

CHX petitioned the SEC in February of this year to adopt a rule finding the CHX's Tier I listing standards to be substantially similar to those of the NYSE, Amex or Nasdaq/NMS. If the SEC adopts such a rule, any security listed on the CHX under its Tier I standards would be exempt from registration in all fifty states.

The Commission has recently published for comment proposed Rule 146(b) which would designate various exchanges' listing standards as being substantially similar to those of the NYSE, Amex or Nasdaq/NMS.<sup>6</sup> The Commission has indicated that it preliminarily believes that the only deficiency in the CHX Tier I standards, which precludes it from designating the CHX Tier I securities as qualifying, is that there is no minimum share price requirement for continued listing on Tier I. If such deficiency was corrected, the SEC indicated that it would consider including CHX's Tier I securities in the final Rule 146(b).

As a result of the above, the CHX is proposing to amend Article XXVIII, Rule 14 of the Exchange rules to add a minimum share price requirement for continued listing of common stock on Tier I. The proposed amendment is virtually identical to Amex's requirement. In essence, the proposed amendment states that an issuer that has a common stock listed under Tier I that is selling for a substantial period of time at a low price per share must effect a reverse split within a reasonable period of time after being notified that the Exchange deems such action to be appropriate. The proposed amendment then sets forth examples of pertinent factors which the Exchange will review in determining whether a reverse split is appropriate. If the issuer fails to effect a reverse split, then the Exchange would initiate a proceeding to delist the issuer's common stock from Tier I.

### 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, with the requirements of section 6(b).<sup>7</sup> Specifically, the Commission believes the proposal is consistent with the section 6(b)(5)<sup>8</sup> requirement that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and

manipulative acts, and, in general, to protect investors and the public interest.<sup>9</sup> New Exchange Rule 14(a)(4) provides the CHX with specific authority to require an issuer with common stock listed on Tier I to effect a reverse stock split when the issue is selling for a substantial period of time at a low price per share. If such issuer does not effect a reverse split of the shares, which should have the effect of increasing share price, within a reasonable period of time after being notified that the Exchange deems the reverse split to be appropriate, the Exchange will delist the issuer's stock.

In establishing criteria to uphold the quality of its market, the Commission believes that it is appropriate for the Exchange to have a maintenance standard for securities selling at low prices in conjunction with the other standards for listing and maintenance. The Commission finds that the share price maintenance standard is a reasonable measure for the Exchange to use to maintain its quality control standards for issuers listed on Tier I of the Exchange and is a reasonable standard to use to remove low-priced securities from the Exchange. As noted above, under the rule, the issuer will have the opportunity to remedy concerns about stock selling at a low price by effecting a reverse stock split.

The Commission also believes that the addition of the share price maintenance standard to the Exchange's maintenance requirements for common stock should help the Exchange monitor the continued financial stability of companies listed on Tier I because low share prices can sometimes be the result of financial difficulty with the issuer. The maintenance standard will also help ensure that stocks that are more susceptible to manipulation will not be traded on the Exchange. This should protect investors and the public interest consistent with section 6(b)(5) of the Act.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-CHX-97-17) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

<sup>9</sup> In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-24865 Filed 9-18-97; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39076; File No. SR-CHX-97-06]

### Order Granting Approval to Proposed Rule Change

September 15, 1997.

Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change by the Chicago Stock Exchange, Inc., Relating to Listing and Trading Standards for Portfolio Depository Receipts.

#### I. Introduction

On March 17, 1997,<sup>1</sup> the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>2</sup> and Rule 19b-4 thereunder,<sup>3</sup> a proposed rule change to add Rule 25 to Article XXVIII of CHX's rules relating to the listing and trading of Portfolio Depository Receipts ("PDRs").

The proposed rule change as amended by Amendment Nos. 1, 2, and 3, together with the substance of the proposal, was published for comment in Securities Exchange Act Release No. 38777 (June 26, 1997) 62 FR 35866 (July 2, 1997). One comment letter was received in response to the proposal.<sup>4</sup>

#### II. Background and Description

The Exchange proposes to adopt new Rule 25 under Article XXVIII to accommodate the trading of PDRs, securities which are interests in a unit investment trust ("Trust") holding a

<sup>1</sup> On June 4, 1997, the Exchange filed Amendment No. 1 to this rule filing. Amendment No. 1 supersedes entirely the Exchange's rule filing and was incorporated into the notice in its entirety. On June 17, 1997 and June 24, 1997, the Exchange filed Amendment Nos. 2 and 3 respectively; Amendment No. 3 replaces Amendment No. 2 in its entirety and the substance of Amendment No. 3 was incorporated into the notice. See letter from J. Craig Long, Attorney, Foley & Lardner, to Ivette Lopez, Assistant Director, Market Regulation, Commission, dated May 27, 1997 ("Amendment No. 1") and letters from David T. Rusoff, Attorney, Foley & Lardner, to Sharon Lawson, Senior Special Counsel, Market Regulation, Commission, dated June 13, 1997 ("Amendment No. 2") and June 18, 1997 ("Amendment No. 3") respectively.

