

company organized as a Maryland corporation. On May 15, 1992, applicant, then known as "Seligman Henderson Small Capitalization Interval Fund, Inc.," filed a notification of registration on Form N-8A pursuant to section 8(a) of the Act. On September 23, 1992, applicant filed a registration statement on Form N-1A pursuant to section 8(b) of the Act, as well as an amended notification of registration changing its name. Applicant's registration statement has not been declared effective and the applicant has not made a public offering of its shares.

2. Applicant has not issued or sold any securities. As of the date of filing of the application, applicant has no security holders, liabilities, or assets. Applicant is not a party to any litigation or administrative proceeding.

3. Applicant is not now engaged, nor does it propose to engage, in any business activities other than those necessary for the winding-up of its affairs.

4. Applicant is in the process of dissolving its existence under Maryland law, including filing Articles of Dissolution with the Maryland Department of Assessment and Taxation.

For the SEC, by the Division of Investment Management, under delegated authority.
Margaret H. McFarland,
Deputy Secretary.

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[Release No. 34-37589; International Series Release No 1015; File No. SR-CHX-96-12]

**Self-Regulatory Organizations;
Chicago Stock Exchange, Inc.; Order
Approving Proposed Rule Change and
Notice of Filing and Order Granting
Accelerated Approval of Amendment
No. 2 Thereto Relating to Listing
Standards for Investment Company
Units**

August 21, 1996.

I. Introduction

On March 27, 1996, the Chicago Stock Exchange, Inc. ("CHX" 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 proposed rule change to amend Article XXVIII of its rules governing the listing requirements of securities on the CHX, as well as Article XXX of the CHX's rules governing specialists. On April 12,

1996, the CHX filed Amendment No. 1 to the proposal.³ Notice of the proposed rule change and Amendment No. 1 thereto appeared in the Federal Register on April 23, 1996.⁴ No comments were received by the Commission. The CHX submitted Amendment No. 2 ("Amendment No. 2") to the proposal on August 20, 1996 to address issues related to Exchange Trading of the Investment Company Units.⁵ This order approves the proposal, as amended, and solicits comments on Amendment No. 2.

II. Description of the Proposal

A. Introduction

The Exchange is proposing listing standards for units of trading ("Units") that represent an interest in a registered investment company ("Investment Company") that could be organized as a unit investment trust ("UIT"), an open-end management investment company, or a similar entity. The Investment Company would hold securities comprising, or otherwise based on or representing an investment in, an index or portfolio of securities. The Investment Company either could hold the securities directly or could hold another security representing the index or portfolio of securities (such as shares of a UIT that holds shares of an open-end management investment company).

Under the proposed rules, the Investment Company would be required either to: (i) Hold securities comprising or otherwise based on or representing an interest in an index or portfolio of securities, or (ii) hold securities in another registered investment company.⁶ The Investment Company would then issue Units in a specified aggregate number in return for a deposit of either: (i) Shares of securities comprising or otherwise based on the relevant index or portfolio, or (ii) shares of an Investment Company. In addition to or instead of the "in-kind" deposit, the Investment Company might require

a cash deposit. Thus, Units could be structured as series of an open-end management investment company investing in a portfolio of securities ("Fund-only structure"). Alternatively, Units could be structured as UITs that have as their assets shares of an open-end management investment company holding a portfolio of securities ("Fund/UIT structure"). Unit holders would receive periodic cash payments corresponding to the regular cash dividends or distributions declared with respect to the securities held by the Investment Company (after subtracting applicable expenses and charges).

Units would be distributed in "Creation Transactions." To effect a Creation Transaction in a Fund-only structure, an entity would be shares from the investment company ("Fund") in "Creation Unit" size aggregations in exchange for a deposit of a basket of securities reflecting the securities underlying the Fund and/or a cash deposit. To effect a Creation Transaction in a Fund/UIT structure, an entity would buy a Fund share from the open-end management investment company with a similar deposit and exchange it with the UIT for a Creation Unit.⁷ The owner of a Creation unit could then subdivide the Creation Unit into a specific number of identical fractional non-redeemable sub-units, the Units, that would constitute the securities traded. Units could be recombined into Creation Unit aggregations, and redeemed for the securities underlying the Fund and/or an amount of cash, either directly, or indirectly, depending on the structure chosen. The securities would not be redeemable other than in Creation Unit aggregations.⁸

Dealing in Units on the Exchange will be conducted pursuant to the Exchange's general agency-auction trading rules. The Exchange's general dealing and settlement rules will apply, including its rules on clearance and settlement of securities transactions and its equity margin rules. Other generally applicable Exchange equity rules and procedures also will apply. Unless the prospectus for a specific security states otherwise, the Units trading on the Exchange will have one vote per share; however, as with other securities issued by registered investment companies, there will not be a "pass-through" of the voting rights on the actual index securities held by a fund or directly or indirectly by a trust.

With respect to specialist dealings, Article XXX, Rule 23(a) of the Exchange's Rules precludes certain business relationships between an

³ Amendment No. 1 serves to supersede entirely the Exchange's initial rule filing. Letter from Charles R. Haywood, Foley Larnder, to Francois Mazur, Attorney, Office of Market Supervision ("OMS"), Division of Market Regulation ("Division"), Commission, dated April 11, 1996 ("Amendment No. 1").

