

C. Surveillance

The Commission believes that a surveillance sharing agreement between an exchange proposing to list a security index derivative product and the exchange(s) trading the securities underlying the derivative product is an important measure for the surveillance of the derivative and underlying securities markets. Such agreements ensure the availability of the information necessary to detect and deter potential manipulations and other trading abuses, thereby making the security index product less readily susceptible to manipulation. In this regard, the Amex, and the NYSE and the NASD (where the component securities of the Index are currently listed) are all members of the Intermarket Surveillance Group ("ISG"), which provides for the exchange of all necessary surveillance information.²⁷

D. Market Impact

The Commission believes that the listing and trading of warrants on the Index will not adversely impact the underlying securities. First, the Amex's existing index warrants surveillance procedures will apply to warrants on the Index. Second, the Index is comprised of highly-capitalized securities that are actively-traded. Lastly, the Amex has established reasonable position and exercise limits for narrow-based stock index warrants,²⁸ which will serve to minimize potential manipulation and other stock market concerns.

The Commission finds good cause to approve the proposed rule filing, including Amendment Nos. 1 and 2, prior to the thirtieth day after the date of publication of notice of filing thereof

in the Federal Register. The Commission notes that to date no comments were received on the proposal. The Commission also notes that accelerated approval of this rule filing is based, in part, on the following facts: (i) The Amex is presently seeking authority to list and trade only a single issuance of warrants on the Index which have a term of two-years; (ii) the Index's component securities are highly-capitalized and actively-traded; and (iii) the Amex has represented that the warrants on the Index will comply in all respects with the Exchange rules governing the listing and trading of narrow-based warrants, including Amex Rules 1100 through 1110, Amex Rule 462, and Section 106 of the Amex Company Guide. Moreover, Amendment No. 1 to the Amex's proposal describes details of certain Index maintenance procedures and the Index calculation methodology. In this regard, the Commission believes that the Exchange's monthly review of the Index's component securities for options eligibility, percentage weight, and trading volume, as described above, will help to ensure that the Index maintains its intended market character as well as remains an appropriate trading vehicle for public customers. In addition, the equal-dollar methodology is a well-established index calculation method and therefore does not present any new or novel regulatory issues. Lastly, although Amendment Nos. 1 and 2 change the Index's component securities, these modifications are minor and consistent with the Index's general objective. In this context, the Index continues to be comprised of actively-traded and highly-capitalized securities. Accordingly, the Commission believes that it is consistent with Section 6(b)(5) of the Act to approve the proposed rule change, including Amendment Nos. 1 and 2, on an accelerated basis.

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2. 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 at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-96-12 and should be submitted by June 7, 1996.

IV. Conclusion

For the foregoing reasons, the Commission finds that the Amex's proposal to list and trade warrants based on the Select Technology Stock Index is consistent with the requirements of the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁹ that the proposed rule change (SR-Amex-96-12), as amended, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁰

Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37196; File No. SR-CBOE-96-18]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to a Hedge Exemption for Industry (Narrow-Based) Index Options

May 10, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on March 18, 1996, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the self-regulatory organization.² The

²⁹ 15 U.S.C. § 78s (b)(2) (1988).

³⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1) (1988).

² On April 15, 1996, the Exchange amended its proposal to indicate that, in connection with the narrow-based index hedge exemption, the CBOE's Department of Market Regulation will monitor daily to determine that each exempted option contract is hedged by the equivalent dollar amount of component securities and for unusual option and stock activity. In addition, the CBOE notes that the hedge exemption account must promptly notify the Exchange of material changes in the portfolio. See

Continued

²⁷ The ISG was formed on July 14, 1983 to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. The members of the ISG are: the Amex; the Boston Stock Exchange, Inc.; the Chicago Board Options Exchange, Inc.; the Chicago Stock Exchange, Inc.; the NASD; the NYSE; the Pacific Stock Exchange, Inc.; and the Philadelphia Stock Exchange, Inc. Due to the potential opportunities for trading abuses involving stock index futures, stock options, and the underlying stock, as well as for the need for greater sharing of surveillance information for these potential intermarket trading abuses, the major stock index futures exchanges (e.g., the Chicago Mercantile Exchange and the Chicago Board of Trade) have also joined the ISG as affiliate members.