<sup>2</sup> 15 U.S.C. 78s(b)(1).

<sup>3</sup> 17 CFR 240.19b-4.

<sup>4</sup> See Letter from James F. Duffy, Executive Vice President and General Counsel, Legal and Regulatory Policy, American Stock Exchange, to Jonathan G. Katz, Secretary, Commission, dated July 31, 1997 ("Amex Comment Letter").

<sup>6</sup> Securities Exchange Act Release No. 38728, Securities Act Release No. 7422 (June 10, 1997).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

portfolio of securities linked to an index. Each Trust will provide investors with an instrument that: (i) Closely tracks the underlying portfolio of securities, (ii) trades like a share of common stock, and (iii) pays holders of the instrument periodic dividends proportionate to those paid with respect to the underlying portfolio of securities, less certain expenses (as described in the Trust prospectus).

Under the proposal, the exchange may list and trade, or trade pursuant to unlisted trading privileges ("UTP"), PDRs based on one or more stock indexes or securities portfolios. PDRs based on each particular stock index or portfolio shall be designated as a separate series and identified by a unique symbol. The stocks that are included in an index or portfolio on which PDRs are based shall be selected by the Exchange, or by such other person as shall have a proprietary interest in and authorized use of such index or portfolio, and may be revised as deemed necessary or appropriate to maintain the quality and character of the index or portfolio. As discussed in more detail below, CHX intends to trade two existing PDRs currently traded on the American Stock Exchange ("Amex")—Standard & Poor's Depositary Receipts ("SPDRs") and Standard & Poor's MidCap 400 Depositary Receipts ("MidCap SPDRs")—pursuant to UTP upon approval of these listing standards. CHX is not asking for permission to list SPDRs or MidCap SPDRs at this time, but rather will trade SPDRs and MidCap SPDRs pursuant to unlisted trading privileges once the generic listing standards set forth herein are approved. Pursuant to Rule 12f-5 under the Act, in order to trade a particular class or type of security pursuant to unlisted trading privileges, CHX must have rules providing for transactions in such class or type of security. The Amex has enacted listing standards for PDRs, and CHX's proposed rule change is designed to create similar standards for PDR listing and/or trading on CHX.

If at a later time CHX and the issuer of the product desire to list SPDRs and MidCap SPDRs or any other PDRs on the Exchange, the Exchange will request Commission approval for that listing in a separate proposed rule change filed pursuant to Section 19(b) of the Act.<sup>5</sup>

<sup>5</sup> The Commission notes that CHX, if it were to file a proposed rule change to list and trade a new PDR, would have to request the appropriate exemptions for the new product under the Investment Company Act of 1940 ("Investment Company Act") (such as those exemptions requested for SPDRs and MidCap SPDRs), such an exemption from Investment Company Act Section

Additionally, in the event a new PDR is listed on another exchange using listing standards that are different than current CHX listing standards or the CHX listing standards proposed in this filing, the CHX will file a proposed rule change pursuant to Section 19(b) of the Act to adopt the listing standard before it trades that PDR pursuant to unlisted trading privileges.

#### *Criteria for Initial and Continued Listing*

In connection with an initial listing, the Exchange proposes that, for each Trust of PDRs, the Exchange will establish a minimum number of PDRs required to be outstanding at the time of commencement of Exchange trading, and such minimum number will be filed with the Commission in connection with any required submission under Rule 19b-4 for each Trust. If the Exchange trades a particular PDR pursuant to unlisted trading privileges, the Exchange will follow the listing exchange's determination of the appropriate minimum number.

Because the Trust operates an open-end type basis, and because the number of PDR holders is subject to substantial fluctuations depending on market conditions, the Exchange believes it would be inappropriate and burdensome on PDR holders to consider suspending trading in or delisting a series of PDRs, with the consequent termination of the Trust, unless the number of holders remains severely depressed during an extended time period. Therefore, twelve months after the formation of a Trust and commencement of Exchange trading, the Exchange will consider suspension of trading in, or removal from listing of, a Trust when, in its opinion, further dealing in such securities appears unwarranted under the following circumstances:

(a) If the Trust on which the PDRs are based has more than 60 days remaining until termination and there have been fewer than 50 record and/or beneficial holders of the PDRs for 30 or more consecutive trading days; or

(b) If the index on which the Trust is based is no longer calculated, or

(c) If such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable.