⁴ See Securities Exchange Act Release No. 37121 (April 17, 1996), 61 FR 17932.

⁵ See Letter from David Rusoff, Foley & Lardner, to Michael Walinskas, SEC, dated August 20, 1996. Specifically, Amendment No. 2 amends Interpretation and Policy .01 of Article XXVIII, Rule 23 to require that for the Japan Series, 500,000 Units (as defined below) be outstanding prior to the commencement of trading of a series of Units on the Exchange.

⁶ Telephone Conversation between David T. Rusoff, Foley & Lardner, and Francois Mazur, Attorney, OMS, Division, Commission, on April 12, 1996.

⁷ *Id.*

⁸ *Id.*

¹ 15 U.S.C. § 78s(b)(1) (1988).

² 17 CFR 240.19b-4.

issuer of an "exclusive issue" and the specialist in that exclusive issue.⁹ Rule 23(a) could be interpreted to prevent a specialist from engaging in Creation Transactions with the issuer of Units. The Exchange believes, however, that such market activities could enhance liquidity in the Units and facilitate the specialist's market-making responsibilities. In addition, since the specialist will be able to engage in Creation Transactions and redemptions only according to the same terms and conditions as every other investor (and only at net asset value), the Exchange believes that there is no potential for abuse.

Therefore, the Exchange proposes amending Article XXX, Rule 23(a) to permit specialists to engage in these types of transactions if such transactions would facilitate the maintenance of a fair and orderly market in Units. Any Creation Transactions in which the specialist engages, however, will have to be effected through the Distributor (as defined herein), and not directly with the issuer. This requirement will make clear that the specialist is purchasing Units in Creation Unit-size aggregations only to facilitate normal specialist trading activity.

With respect to investor disclosure, the Exchange notes that pursuant to the requirements of the Securities Act of 1933 ("1933 Act") all investors in Units will receive a prospectus regarding the Units. Because the Units will be in continuous distribution, the prospectus delivery requirements of the 1933 Act will apply to all investors in Units. It is possible, however, that an exemption from the prospectus delivery requirement may be obtained at some point in the future with respect to Units listed or traded on the Exchange. In the event of such an exemption the Exchange will discuss with Commission staff the appropriate level of disclosure that should be required with respect to the Units being listed or traded, as appropriate, and will file any necessary rule change to provide for such disclosure.

Upon the initial listing of any class of Units or trading of such Units pursuant to unlisted trading privileges ("UTP"), the Exchange will issue a circular to its membership explaining the unique characteristics and risks of this type of security. The circular will, among other things, inform member organizations of

their responsibility to deliver a prospectus to investors. The circular also will note that before an Exchange member undertakes to recommend a transaction in Units, it should make a determination that it is in compliance with applicable rules of other self-regulatory organizations of which it is a member, including applicable suitability and know-your-customer rules.

With respect to trading halts, the trading of Units would be halted, along with the trading of all other listed stocks, in the event the "circuit breaker" thresholds of Article IX, Rule 10A are reached.

The Exchange proposes that Units trade either in certificated form or solely through the use of a global certificate. Permitting the use of global certificates would be consistent with expediting the processing of transactions in Units and would minimize the costs of engaging in transactions in these securities.

One existing form of Units are CountryBaskets ("CBs"),¹⁰ which are created pursuant to a Fund-only structure. In March 1996, the New York Stock Exchange ("NYSE") received Commission approval to list and trade CountryBaskets.¹¹ CHX currently will not list CountryBaskets, but rather seeks to trade CountryBaskets pursuant to unlisted trading privileges ("UTP") once the generic listing standards set forth herein are approved.

Pursuant to Rule 12f-5 under the Act,¹² prior to trading a particular class or type of security pursuant to UTP, CHX must have listing standards comparable to those of the primary exchange on which the security is listed. The NYSE has adopted listing standards for Units, and CHX's proposed rule change is designed to create similar standards for Unit listing and/or trading on CHX. As stated above, CHX intends to trade CountryBaskets pursuant to UTP upon approval of this rule filing.

B. CountryBaskets Generally

CountryBaskets are issued as series of an open-end management investment company that invest in a portfolio of securities ("Index Securities") included in a corresponding index.¹³ Each series of the investment company is designed

to provide investment results that substantially correspond to the price and yield performance of a corresponding FT/S&P-Actuaries World Index ("Index" or "FT/S&P").¹⁴ The nine series of Funds that currently exist are based on the following Indices: Australia, France, Germany, Hong Kong, Italy, Japan, South Africa, United Kingdom, and the United States.

C. Distribution of Units

Units are distributed through Creation Transactions. To effect a Creation Transaction, a person buys Fund shares from the Fund at their net asset value ("NAV") next computed. The sales will be in Creation Unit-size aggregations in exchange for a deposit ("Deposit") of Index Securities (a "Fund Basket") and a specified amount of cash sufficient to equal the NAV of such shares.

