, the Commission will:

A. By order approve such proposed rule change, or

B. Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 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, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to file number SR-CBOE-99-05 in the caption above and should be submitted by February 25, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁵

Margaret H. McFarland,

Deputy Secretary.

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⁵ 15 U.S.C. 78f(b)(5).