A Trust shall terminate upon removal from Exchange listing and its PDRs will be redeemed in accordance with provisions of the Trust prospectus. A Trust may also terminate under such other conditions as may be set forth in

22(d) and Rule 22c-1 thereunder to allow the PDR to trade in the secondary market.

the Trust prospectus. For example, the sponsor of the Trust ("Sponsor"), following notice to PDR holders, shall have discretion to direct that the Trust be terminated if the value of securities in such Trust falls below a specified amount.

#### *Trading of PDRs*

Dealings in PDRs 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 will also apply, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of specialists.<sup>6</sup>

With respect to trading halts, the trading of PDRs will be halted, along with the trading of all other listed or traded stocks, in the event the "circuit breaker" thresholds of CHX Article IX, Rule 10A are reached. In addition, for PDRs tied to an index, the triggering of futures price limits for the Standard & Poor's 500 Composite Price Index ("S&P 500 Index"), Standard & Poor's 100 Composite Price Stock Index ("S&P 100 Index"), or Major Market Index ("MMI") futures contracts will not, in itself, result in a halt in PDR trading or a delayed opening. However, the Exchange could consider such an event, along with other factors, such as a halt in trading in S&P 100 Index Options ("OEX"), S&P 500 Index Options ("SPX"), or MMI Options ("XMI"), in deciding whether to halt trading in PDRs.

Under the proposed rule change, the Exchange will issue a circular to members informing them of Exchange policies regarding trading halts in such securities. The circular will make clear that, in addition to other factors that may be relevant, the Exchange may consider factors such as those set forth in Article XXXVI, Rule 19, the Exchange's rule governing trading halts for Basket trading (except that the term "Basket" shall be replaced by "stock index") in exercising its direction to

<sup>6</sup> The Commission notes that CHX has stated its intention to file a proposed rule change in the near future in order to create a know-your-customer rule in which a member, before recommending a transaction in a security, would have to use due diligence to learn the essential facts relating to every customer, every order, and every account accepted by the member. Telephone call between Craig Long, Attorney, Foley & Lardner, Sharon Lawson, Senior Special Counsel, Market Regulation, Commission, and Heather Seidel, Attorney, Market Regulation, Commission, on July 29, 1997.

halt or suspend trading. For a PDR based on an index, these factors would include whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value, or whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

#### Disclosure

Proposed Rule 25 of Article XXVIII requires that members and member organizations provide to all purchasers of each series of PDRs a written description of the terms and characteristics of such securities, in a form approved by the Exchange, not later than the time a confirmation of the first transaction in such series of PDRs is delivered to such purchaser. In this regard, a member or member organization carrying an omnibus account for a non-member broker-dealer will be required to inform such non-member that execution of an order to purchase PDRs for such omnibus account will be deemed to constitute an agreement by the non-member to make such written description available to its customers on the same terms as are directly applicable to member and member organizations. The written description must be included with any sales material on that series of PDRs that a member provides to customers or the public. Moreover, other written materials provided by a member or member organization to customers or the public making specific reference to a series of PDRs as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of PDRs] is available from your broker. It is recommended that you obtain and review such circular before purchasing [the series of PDRs]. In addition, upon request you may obtain from your broker a prospectus for [the series of PDRs]." Additionally, as noted above, the Exchange requires that members and member organizations provide customers with a copy of the prospectus for a series of PDRs upon request.

With respect to disclosure, because SPDRs and MidCap SPDRs will be traded pursuant to unlisted trading privileges and will not be listed on CHX at this time, CHX does not intend to create its own product description to satisfy the requirements of proposed Rule 25(c) of Article XXVIII, which requires members to provide to purchasers, a written description of the terms and characteristics of SPDRs and

MidCap SPDRs in a form approved by the Exchange. Instead, the CHX will deem a member or member organization to be in compliance with this requirement if the member delivers either: (i) The current product description produced by the Amex from time to time, or (ii) the current prospectus for the SPDR or MidCap SPDR, as the case may be.<sup>7</sup> It will be the member's responsibility to obtain these materials directly from Amex<sup>8</sup> for forwarding to purchasers in the time frames prescribed by CHX and Commission rules. The CHX will notify members and member organizations of this requirement in a notice to members.

Notwithstanding the foregoing discussion concerning the applicability of the Exchange's equity trading rules to PDRs generally, the Intermarket Trading System ("ITS") rules briefly will not be applicable to SPDRs and MidCap SPDRs traded on the CHX pursuant to unlisted trading privileges. Currently, ITS is being modified in order to accommodate trading in a minimum variation of  $\frac{1}{64}$ , but the changes are not yet complete. When such changes are made, which is expected in the near future, CHX intends to request that SPDRs and MidCap SPDRs be designated as ITS Securities. At such time as they are designated ITS securities, the ITS rules will apply to trading in SPDRs and MidCap SPDRs.