Units in Creation Unit-size aggregations may be redeemed, at NAV, generally for an in-kind distribution of Index Securities comprising the Fund shares, plus a cash payment. A Creation Unit-size aggregation of Fund shares represents securities with approximately \$2 to \$9.5 million in market value. The Creation Unit is disaggregated into the individual Units that trade on an Exchange, currently the NYSE.¹⁵ For the nine initial CountryBasket securities, there are the following number of Units per Creation Unit:

¹⁴ According to Amendment No. 1 to SR-NYSE-95-23, the Indices are a continuation of the FT-Actuaries World Indices, which were jointly founded by The Financial Times Limited ("FT"), Goldman, Sachs & Co. ("Goldman"), and NatWest Securities Limited ("NatWest," and each a "Founding Member"). In May 1995, Standard & Poor's ("S&P"), a division of The McGraw-Hill Companies, Inc., joined FT and Goldman as co-publishers of the predecessor to the Indices. As part of the new arrangement, NatWest withdrew from the management of those Indices, but continues to be recognized as a Founding Member. The Indices are now jointly owned by S&P, FT and Goldman. Following a transition period, FT and S&P will jointly calculate the Indices. In November 1995, FT transferred its ownership rights in the Indices to FT-SE International, a new company jointly owned by the FT and the London Stock Exchange. By the end of 1996, it is expected that FT-SE International will assume responsibility for calculating the European and Asia-Pacific Indices and S&P will calculate the U.S. Index.

¹⁵ If a Fund/UIT structure instead had been used, a "Redeemable Unit" would represent the functional equivalent of the Creation Unit. The owner of a Redeemable Unit could separate it into a specific number of identical fractional non-redeemable sub-units that would constitute the Units traded on the Exchange. In the case of the Germany CountryBasket series, for example, there would be 100,000 Units per Redeemable Unit. These Units could be recombined into Redeemable Units and then redeemed, at NAV, for the appropriate number of Fund shares. In turn, the Fund shares could be redeemed for the Index Securities and cash. The Units would not be redeemable other than in the Creation Unit aggregations.

⁹ Interpretation and Policy .01 of Article XXX, Rule 23 defines "exclusive issue" as the stock of any company traded on the Exchange not otherwise traded on the NYSE, American Stock Exchange, or NASDAQ/NMS, and, where there exists another market for such issue, the Exchange has executed 15% or more of the volume in the issue during the three previous months.

¹⁰ CHX understands that "CountryBaskets" and "The CountryBaskets Index Fund" are service marks of Deutsche Morgan Grenfell/C.J. Lawrence, Inc. ("DMG"), the investment adviser to the fund.

¹¹ Securities Exchange Act Release No. 36923 (March 5, 1996), 61 FR 10410.

¹² 17 CFR 240.12f-5.

¹³ The information describing the structure and mechanics of CountryBaskets has been restated from File No. SR-NYSE-95-23. See Securities Exchange Act Release No. 36923, *supra* note 11.

Australia	100,000
France	100,000
Germany	100,000
Hong Kong	100,000
Italy	100,000
Japan	250,000
South Africa	100,000
United Kingdom	100,000
United States	100,000

D. Exchange Trading of Units

The Exchange will require that there be at least 300,000 tradable Units outstanding before trading can begin.¹⁶ The Exchange will consider the suspension of trading of a series of Units if:

- after the first year of trading, there are fewer than 50 record or beneficial holders of the Units for 30 or more consecutive trading days;
- the value of the underlying index or portfolio of securities no longer is calculated or available; or
- there occurs another event that makes further dealings in the Units on the Exchange inadvisable.¹⁷

E. The FT/S&P-Actuaries World Indices

Deutsche Bank Securities Corporation, formerly investment adviser to the Funds, provided the NYSE with certain information describing the FT/S&P-Actuaries World Indices, contained within NYSE filing SR-NYSE-95-23, as amended.

1. Establishing an Index

The FT/S&P are jointly compiled by The Financial Times Limited, Goldman, Sachs & Co., and Standard & Poor's, a division of The McGraw-Hill Companies, Inc., in conjunction with the Institute of Actuaries (together, the "Consortium").¹⁸ The aim of the Consortium is to create and maintain a series of high quality equity indices for use by the global investment community. Specifically, the Consortium seeks to establish and

maintain the FT/S&P so that with respect to their corresponding markets, they are comprehensive, consistent, flexible, accurate, investible, and representative.

The World Index Policy Committee ("WIPC") makes all policy decisions concerning the FT/S&P, including objectives, selection criteria, liquidity requirements, calculation methodologies, and the timing and disclosure of additions and deletions. The WIPC makes those decisions in a manner that is consistent with the stated aims and objectives of the Consortium. In general, the WIPC aims for a minimum of 70 percent coverage of the aggregate value of all domestic exchange-listed stocks in every country, region and sector in which it maintains an index.

The WIPC consists of one representative of each Consortium member, one member nominated by each of the parties as representing an actual or prospective main user group of the World Indices, and a Chairman and additional member who are members of the Institute of Actuaries or the Facility of Actuaries.