²⁸ The Commission notes that position limits for narrow-based stock index warrants are set at a level roughly equivalent to 75 percent of narrow-based index options. As a result, position limits for warrants based on the Index will be nine million. See Securities Exchange Act Release No. 37007 (March 21, 1996), 61 FR 14165 (March 29, 1996) (order approving establishment of uniform listing and trading guidelines for narrow-based stock index warrants) (SR-Amex-95-39).

Commission is approving this proposal on an accelerated basis.

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

The CBOE proposes to amend CBOE Rule 24.4A, "Position Limits for Industry Index Options," to establish a hedge exemption from industry (narrow-based) index option position and exercise limits.³ The Commission previously has approved similar proposals by the Philadelphia Stock Exchange, Inc. ("PHLX") and the Pacific Stock Exchange, Inc. ("PSE").⁴

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

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 self-regulatory organization 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 self-regulatory organization has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.

(A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed rule Change

The CBOE proposes to adopt new Interpretation and Policies .01 and .02 to CBOE Rule 24.4A to establish an industry hedge exemption based on the industry index hedge exemptions filed by the PHLX and the PSE, which were approved recently by the Commission.⁵ Interpretation and Policy .02 establishes

certain compliance requirements for industry index hedge exemption accounts.

Currently, the Exchange has an equity option hedge exemption and a broad-based option index hedge exemption, but no hedge exemption for positions in CBOE industry index options. The CBOE states that its proposal will adopt the same formula used by the PHLX and the PSE for their industry index hedge exemptions, with minor modifications. The proposed narrow-based hedge exemption will be available to both broker-dealers and customers.

In order to qualify for the proposed hedge exemption, a position must be "hedged" by share positions in at least 75% of the number of component stocks of the index, or securities convertible into such stock. The proposed exemption is in addition to the standard limit and other exemptions and may not exceed twice the standard limit established under CBOE Rule 24.4A. The underlying value of the option position may not exceed the value of the underlying portfolio. The value of the underlying portfolio is determined as follows: (1) The total market value of the net stock position; and (2) for positions in excess of the standard limit, subtract the underlying market value⁶ of (a) any offsetting calls and puts in the respective index option class; (b) any offsetting positions in stock index futures; and (c) any economically equivalent position (assuming no other hedges for these contracts exist).

Further, the proposal requires that both the options and stock positions be initiated and liquidated in an orderly manner. Specifically, a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position.

The CBOE notes that its proposal makes minor modifications to the PHLX's narrow-based index hedge exemption requirements to conform the CBOE's language to a pending CBOE proposal to amend broad-based index options position limits and exemptions.⁷ According to the CBOE, the Exchange's modifications do not affect the hedge exemption definition or the calculation of the value of the portfolio, but will impose uniform CBOE Department of market Regulation

monitoring requirements for both the proposed narrow-based and broad-based index hedge exemptions.

Under the proposal, exercise limits will continue to correspond to position limits, so that investors may exercise the number of contracts set forth as the position limit, as well as those contracts exempted by this proposal, during five consecutive business days.

As of March 1, 1996, the CBOE trades the following industry index options, with limits as shown:

- (1) S&P Banking Index—12,000 contracts;
- (2) S&P Chemical Index—9,000 contracts;
- (3) S&P Health Care Index—9,000 contracts;
- (4) S&P Insurance Index—9,000 contracts;
- (5) S&P Retail Index—9,000 contracts;
- (6) S&P Transportation Index—9,000 contracts;
- (7) CBOE Software Index—9,000 contracts;
- (8) CBOE Environmental Index—9,000 contracts;
- (9) CBOE Gaming Index—9,000 contracts;
- (10) CBOE Global Telecommunications Index—12,000 contracts;
- (11) CBOE Israel Index—9,000 contracts;
- (12) CBOE Mexico Index—12,000 contracts;
- (13) CBOE REIT Index—12,000 contracts;
- (14) CBOE Telecommunications Index—12,000 contracts;
- (15) CBOE Biotech Index—9,000 contracts;
- (16) CBOE Latin 15 Index—12,000 contracts; and
- (17) CBOE High Technology Index—12,000 contracts.