The current inapplicability of the ITS rules means, among other things, that the ITS trade-through rule will not apply. However, the CHX's BEST Rule, Article XX, Rule 37(a), will still be applicable to SPDRs and MidCap SPDRs, thereby guaranteeing the execution of certain agency orders on the basis of the size and price associated with the best bid (for a sell order) or best offer (for a buy order) among the Amex, Boston, Cincinnati, Chicago, New York, Pacific, Philadelphia and the Intermarket Trading System/Computer Assisted Execution System quote, which quote is defined in SR-CHX-97-9 as the

"ITS BBO."<sup>9</sup> Because SPDRs and MidCap SPDRs are not traded in all of these market centers,<sup>10</sup> for purposes of this filing only, the ITS BBO is limited to those market centers listed above that trade SPDRs and MidCap SPDRs.<sup>11</sup> For example, if a CHX specialist receives an agency limit order for a SPDR, so long as all of the eligibility requirements of the BEST Rule are met, the specialist will be required to execute that order if there has been a price penetration in the primary market. In addition, if the Amex specialist is disseminating the best quote for SPDRs, the CHX specialist will be required to execute eligible agency market orders for SPDRs at the price quoted on the Amex, even if the CHX specialist is not, himself, quoting at that price. The CHX SPDR and MidCap SPDR specialist will have the ability to monitor the current quotations being disseminated by the Amex specialist on a real-time basis. The quotations for SPDRs and MidCap SPDRs are disseminated through the Consolidated Quotation System and are available for viewing by the CHX specialist at his or her post. Finally, the CHX specialist will have access to the Amex through the Amex's PER System (albeit through a correspondent firm). This will enable the CHX specialist to place limit orders on the Amex specialist's book or send market orders to the Amex specialist for execution against the Amex specialist's quote. In its filing, CHX states that these factors should minimize the possibility that a

<sup>9</sup> The Commission notes that SR-CHX-97-9, as amended to remove the phrase "size and price associated with the" from the filing, has become effective. See Securities Exchange Act Release No. 38772 (June 25, 1997). In addition, CHX represents that it will submit a separate rule filing pursuant to Section 19(b)(2) of the Act further amending the BEST Rule to add size and price to the definition of the ITS/BBO. Phone conversation between David Rusoff, Attorney, Foley & Lardner, and David Sieradzki, Attorney, Market Regulation, Commission, on June 17, 1997.

<sup>10</sup> Currently SPDRs and MidCap SPDRs are only traded on Amex.

<sup>11</sup> Under the BEST Rule, Exchange specialists are required to guarantee executions of all agency market and limit orders for Dual Trading System issues from 100 up to and including 2099 shares. Subject to the requirements of the short sale rule, the specialist must fill all agency market orders at a price equal to or better than the ITS BBO. For all agency limit orders in Dual Trading System issues, the specialist must fill the order if: (1) The ITS BBO at the limit price has been exhausted in the primary market; (2) there has been a price penetration of the limit in the primary market (generally known as a trade-through of a CHX limit order); or (3) the issue is trading at the limit price on the primary market unless it can be demonstrated that the order would not have been executed if it had been transmitted to the primary market or the broker and specialist agree to a specific volume related to, or other criteria for, requiring a fill.

<sup>7</sup> CHX plans to notify its members in an information circular that it is their responsibility to inform customers of the nature and terms of SPDRs and MidCap SPDRs prior to recommending their purchase. The circular also states that members must deliver a SPDR or MidCap SPDR product description to all purchases of the products and that they must provide the prospectus upon request.

<sup>8</sup> The Commission notes that Amex, in its comment letter to this rule filing, stated that the Distributor does not have responsibility for disseminating the SPDR and MidCap SPDR product descriptions; therefore, CHX members cannot obtain the product description from the Distributor, as noted in the notice release, but can obtain its form Amex. See Amex Comment Letter, *supra* note 4, and Section III *infra*.

CHX originated trade-through will occur.

#### *SPDRs and MidCap SPDRs Generally*

As discussed above, rules to accommodate the trading of PDRs generally on Amex, along with Amex's trading of SPDRs and MidCap SPDRs, were previously approved by the Commission.<sup>12</sup> The information provided below is intended to provide a description of how SPDRs and MidCap SPDRs are created and traded and is almost identical to that discussed in the original Amex Approval Order. The Sponsor of each series of PDRs traded on the Amex is PDR Services Corporation, a wholly-owned subsidiary of the Amex. The PDRs are issued by a Trust in a specified minimum aggregate quantity ("Creation Unit") in return for a deposit consisting of specified numbers of shares of stock plus a cash amount.