A country must satisfy the following criteria for the WIPC to include it in the FT/S&P-Actuaries World Indices: (1) Direct equity investment by non-nationals must be permitted; (2) accurate and timely data must be available; (3) no significant exchange controls should exist that would prevent the timely repatriation of capital or dividends; (4) significant international investor interest in the local equity market must have been demonstrated; and (5) adequate liquidity must exist.

Securities in the FT/S&P are subject to the following "investibility screens": (1) Securities comprising the bottom five percent of any market's capitalization are excluded; (2) securities must be eligible to be owned by foreign investors; (3) 25 percent or more of the full capitalization of eligible securities must be publicly available for investment and not in the hands of a single party or parties "acting in concert"; and (4) securities that fail to trade for more than 15 business days within each of two consecutive quarters are excluded.

The WIPC seeks to select constituent stocks that capture 85 percent of the equity that remains in any market (known as the "investible universe") after applying the investibility screens. Securities are selected with regard to economic sector and market capitalization to make a given FT/S&P highly representative of the overall economic sector make-up and market capitalization distribution of the investible universe of a market.

2. Maintaining an Index

The WIPC may add securities to the FT/S&P for any of the following reasons: (1) The addition would make the economic sector make-up and market capitalization distribution of the FT/S&P component more representative of its investible universe; (2) a non-constituent security has gained in importance and replaces an existing constituent security under the rules of review established by the WIPC; (3) the FT/S&P component represents less than its targeted percentage of the capitalization of its investible universe (usually in cases where the investible universe has grown faster than the corresponding FT/S&P); (4) a new, eligible security becomes available whose total capitalization is one percent or more of the current capitalization of the relevant FT/S&P; (5) an existing constituent "spins off" a part of its business and issues new equity to the existing shareholders; or (6) changes in investibility factors lead to a stock becoming eligible for inclusion and that stock now qualifies on other grounds.

The WIPC may adjust the FT/S&P for any of the following reasons: (1) The component comprises too high a percentage of its representative universe; (2) a review by the WIPC shows that a constituent security has declined in importance and should be replaced by a non-constituent security; (3) the deletion of a security that has declined in importance would make the FT/S&P more representative of the economic make-up of its investible universe; (4) circumstances regarding investibility and free float change, causing the constituent security to fail the FT/S&P screening criteria; (5) an existing constituent security is acquired by another entity; or (6) the stock has been suspended from trading for a period of more than ten working days. Generally, but not in all cases, changes resulting from review by the WIPC occur at the end of a calendar quarter. Changes resulting from merger or "spin-off" activity will be effectuated as soon as practicable.

3. Dissemination of Changes to the Constituent Stocks in the Indices

Changes to an Index made during a calendar quarter are noted at the foot of the tables containing the Indices that are published daily in the FT. Consistent with the FT publication policy, these changes also are shown prior to the actual day of implementation (unless for reasons beyond the control of FT this is not possible). Decisions regarding the addition of new eligible constituent stocks that are unrelated to existing stocks in an Index, or weighting changes

¹⁶ For the Japan series, 500,000 worth of DBs, representing two Creation Units, will be required to be outstanding prior to commencing trading. See Amendment No. 2.

¹⁷ The Commission notes that the fund must invest at least 95% of its net assets in the securities of the appropriate Index and that the weighting of the portfolio securities of each series will substantially correspond to their proportional representation in each Index, helps to reduce concerns that Units could become a surrogate for trading in a single or a few unregistered stocks. See Securities Exchange Act Release No. 36923, *supra* note 11. In the unlikely event, however, that this were to occur, the Commission would expect the CHX to suspend trading in the securities to ensure compliance with the Act.

¹⁸ In Amendment No. 1 to SR-NYSE-95-23, the NYSE stated that certain modifications had occurred to the Indices. The CHX's filing has incorporated the additional information, and operates under the assumption that the original information detailed in SR-NYSE-95-23 continues to be accurate to the extent not modified by the NYSE's amendment.

to existing constituent stocks, are announced in the FT at least four working days before they are implemented. Monday editions of the FT also show all constituent changes made during the previous week, together with base values for each Index. Changes to be made in an Index at the end of a calendar quarter are published as soon as is practicable following the quarterly meeting of the World Indices Policy Committee, but before the quarter-end.

4. Calculation and Dissemination of an Index

The FT/S&P are calculated through widely accepted mathematical formulae, with the effect that the Indices are weighted arithmetic averages of the price relatives of the constituents—as produced solely by changes in the marketplace—adjusted for intervening capital changes. The FT/S&P are base-weighted aggregates of the initial market capitalization, the price of each issue being weighted by the number of shares outstanding, modified to reflect only those shares outstanding that are eligible to be owned by foreign investors.

For each constituent security, the implied annual dividend is divided by 260 (an accepted approximation for the number of business days in a calendar year). This dividend is then reinvested daily according to standard actuarial calculations. Distributions affect adjustments to the base capital or the price per share in accordance with prescribed FT/S&P standards. The Indices' values and related performance figures for various periods of time are calculated daily and are disseminated to the public.