The CBOE will require that documentation regarding the qualified stock portfolio be filed with the CBOE's Department of Market Regulation on behalf of a hedge exemption account seeking an exemption. Proposed Interpretation and Policy .02 contains compliance requirements for industry hedge exemption accounts which are identical to the compliance requirements proposed in a pending CBOE proposal for broad-based index hedge exemption accounts.⁸ The Exchange states that its Department of Market Regulation will continue to monitor trading activity in industry index options to detect potential abuses, and review to ensure that closing positions subject to an exemption is

Letter from Margaret G. Abrams, Senior Attorney, CBOE, to Yvonne Fraticelli, Attorney, Commission, dated April 10, 1996 ("Amendment No. 1").

³ Position limits impose a ceiling on the number of option contracts which an investor or group of investors acting in concert may hold or write in each class of options on the same side of the market (i.e., aggregating long calls and short puts or long puts and short calls). Exercise limits prohibit an investor or group of investors acting in concert from exercising more than a specified number of puts or calls in a particular class within five consecutive business days.

⁴ See Securities Exchange Act Release Nos. 36858 (February 16, 1996), 61 FR 7295 (February 27, 1996) (order approving File No. SR-PHLX-95-45) ("PHLX Approval Order"); and 36981 (March 15, 1996), 61 FR 11929 (March 22, 1996) (order approving File No. SR-PSE-95-28) ("PSE Approval Order").

⁵ See PHLX Approval Order and PSE Approval Order, *supra* note 4.

⁶ The CBOE uses the term "underlying market value," instead of the equivalent term "notional value," which the PHLX uses in its proposal, for consistency with a pending CBOE proposal to amend the CBOE's broad-based index hedge exemption. See Securities Exchange Act Release No. 36738 (January 19, 1996), 61 FR 2324 (January 25, 1996) (notice of filing of File No. SR-CBOE-96-01) ("Broad-Based Index Option Proposal").

⁷ See Broad-Based Index Option Proposal, *supra* note 6.

⁸ See Broad-Based Index Option Proposal, *supra* note 6.

conducted in a fair and orderly manner. In addition, the CBOE's Department of Market Regulation will monitor daily to determine that each exempted option contract is hedged by the equivalent dollar amount of component securities and for unusual option and stock activity.⁹

The CBOE notes that the proposed industry index hedge exemption contains build-in safeguards. Specifically, the "basket" of stocks constituting the hedge must be comprised of at least 75% of the stocks underlying the index. The hedge exemption account must promptly notify the Exchange of any material changes in the value of the portfolio.¹⁰ Further, both the options and stock positions must be initiated and liquidated in an orderly manner, so that a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position. Finally, the aggregate underlying value of the industry index option position cannot exceed the market value of the underlying hedging portfolio, to ensure that stock transactions are not used to manipulate the market in a manner benefiting the option position.

The Exchange believes that the proposal is consistent with Section 6 of this Act, in general, and, in particular, with Section 6(b)(5), in the narrow-based hedge exemption should increase the depth and liquidity of narrow-based index options markets and allow more effective hedging by investors without increasing the potential for market disruption, thereby removing impediments to and perfecting the mechanism of a free and open market and a national market system in a manner consistent with the protection of investors and the public interest.

(B) Self-Regulatory Organization's Statement on Burden on Competition

The CBOE does not believe that the proposed rule change will impose any 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.

III. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

The CBOE has requested that the proposed rule change be given

accelerated effectiveness pursuant to Section 19(b)(2) of the Act. The CBOE believes that approval on an accelerated basis would promote fair competition among exchanges and eliminate the risk, in a multiple-exchange trading environment, of investor confusion respecting hedge exemptions for industry index options. As noted above, the Commission has previously approved similar proposals submitted by the PHLX and the PSE.¹¹ The CBOE believes that the proposal presents no significant new issues.

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).¹² The Commission concludes, as it has found previously,¹³ that providing for increased position and exercise limits for narrow-based index options in circumstances where those excess positions are fully hedged with offsetting stock positions will provide greater depth and liquidity to the market and will allow investors to hedge their stock portfolios more effectively, without significantly increasing concerns regarding inter-market manipulations or disruptions of either the options market or the underlying stock market.