The first Trust to be formed in connection with the issuance of PDRs was based on the S&P 500 Index, known as Standard & Poor's Depositary Receipts ("SPDRs"). SPDRs have been trading on the Amex since January 29, 1993. The second Trust to be formed in connection with the issuance of PDRs was based on the S&P MidCap 400 Index,<sup>13</sup> known as Standard & Poor's MidCap 400 Depositary Receipts ("MidCap SPDRs").<sup>14</sup> The Sponsor of the two Trusts has entered into trust agreements with a trustee in accordance with Section 26 of the Investment Company Act of 1940. PDR Distributors, Inc. ("Distributor") acts as underwriter of both SPDRs and MidCap SPDRs on an agency basis. The Distributor is a registered broker-dealer, a member of the National Association of Securities Dealers, Inc., and a wholly-owned subsidiary of Signature Financial Group, Inc.

#### *SPDR and MidCap SPDR Creation*

All orders to create SPDRs or MidCap SPDRs in creation unit size must be placed with the Distributor, and it is the responsibility of the Distributor to transmit such orders to the Trustee.<sup>15</sup>

<sup>12</sup> See Securities Exchange Act Release No. 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) ("Amex Approval Order").

<sup>13</sup> The S&P MidCap 400 Index is a capitalization-weighted index of 400 actively traded securities that includes issues selected from a population of 1,700 securities, each with a year-end market-value capitalization of between \$200 million and \$5 billion. The issues included in the Index cover a broad range of major industry groups, including industrials, transportation, utilities, and financials.

<sup>14</sup> See Securities Exchange Act Release No. 35534 (March 24, 1995), 60 FR 16686 (March 31, 1995) ("Amex MidCap Approval Order").

<sup>15</sup> To be eligible to place orders to create MidCap SPDRs as described below, an entity or person

Payment with respect to creation orders placed through the Distribution will be made by: (1) The "in-kind" deposit with the Trustee of a specified portfolio of securities that is formulated to mirror, to the extent practicable, the component securities of the underlying index or portfolio, and (2) a cash payment sufficient to enable the Trustee to make a distribution to the holders of beneficial interests in the Trust on the next dividend payment date as if all the securities had been held for the entire accumulation period for the distribution ("Dividend Equivalent Payment"), subject to certain specified adjustments. The securities and cash accepted by the trustee are referred to, in the aggregate, as a "Portfolio Deposit."<sup>16</sup> Upon receipt of a Portfolio Deposit in payment for a creation order placed through the Distributor as described above, the Trustee will issue a specified number of SPDRs or MidCap SPDRs, which aggregate numbers are referred to as a "Creation Unit." Currently, a Creation Unit will be made up of 25,000 MidCap SPDRs or 50,000 SPDRs.<sup>17</sup> Individual SPDRs or MidCap SPDRs can then be traded in the secondary market like other equity securities. Portfolio Deposits are expected to be made primarily by institutional investors, arbitrageurs, and the Exchange specialist. The price of SPDRs and MidCap SPDRs will be based on a current bid/offer market. The minimum fraction for trading in SPDRs and MidCap SPDRs on Amex is 1/64ths. The CHX has proposed this same minimum variation for the trading of SPDRs and MidCap SPDRs on CHX.

The Trustee or Sponsor will make available: (1) On a daily basis, a list of the names and required number of shares for each of the securities in the current Portfolio Deposit; (2) on a

minute-by-minute basis throughout the day, a number representing the value (on a per SPDR or MidCap SPDR basis) of the securities portion of a Portfolio Deposit in effect on such day; and (3) on a daily basis, the accumulated dividends, less expenses, per outstanding SPDR or MidCap SPDR.<sup>18</sup>

#### *Redemption of SPDRs and MidCap SPDRs*

SPDRs and MidCap SPDRs in Creation Unit size aggregations will be redeemable in kind by tendering them to the Trustee. While holders may sell SPDRs and MidCap SPDRs in the secondary market at any time, they must accumulate at least 50,000 (or multiples thereof) to redeem SPDRs or 25,000 (or multiples thereof) to redeem MidCap SPDRs through the Trust. SPDRs and MidCap SPDRs will remain outstanding until redeemed or until the termination of the Trust. Creation Units will be redeemable on any business day in exchange for a portfolio of the securities held by the Trust identical in weighting and composition to the securities portion of a Portfolio Deposit in effect on the date a request is made for redemption, together with a "Cash Component" (as defined in the Trust prospectus), including accumulated dividends, less expenses, through the date of redemption. The number of shares of each of the securities transferred to the redeeming holder will be the number of shares of each of the component stocks in a Portfolio Deposit on the day a redemption notice is received by the Trustee, multiplied by the number of Creation Units being redeemed. Nominal service fees may be charged in connection with the creation and redemption of Creation Units. The Trustee will cancel all tendered Creation Units upon redemption.<sup>19</sup>

#### *Distribution of SPDRs and MidCap SPDRs*

The SPDR Trust and the MidCap SPDR Trust pay dividends quarterly.