The FT/S&P are valued in terms of local currency, U.S. dollars, and U.K. pounds sterling, thereby allowing the effect of currency value on the Index value to be measured. Changes to the Indices are announced as soon as possible, and on Mondays the Financial Times publishes a list of changes to each Index implemented during the previous week, if any. The FT/S&P are calculated once a day on weekdays when one or more of the constituents markets are open; the Indices are syndicated and published in the financial sections of several newspapers worldwide. FT/S&P data also may be purchased electronically.

F. Indicative Values

Recognizing the importance of having current information on the value of the Indices, DMG has arranged for Telesphere Corporation (formerly Telekurs (North America) Inc.) ("Telesphere") to calculate "indicative

values" for the nine Indices on which CountryBaskets are based. CHX understands that the NYSE provides for the dissemination of these indicative values through the facilities of the Consolidated Tape Association ("CTA").

In calculating "indicative values," Telesphere uses the most currently available stock price information for the constituent stocks in an Index (based on home currency prices) and prevailing currency exchange rates to translate the Index value into U.S. dollars.

Telesphere also uses the same pricing algorithm and methodology as the Index calculators in calculating the indicative values. These values are disseminated every 30 seconds by the NYSE during regular trading hours of 9:30 A.M. to 4:00 P.M. Eastern time. Because trading hours in the markets for the stocks underlying the Indices differ, the calculation of the indicative values are effected as follows:

- *Pacific Rim.* Australia, Hong Kong, and Japan. There is no overlap between the NYSE trading hours and the home-country trading hours. Thus, the indicative values always reflect the closing prices of the underlying securities on the most recently completed trading day, but are updated every 30 seconds to reflect changes in exchange rates.

- *Europe.* France, Germany, Italy, and the United Kingdom. There is some overlap between NYSE trading hours and home-country trading hours. Thus, the 30-second updates for these Indices reflect changes in both current stock price information and currency exchange rates while the relevant market is open; it reflects only changes in exchange rates once the home-market closes.

- *United States.* Each 30-second update reflects the current price of U.S. component stocks.

- *South Africa.* During Eastern Standard Time there is no overlap between NYSE and South African trading hours. During Eastern Daylight Savings Time there is a half-hour overlap. Thus, during Standard Time, the disseminated Index values reflect the closing South African prices. During Daylight Savings Time, there is a real-time feed of stock prices from the Johannesburg Stock Exchange and there is a real-time calculation of the indicative value of the index at 30-second intervals during the half-hour overlap.

While these indicative values are not the official values of the Indices (which continue to be calculated and disseminated once each day), the Exchange believes that these values provide investors with accurate, timely

information on the values of the Indices. Providing standardized information through CTA facilities should help ensure that all investors have equal access to this market information. While some market participants may be able to perform these calculations for their own trading purposes during the business day, many participants lack sufficient resources to do so. Of course, it cannot be guaranteed that the indicative value will at all times be a completely accurate reflection of the value of the underlying Index.¹⁹

Although the CHX operates under Central Time, its trading hours coincide with those of the NYSE. Therefore, the time zone difference will not affect the ability to trade CountryBaskets on the CHX with full price information.

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 believes that the Exchange's proposal to establish listing standards for Units and to trade CountryBaskets pursuant to UTP will provide investors with a convenient way to participate in domestic and foreign securities markets. The Exchange's proposal should help to provide investors with increased flexibility in satisfying their investments with increased flexibility in satisfying their investment needs by allowing them to purchase and sell at negotiated prices throughout the business day securities that replicate the performance of several portfolios of stocks.²¹ Accordingly, the Commission finds that the Exchange's proposal will facilitate transactions in securities, remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, protect investors and the public interest, and is not designed to permit unfair discrimination between

¹⁹ In the unlikely event that Telesphere determines that it no longer will calculate the indicative value of the Indices, according to the NYSE, DMG will seek to find another entity to provide such values on substantially the same basis as Telesphere. If this were to occur, the NYSE has represented that it will consult with the staff of the Division to ensure that the staff finds any proposed new arrangements acceptable, including the possibility of ending trading in the securities.

²⁰ 15 U.S.C. 78f(b)(5) (1988).

²¹ The Commission notes that unlike typical open-end management investment companies, where investors have the right to redeem their fund shares on a daily basis, investors in Units only could redeem Units in Creation Unit size aggregations.

customers, issuers, brokers, or dealers.²² The Commission also believes that the Exchange's proposal is consistent with Section 12(f) of the Act²³ relating to trading securities pursuant to UTP.

The CHX seeks to trade CBs pursuant to UTP. In approving the NYSE's proposal to list and trade CBs, the Commission noted that the estimated cost of an individual CB security, approximately \$20 to \$50, should make it attractive to individual retail investors who wish to hold a security replicating the performance of a portfolio of foreign or domestic stocks. The Commission also stated that it believes that CBs will provide investors with several advantages over standard open-end management investment companies specializing in such stocks, and in particular, investors will be able to trade CBs continuously throughout the business day in secondary market transactions at negotiated prices.²⁴ In contrast, Investment Company Act Rule 22c-1²⁵ limits holders and prospective holders of open-end management investment company shares to purchasing or redeeming securities of the fund based on the net asset value of the securities held by the fund as designated by the board of directors. Thus, the Commission stated that CBs should allow investors to: (1) Respond quickly to market changes through intra-day trading opportunities; (2) engage in hedging strategies not currently

available to retail investors; and (3) reduce transaction costs for trading a portfolio of securities.