Specifically, the CBOE proposal contains safeguards that should make it difficult to use the exempted positions to disrupt or manipulate the market. First, requests for the exemption must be approved by the CBOE, which should ensure that the hedges are appropriate for the position being taken and are in compliance with CBOE rules. Second, the stock portfolio must consist of at least 75% of the number of component securities underlying the index, and must correspond in value to the value of the options position hedged, so that the increased positions are less likely to be used in a leveraged manner in any manipulative scheme. As noted above, the value of the hedging portfolio is equal to (1) the total market value of the net stock position; less (2) the value of (a) any offsetting calls and puts in the respective index option class; (b) any offsetting positions in stock index futures; and (c) any economically equivalent positions (assuming no other hedges for these contracts exist).¹⁴

Third, both the options and the stock positions must be initiated and liquidated in an orderly manner. Moreover, a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position, thereby helping to ensure that the stock transactions are not used to impact the market so as to benefit the options positions. Fourth, the CBOE must be notified of any material change in the portfolio.¹⁵ Fifth, the maximum hedge exemption position is two times the existing limit. The "two times the limit" is not automatic and the CBOE has the authority to approve a hedge limit for less than that amount.

The Commission notes that the CBOE's surveillance procedures are designed to detect as well as deter manipulation and market disruptions. In particular, the CBOE's Department of Market Regulation will monitor the options position of a person utilizing the hedge exemption on a daily basis to determine that each option contract is hedged by the equivalent dollar amount of component securities.¹⁶ In addition, the CBOE's Department of Market Regulation will continue to monitor trading activity in industry index options to detect potential abuses, and will review such activity and ensure that closing positions subject to an exemption is conducted in a fair and orderly manner. Violation of any of the provisions of CBOE Rule 24.4A and the interpretations and policies thereunder, absent reasonable justification or excuse, will result in the withdrawal of the hedge exemption and subsequent denial of an application for a hedge exemption thereunder.

The Commission believes that it is reasonable for the CBOE to allow broker-dealers, as well as public customers, to utilize the proposed hedge exemption.¹⁷ The Commission believes that extending the narrow-based index option hedge exemption to broker-

reported promptly to the CBOE. In such a case, the value of the stock portfolio would be reduced accordingly and therefore the hedged options position must also be reduced. As noted above, a reduction of the options position must occur at or before the corresponding reduction in the stock portfolio position.

¹⁵ See Amendment No. 1, *supra* note 2.

¹⁶ See Amendment No. 1, *supra* note 2. Market participants granted a hedge exemption must promptly notify the Exchange of material changes in the portfolio.

¹⁷ The Commission notes that broker-dealers and public customers may utilize the CBOE's equity hedge exemption. See CBOE Rule 4.11, Interpretation and Policy .04, and Securities Exchange Act Release No. 35738 (May 18, 1995), 60 FR 27573 (May 24, 1995) (order approving File Nos. SR-Amex-95-13, SR-CBOE-95-13, SR-NYSE-95-04, SR-PSE-95-05, and SR-PHLX-95-10) (permanently approving hedge exemption pilot programs).

¹¹ See PHLX Approval Order and PSE Approval Order, *supra* note 4.

¹² 15 U.S.C. 78f(b) (1988 & Supp. V 1993).

¹³ See PHLX Approval Order and PSE Approval Order, *supra* note 4.

¹⁴ If a hedge position ceases to exist, this would be viewed as a material change which must be

² See Amendment No. 1, *supra* note 2.

¹⁰ *Id.*

dealers may help to increase the depth and liquidity of the market for industry index options and may help to ensure that public customers receive the full benefit of the exemption. Moreover, the CBOE's monitoring procedures, as described above, should be able to detect any abuses and ensure that the options position, whether broker-dealer or customer, is properly hedged.