<sup>18</sup> The Trustee of the SPDR Trust will have the right to vote any of the voting stocks held by the Trust, and will vote such stocks of each issuer in the same proportion as all other voting shares of that issuer voted. Therefore, SPDR holders will not be able to directly vote the shares of the issuers underlying the SPDRs.

<sup>19</sup> An investor redeeming a Creation Unit will receive Index securities and cash identical to the Portfolio Deposit required of an investor wishing to purchase a Creation Unit on that particular day. Since the Trust will redeem in kind rather than for cash, the Trustee will not be forced to maintain cash reserves for redemptions. This should allow the Trust's resources to be committed as fully as possible to tracking the underlying Index, enabling the Trust to track the Index more closely than other basket products that must allocate a portion of their assets for cash redemptions.

either must be a participant in the Continuous Net Settlement ("CNS") system of the National Securities Clearing Corporation ("NSCC") or a Depository Trust Company ("DTC") participant. Upon acceptance of an order to create MidCap SPDRs, the Distributor will instruct the Trustee to initiate the book-entry movement of the appropriate number of MidCap SPDRs to the account of the entity placing the order. MidCap SPDRs will be maintained in book-entry form at DTC.

<sup>16</sup> A Portfolio Deposit also will include a cash payment equal to a pro rata portion of the dividends accrued on the Trust's portfolio securities since the last dividend payment by the Trust, plus or minus an amount designed to compensate for any difference between the net asset value of the Portfolio Deposit and the underlying Index caused by, among other things, the fact that a Portfolio Deposit cannot contain fractional shares.

<sup>17</sup> The Trust will issue SPDRs in exchange for "Portfolio Deposits" of all of the S&P 500 Index securities, weighted according to their representation in the Index. The Trust is structured so that the net asset value of an individual SPDR should equal one-tenth of the value of the S&P 500 Index.

The regular quarterly ex-dividend date for SPDRs and MidCap SPDRs is the third Friday in March, June, September, and December, unless that day is a New York Stock Exchange holiday, in which case the ex-dividend date will be the preceding Thursday. Holders of SPDRs and MidCap SPDRs on the business day preceding the ex-dividend date will be entitled to receive an amount representing dividends accumulated through the quarterly dividend period preceding such ex-dividend date net of fees and expenses for such period. The payment of dividends will be made on the last Exchange business day in the calendar month following the ex-dividend date ("Dividend Payment Date"). On the Dividend Payment Date, dividends payable for those securities with ex-dividend dates following within the period from the ex-dividend date most recently preceding the current ex-dividend date will be distributed. The Trustee will compute on a daily basis the dividends accumulated within each quarterly dividend period. Dividend payments will be made through DTC and its participants to all such holders with funds received from the Trustee.

The MidCap SPDR Trust intends to make the DTC DRS available for use by MidCap SPDR holders through DTC participant brokers for reinvestment of their cash proceeds. The DTC DRS is also available to holders of SPDRs. Because some brokers may choose not to offer the DTC DRS, an interested investor would have to consult his or her broker to ascertain the availability of dividend reinvestment through that broker. The Trustee will use the cash proceeds of MidCap SPDR holders participating in the reinvestment to obtain the Index securities necessary to create the requisite number of SPDRs.<sup>20</sup> Any cash remaining will be distributed pro rata to participants in the dividend reinvestment.

### III. Summary of Comments

The Commission received one comment letter on the proposed rule change, from Amex.<sup>21</sup> Amex commented on two aspects of the proposal, the requirement that CHX members deliver a product description to purchasers of PDRs no later than the time a confirmation is delivered to the purchasers, and on the trading of SPDRs and MidCap SPDRs pursuant to the ITS.

With regard to the first issue, Amex notes that CHX will not create its own product description but will deem its

members in compliance with the delivery requirement if it delivers Amex's current product description or the current SPDR or MidCap SPDR prospectus, as applicable. CHX does not intend to supply these materials to its members but will require them to obtain the documents from Amex or the distributor of SPDRs and MidCap SPDRs.

Amex states that it does not object to the occasional request for prospectuses and Product Descriptions made in connection with trades on CHX, but reserves the right to charge a reasonable amount for the materials, if it finds that the requests become burdensome.<sup>22</sup> Amex also notes that the Distributor is not responsible for providing the Product Descriptions, that it is Amex's responsibility to provide the materials to Amex members in connection with the Exchange trading and compliance with Amex Rule 1000.