Although the value of CBs will be based on the value of the securities and cash held in the Fund, CBs are not leveraged instruments.²⁶ In essence, CBs are equity securities that represent an interest in a portfolio of stocks designed to reflect substantially the applicable FT/S&P Index. Accordingly, it is appropriate to regulate CBs in a manner similar to other equity securities. Nevertheless, in approving the CHX's proposal to trade CBs, the Commission believes that the unique nature of CBs requires that certain product design, disclosure, trading, and other issues be addressed.

A. CountryBaskets Generally

As stated in the approval of the NYSE's proposal to list and trade CBs,²⁷ the Commission believes that the CBs are reasonably designed to provide investors with an investment vehicle that substantially reflects in value the Index it is designed upon, and, in turn, the performance of the specified U.S. or foreign market. In this regard, the Commission notes that the WIPC imposes specific criteria in its selection of Index countries and components. For a market to be eligible for inclusion in an FT/S&P Index, it must allow direct equity investment by non-nationals, make timely and accurate data available, impose no significant exchange controls, demonstrate significant international investment interest, and be sufficiently liquid. For a security to be included in a given Index, it may not be in the bottom 5% of a market's capitalization, it must be eligible to be owned by foreigners, 25% of its full capitalization must be publicly available for investment, and it may not fail to trade for more than 15 business days within each of two consecutive quarters. The aim of component selection is to make Index components highly representative of the over-all economic sector make-up and market capitalization of a given market. The Commission believes that these criteria should serve to ensure that the underlying securities of these Indices are well capitalized and actively traded.

The Commission also notes that the CB series' investment policies require that at least 95% of a CB series' investments be in the equity securities that are the constituent securities of the relevant FT/S&P Index. In addition, the weighting of the portfolio securities of each series substantially correspond to their proportional representation in the corresponding FT/S&P Index.²⁸ This will help to ensure that an investment in CBs is substantially similar to an investment in the securities comprising the related FT/S&P Index.

B. Disclosure

The Commission believes that the Exchange's proposal should ensure that investors have information that will allow them to be adequately apprised of the terms, characteristics, and risks of trading Units, including CBs.²⁹ As noted above, all Unit investors, including investors purchasing CBs in the secondary market at the CHX pursuant to UTP, will receive a prospectus regarding the product. Because Units, including CBs trading on the CHX pursuant to UTP, will be in continuous distribution, the prospectus delivery requirements of the Securities Act of 1933 will apply both to initial investors, and to all investors purchasing such securities in the secondary market at the CHX. The prospectus will address the special characteristics of a particular Unit, including a statement regarding that Unit's redeemability, and method of creation. With respect to CBs, the prospectus will state specifically that CBs individually are not redeemable.

The Commission also notes that upon the initial listing of or extension of unlisted trading privileges to any class of Units, including CBs, the Exchange will issue a circular to its members explaining the unique characteristics and risks of this type of security. The circular will note that before an Exchange member undertakes to recommend a transaction in Units, it should make a determination that it is in compliance with applicable rules of other self-regulatory organizations of which it is a member, including applicable suitability and know-your-

²² Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of exchange trading for new products upon a finding that the introduction of the product is in the public interest. Such a finding would be difficult with respect to a product that served no investment, hedging or other economic function, because any benefits that might be derived by market participants would likely be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

²³ 15 U.S.C. § 78s(l) (1994).

²⁴ Because of potential arbitrage opportunities, the Commission believes that CBs should not trade at a material discount or premium in relation to their net asset value. The mere potential for arbitrage should keep the market price of CBs comparable to their net asset values; therefore, arbitrage activity likely will not be significant. In addition, the Fund will redeem in-kind, thereby enabling the Fund to invest virtually all of its assets in securities comprising the FT/S&P Indices.

²⁵ 17 CFR 270.22c-1. Investment Company Act Rule 22c-1 generally provides that a registered investment company issuing a redeemable security, its principal underwriter, and dealers in that security may sell, redeem, or repurchase the security only at a price based on the net asset value next computed after receipt of an investor's request to purchase, redeem, or resell. The net asset value of an open-end management investment company generally is computed once daily Monday through Friday as designated by the investment company's board of directors. The Commission granted CBs an exemption from this provision to allow them to trade in the secondary market at negotiated prices. See Investment Company Act Release No. 21802; International Series Release No. 943, March 5, 1996.

²⁶ In contrast, proposals to list exchange-traded derivative products that contain a built-in leverage feature or component raise additional regulatory issues, including heightened concerns regarding manipulation, market impact, and customer suitability. See e.g., Securities Exchange Act Release No. 36165 (August 29, 1995), 60 FR 46653 (relating to the establishment of uniform listing and trading guidelines for stock index, currency, and currency index warrants).

²⁷ Securities Exchange Act Release No. 36923, *supra* note 11.