The Commission finds good cause for approving the proposed rule change and Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. As noted above, the Commission previously has approved similar proposals submitted by the PHLX and the PSE.¹⁸ The PHLX's and PSE's proposals were published for the full notice and comment period and the Commission received no comments on their proposals. The CBOE's proposal raises no new regulatory issues. Amendment No. 1 strengthens the CBOE's proposal by indicating that the CBOE's Department of Market Regulation will monitor hedge exemption accounts daily to determine that each exempted option contract is hedged by the equivalent dollar amount of component securities. Accordingly, the Commission believes it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve the proposed rule change and Amendment No. 1 to the proposed rule change on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., 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 at the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, D.C. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory

organization. All submissions should refer to the file number in the caption above and should be submitted by [insert date 21 days after the date of this publication].

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-96-18), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-37189; International Series Release No. 977; File No. SR-CBOE-96-09]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendments Thereto Relating to the Listing and Trading of Options on the Mexican Indice de Precios y Cotizaciones

May 9, 1996.

On February 27, 1996, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to list and trade options on the Indice de Precios y Cotizaciones ("IPC" or "Index"), a cash-settled, broad-based index designed to represent the overall Mexican equity market. The IPC was created, and is maintained, by the Mexican Stock Exchange ("Bolsa") and is widely recognized as the benchmark equity index for Mexico. Notice of the proposed rule change appeared in the Federal Register on March 12, 1996.³ No comments were received on the proposal.

On March 29, 1996, CBOE submitted Amendment No. 1 ("Amendment No. 1") to the proposal to address issues related to Index maintenance criteria.⁴ On April 11, 1996, CBOE submitted Amendment No. 2 ("Amendment No. 2") to the proposal to clarify certain Index maintenance criteria and to

address issues relating to the reduction and aggregation of position limits.⁵ On May 7, 1996, CBOE submitted Amendment No. 3 ("Amendment No. 3," together with Amendments No. 1 and 2, "Amendments") to the proposal to clarify CBOE's procedures for reducing position limits if the Index is subsequently reclassified as narrow-based.⁶ This order approves the proposal, as amended, and solicits comments on the Amendments.

I. Description of the Proposal

The purpose of the proposed rule change is to permit the Exchange to list and trade cash-settled, European-style⁷ stock index options on the IPC, a broad-based, capitalization-weighted index comprised of 35 of the largest and most liquid stocks (issued by 28 issuers) on the Bolsa.⁸ The Exchange believes that options on the Index will provide investors with a low-cost means of participating in the performance of the Mexican economy and hedging against the risk of investing in that economy.

Index Design

The Index was designed by and is maintained by the Bolsa. These stocks selected for inclusion in the IPC were chosen based upon a combination of criteria relating to their trading volume and market capitalization. The Bolsa reviews a component's compliance with these criteria every two months. There are three criteria which could keep a potential replacement component stock from being added to the Index. First, suspended issues or those which have a material possibility of being suspended will not be included in the Index. Second, if the combined weight of two or more series of an index represented company were to exceed 15% of the weight of the Index, then only the series with the highest trading volume will be allowed to remain in the Index. Third, if a company is a subsidiary of another company that is in the Index and it represents more than 75% of the assets of the holding company it will not be included.

The IPC is composed of stocks from eighteen (18) industry groups including: Telecommunications, Diversified Holding Companies, Banks, Broadcasting, Building Materials, Mining, and Financial Services. The

⁵ See Letter from Joseph Levin, CBOE, to Howard Kramer, SEC, dated April 8, 1996.

⁶ See Letter from Eileen Smith, CBOE, to Stephen Youhn, SEC, dated May 6, 1996.

⁷ A European-style option may only be exercised during a specified period before expiration.

⁸ The Commission notes that Hylsamex SA-BCP is 82% owned by Alfa SA-A and that Tolmex SA-B2 is 99% owned by Cemex Sa.

¹⁸ See PHLX Approval Order and PSE Approval Order, *supra* note 4.

¹⁹ 15 U.S.C. 78f(b)(2) (1988).

²⁰ 17 CFR 200.30-3(a)(12) (1995).

¹ 15 U.S.C. 78s(b)(1) (1988 & Supp. V 1993).

² 17 CFR § 240.19b-4 (1994).

³ See Securities Exchange Act Release No. 36902 (March 5, 1996), 61 FR 10043.

⁴ See Letter from Joseph Levin, CBOE, to Howard Kramer, SEC, dated March 29, 1996.