Second, while Amex acknowledges that SPDRs and MidCap SPDRs are not traded through ITS at this time because ITS cannot currently handle trading in  $\frac{1}{64}$ ths (the minimum increment for MidCap and SPDRs MidCap), it is concerned about the future application of ITS rules to trading of SPDRs and MidCap SPDRs due to ongoing modifications to ITS to permit commitments to trade in increments as small as  $\frac{1}{256}$ ths. Amex states that SPDRs and MidCap SPDRs be designated as ITS securities once these system changes are made. Amex states that while it has no objection to the use of ITS as an intermarket access mechanism for trading of SPDRs and MidCap SPDRs, it has serious concerns about the application of ITS trade through procedures to the trading of these products because of the nature of the product in that they are priced quite differently from common stocks.

Specifically, because of the extreme frequency of quotation changes in SPDRs and MidCap SPDRs, Amex believes that cancellation or expiration of ITS commitments in these products would pose proportionally greater market risk for market makers and investors than for other ITS securities because a price change is far more likely to occur before an ITS commitment can be resent. Amex also believes that because of the frequency of quotation changes in SPDRs and MidCap SPDRs, the Amex specialist must be able to receive very rapid confirmation that his commitment sent to another market

through ITS has been executed, and that a one or two minute time frame (the time during which an ITS commitment is irrevocable) would subject all market participants to an unacceptable level of market risk in a market with rapid quotation changes. Amex states that it intends to address with the Commission and the ITS Operating Committee the ITS procedures that it believes must be changed to permit SPDRs to continue to trade as they were designed to trade.<sup>23</sup>

### IV. Discussion

The Commission finds that the proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of section 6(b)(5).<sup>24</sup> The Commission believes that providing for the exchange-trading on CHX of PDRs, in general, and SPDRs and MidCap SPDRs, in particular, will offer investors an efficient way of participating in the securities markets. Specifically, the Commission believes that the trading on CHX of PDRs, in general, and SPDRs and MidCap SPDRs pursuant to unlisted trading privileges, in particular, will provide investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a low-cost security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day, and by increasing the availability of SPDRs and MidCap SPDRs as an investment tool. The Commission also believes that PDRs will benefit investors by allowing them to trade securities based on unit investment trusts in secondary market transactions.<sup>25</sup> Accordingly, as discussed below, the proposed rule change is consistent with the requirements of Section 6(b)(5) that Exchange rules facilitate transactions in securities while continuing to further investor protection and the public interest.<sup>26</sup>

<sup>23</sup> Additionally, Amex believes it is problematic to apply the current ITS trade-through rule to index-based securities such as SPDRs that trade in  $\frac{1}{64}$ th increments. In addition, Amex believes that the trade through rule's five minute time frame for making a compliant is inappropriately long for these securities.

<sup>24</sup> 15 U.S.C. 78f(b)(5).

<sup>25</sup> The Commission notes, however, that unlike open-end funds where investors have the right to redeem their fund shares on a daily basis, investors could only redeem PDRs in creation unit share sizes. nevertheless, PDRs would have the added benefit of liquidity from the secondary market and PDR holders, unlike holders of most other open-end funds, would be able to dispose of their shares in a secondary market transaction.

<sup>26</sup> In approving this rule, the Commission notes that it has considered the proposed rule's impact on

<sup>20</sup> The creation of PDRs in connection with the DTC DRS represents the only circumstances under which PDRs can be created in other than Creation Unit size aggregations.

<sup>21</sup> See *supra* note 4.

<sup>22</sup> The Commission notes that any imposition of fees would have to be in compliance with the Act, including the filing requirements under Section 19(b) of the Act. See *infra* note 34 and accompanying text.

As the Commission noted in the orders approving SPDRs and MidCap SPDRs for listing and trading on Amex,<sup>27</sup> the Commission believes that the trading on CHX of a security like PDRs in general, and SPDRs and MidCap SPDRs in particular, which replicate the performance of a broad portfolio of stocks, could benefit the securities markets by, among other things, helping to ameliorate the volatility occasionally experienced in these markets. The Commission believes that the creation of one or more products where actual portfolios of stocks or instruments representing a portfolio of stocks, such as PDRs, can trade at a single location in an auction market environment could alter the dynamics of program trading, because the availability of such single transaction portfolio trading could, in effect, restore the execution of program trades to more traditional block trading techniques.<sup>28</sup>

An individual SPDR has a value approximately equal to one-tenth of the value of the S&P 500 Index, and an individual MidCap SPDRs has a value of approximately one-fifth of the value of the S&P MidCap 400 Index, making them more available and useful to individual retail investors desiring to hold a security replicating the performance of a broad portfolio of stocks. Accordingly, the Commission believes that trading of SPDRs and MidCap SPDRs on CHX will provide retail investors with a cost efficient means to make investment decisions based on the direction of the market as a whole and may provide market participants several advantages over existing methods of effecting program trades involving stocks.