²⁸ The actual components, component capitalization, and component weightings for each series as of December 29, 1995, were submitted as part of a Form N-1A registration statement of The CountryBaskets Index Fund, Inc. under the Securities Act of 1933 and the Investment Company Act of 1940. Registration Nos. 33-85710; 811-8734.

²⁹ The CHX states that it may, in the future, seek to obtain an exemption from the prospectus delivery requirement with respect to Units trading on the Exchange. In the event it obtains such an exemption, the Exchange will discuss with Commission staff the appropriate level of disclosure that should be required with respect to the Units being listed, and will file any necessary rule change to provide for such disclosure.

customer rules. The circular also will address members' responsibility to deliver a prospectus to all investors as well as highlight the characteristics of purchases in Units, including CBs, including that they only are redeemable in Creation Unit size aggregations.

C. Trading of CBs

The Commission finds that adequate rules and procedures exist to govern the trading of Units, including the trading of CBs by the CHX pursuant to UTP. In this regard, the Commission notes that Units are deemed equity securities subject to CHX rules applicable to the trading of equity securities. Accordingly, the Exchange's existing general rules that currently apply to the trading of equity securities also will apply to Units, including CBs. These rules include those governing: the auction market (including trading halt provisions pursuant to CHX Article IX, Rule 10A); priority, parity and precedence of orders; members dealing for their own accounts; specialist, odd-lot broker, and registered trader responsibilities; handling of orders and reports; publications of transactions and changes; comparisons and exchange of contracts; marking to the market; settlement of contracts; dividends, interests, and rights; reclamations; closing contracts; and lending securities.³⁰ The CHX also will consider suspending trading in a series of Units if it deems that an event or condition exists that makes further dealings on the Exchange inadvisable.

In addition, the Exchange has proposed specific listing and delisting criteria to accommodate the trading of Units. These criteria should help to ensure that a minimum level of liquidity will exist in each series of Units to allow for the maintenance of fair and orderly markets. The delisting criteria also allows the Exchange to consider the suspension of trading and the delisting of a series of Units, including suspending trading in CBs traded on the Exchange pursuant to UTP, if an event were to occur that made further dealings in such securities inadvisable. This will give the Exchange flexibility to suspend trading and delist Units, if circumstances warrant such action. For example, as noted above, suspending trading in CBs might be appropriate if Telesphere no longer were able to calculate indicative values, and no acceptable alternative arrangements could be found.³¹ In addition, as noted above, in the unlikely event that CBs become a surrogate for trading a single or few securities, such an event could

raise issues pursuant to the Act that would require suspending trading in CBs so as to ensure compliance with the Act.³² Accordingly, the Commission believes that the rules governing the trading of Units provide adequate safeguards to prevent manipulative acts and practices and to protect investors and the public interest.

D. Indicative Indices

The Commission believes that given that the NYSE is disseminating the indicative values for the nine Indices upon which CBs are based, investors are provided with timely and accurate information concerning the value of the FT/S&P. The Commission understands that the information is disseminated through the facilities of the CTA and will reflect currently-available stock price information. Moreover, it is calculated based upon the same pricing algorithm and methodology used by the FT/S&P calculators and is disseminated every 30 seconds during the regular NYSE trading day.³³ In addition, since it is expected that the market value of the CBs will closely track the performance of the applicable FT Index,³⁴ the Commission believes that the indicative values provide investors with adequate information to determine the intra-day value of a given CB series.³⁵

E. Specialists

The Commission finds that it is consistent with the Act to allow a specialist registered in a security issued by an Investment Company to purchase or redeem the listed security from the issuer as appropriate to facilitate the maintenance of a fair and orderly market in that security. The Commission believes that such market activities should enhance liquidity in such securities and facilitate a specialist's market-making responsibilities. In addition, because the specialist only will be able to purchase and redeem Units on the same terms and conditions as any other investor (and only at NAV), and Creation

Transactions must occur through the distributor and not directly with the issuer, the Commission believes that concerns regarding potential abuse are minimized. As noted below, the Exchange's existing surveillance procedures also should ensure that such purchases are only for the purpose of maintaining fair and orderly markets, and not for any other improper or speculative purposes. Finally, the Commission notes that its approval of this aspect of the Exchange's rule proposal does not address any other requirements or obligations under the federal securities laws that may be applicable.³⁶

F. Surveillance

The Commission believes that the CHX's existing surveillance procedures should be adequate to address any concerns associated with specialists purchasing and redeeming Creation Units. The Exchange has represented that its existing surveillance procedures should allow it to identify situations where specialists purchase or redeem Creation Units to ensure compliance with the rule.³⁷

G. Scope of the Commission's Order

The Commission is approving in general the Exchange's proposed listing and delisting standards for Units representing an interest in an Investment Company that would hold a Fund Basket, and specifically the Exchange proposal to trade the nine series of CountryBaskets described herein pursuant to UTP. The Commission notes that Rule 12f-5 under the Act requires that a national securities exchange not extend unlisted trading privileges to any security unless it has in effect a rule or rules providing for transactions in the class or type of security to which the exchange extends unlisted trading privileges.³⁸ The Commission believes that the Exchange's proposed listing standards for Units are consistent with this requirement and will allow the CHX to trade, pursuant to UTP, the nine CBs currently trading on the NYSE. Other similarly structured products would require review by the Commission pursuant to Section 19(b) of the Act prior to being listed on the CHX or

³² See note 17, *supra*.

³³ See Securities Exchange Act Release No. 36923, *supra* note 11.

³⁴ See Form N-1A, *supra* note 28. Each CB series is required to invest the largest proportion of its assets as is practicable, and in any event at least 95% of its net assets, in the securities of the corresponding FT/S&P Index, and the weighting of the portfolio securities of each CB series should substantially correspond to their proportional representation in the relevant FT/S&P Index. *Id.*

³⁵ In addition, each series calculates its NAV per share at the close of the regular trading session for the NYSE on each day that the NYSE is open for business. NAV generally will be based on the last quoted sales price on the securities exchange or national securities market on which a given series' component securities are quoted. *Id.*

³⁶ The Commission notes that with respect to CBs, broker dealers and other persons are cautioned in the prospectus and/or the Fund's statement of additional information that some activities on their part may, depending on the circumstances, result in their being deemed statutory underwriters and subject them to the prospectus delivery and liability provisions of the Securities Act of 1933.

³⁷ Letter from J. Craig Long, Foley & Lardner, to Sharon Lawson, Senior Special Counsel, OMS, Division, dated June 22, 1996.

³⁸ 17 CFR 240.12f-5.

³⁰ See CHX Rules, Parts II & III *passim*.

³¹ See *supra* note 19.

traded pursuant to UTP. Moreover, CBs based on FY/S&P Indices not described herein, would require consultation with the Commission as to whether a filing pursuant to Section 19(b) of the Act is required prior to being listed on the Exchange, or traded pursuant to UTP.

The Commission finds good cause for approving Amendment No. 2 prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 2 amends Interpretation and Policy .01 of Article XXVIII, Rule 23 to require that the Japan Series have a minimum of 500,000 CBs outstanding prior to the commencement of trading on the Exchange. As discussed above, CHX must have listing standards comparable to those of the primary exchange on which the security is traded. The Commission notes that this Amendment brings CHX's listing standards into conformity with those of the NYSE. Accordingly, the Commission does not believe Amendment No. 2 raises any new or unique regulatory issues. Therefore, the Commission believes it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 2 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment No. 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 will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to the file number in the caption above and should be submitted by September 18, 1996.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal, as amended, 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,³⁹ that the proposed rule change (File No. SR-CHX-96-12), as amended is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴⁰

Margaret H. McFarland,

Deputy Secretary.

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[Release No. 34-37590; File No. SR-PSE-96-28]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Pacific Stock Exchange Incorporated Relating to Its Rule on the Evaluation of Its Equity Specialists

August 21, 1996.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. 78s(b)(1), notice is hereby given that on August 18, 1996, the Pacific Stock Exchange Incorporated ("PSE" 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 self-regulatory organization. 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 Exchange is proposing to adopt a pilot program amending its rule on the evaluation of its equity specialists.

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

1. Purpose

The Exchange is proposing to adopt a pilot program amending its rule relating to specialists evaluations for a nine month period from October 1, 1996 to June 30, 1997. Currently, PSE Rule 5.37(a) provides that the Equity Allocation Committee ("EAC") shall evaluate all registered specialists on a quarterly basis and that each registered specialist shall receive an overall evaluation rating based on the following three measures of performance: (1) Specialist Evaluation Questionnaire Survey ("Questionnaire"); (2) SCOREX Limit Order Acceptance Performance; and (3) National Market System Quote Performance.

The Exchange is proposed to modify PSE Rule 5.37(a) by adding three new measures of performance and eliminating one measure of performance. The new measures are: (1) Executions; (2) Book Display Time; and (3) Post 1-P.M. Parameters. The Exchange is also proposing to: add more questions to the Questionnaire and to expand the National Market System Quote Performance measure (for the nine month pilot, this criterion will be referred to as "Quote Performance")¹ to include a performance measure for bettering the quote. In addition, the Exchange is proposing to eliminate SCOREX Limit Order Acceptance Performance as a measure of specialist performance. The Exchange's new rule for the evaluation of specialists will therefore consist of five separate measures of performance, as specified below:

a. Executions. This category, on which 50% of each specialist evaluation is based, consists of four subcategories: (a) Turnaround Time; (b) Holding Orders Without Action; (c) Trading Between the Quote; and (d) Executions in Size Greater Than BBO.

"Turnaround Time" calculates the average number of seconds for all eligible orders up to 1,099 shares based upon the number of seconds between the receipt of a market or marketable limit order in P/COAST and the execution, partial execution, stopping, or cancellation of the order. An order that is moved from the auto-ex screen to the manual screen will accumulate time until it is executed, partially executed, stopped, or canceled. This measurement begins after the stock opens for the day on the primary market. Only those orders received by P/COAST after the

³⁹ 15 U.S.C. 78s(b)(2) (1988).

⁴⁰ 17 CFR 200.30-3(a)(12).

¹ See *infra* text accompanying note 4.