The Commission also believes that PDRs, in general, and SPDRs and MidCap SPDRs, in particular, will provide investors with several advantages over standard open-end S&P 500 Index and S&P MidCap 400 Index mutual fund shares. In particular, investors will have the ability to trade PDRs continuously throughout the business day in secondary market transactions at negotiated prices.<sup>29</sup> In

efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>27</sup> See *supra* notes 12 and 14.

<sup>28</sup> Program trading is defined as index arbitrage or any trading strategy involving the related purchase or sale of a "basket" or group of fifteen or more stocks having a total market value of \$1 million or more.

<sup>29</sup> Because of potential arbitrage opportunities, the Commission believes that PDRs will 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 a PDR comparable to its net asset value, and therefore,

contrast, pursuant to Investment Company Act Rule 22c-1,<sup>30</sup> holders and prospective holders of open-end mutual fund shares are limited 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.<sup>31</sup> Accordingly, PDRs in general, and SPDRs and MidCap SPDRs in particular, will allow investors to (1) Respond quickly to changes in the market; (2) trade at a known price; (3) engage in hedging strategies not currently available to retail investors; and (4) reduce transaction costs for trading a portfolio of securities.

Although PDRs in general, and SPDRs and MidCap SPDRs in particular, are not leveraged instruments, and, therefore, do not possess any of the attributes of stock index options, their prices will still be derived and based upon the securities held in their respective Trusts. In essence, SPDRs are equity securities that are priced off a portfolio of stocks based on the S&P 500 Index and MidCap SPDRs are equity securities that are priced off a portfolio of stocks based on the S&P MidCap 400 Index. Accordingly, the level of risk involved in the purchase or sale of a SPDR or MidCap SPDR (or a PDR in general) is similar to the risk involved in the purchase or sale of traditional common stock, with the exception that the pricing mechanism for SPDRs and MidCap SPDRs (and PDRs in general) is based on a basket of stocks. Nonetheless, the Commission has several specific concerns regarding the trading of these securities. In particular, PDRs raise disclosure, market impact, and secondary market trading issues

arbitrage activity likely will be minimal. In addition, the Commission believes that Trust will track the underlying index more closely than an open-end index fund because the Trust will accept only in-kind deposits, and, therefore, will not incur brokerage expenses in assembling its portfolio. In addition, the Trust will redeem on in kind, thereby enabling the Trust to invest virtually all of its assets in securities comprising the underlying index.

<sup>30</sup> Investment Company Act Rule 22c-1 generally requires 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 a mutual fund generally is computed once daily Monday through Friday as designated by the investment company's board of directors. The Commission granted SPDRs and MidCap SPDRs and exemption from this provision in order to allow them to trade at negotiated prices in the secondary market. The Commission notes that CHX would need to apply for a similar exemption in the instance that it wishes to list and trade a new PDR because the exemptions are specific to SPDRs and MidCap SPDRs.

<sup>31</sup> *Id.*

that must be addressed adequately. As discussed in more detail below, and in the Amex Approval Order,<sup>32</sup> the Commission believes CHX adequately addresses these concerns.

The Commission believes that the CHX proposal contains several provisions that will ensure that investors are adequately apprised of the terms, characteristics, and risks of trading PDRs. As noted above, the proposal contains four aspects addressing disclosure concerns. First, CHX members must provide their customers trading PDRs with a written explanation of any special characteristics and risks attendant to trading such PDR securities (such as SPDRs or MidCap SPDRs), in a form approved by CHX. As discussed above, CHX's filing states that SPDRs and MidCap SPDRs product descriptions should be obtained from Amex. The Commission notes that although Amex commented on CHX's proposed method regarding the delivery of the SPDR and MidCap SPDR product descriptions, and reserved the right to charge CHX members for supplying the product description should the task become burdensome to Amex, Amex did not object to the underlying policy of CHX members obtaining the product description from Amex. The Commission believes that it is reasonable under the Act to allow CHX to require its members to obtain the product description for SPDRs and MidCap SPDRs from Amex.<sup>33</sup> Amex might decide to impose a reasonable charge for this service.<sup>34</sup> The Commission also notes that Amex states that the SPDR and MidCap SPDR product descriptions are only available from Amex, not the Distributor, and therefore CHX members cannot obtain them from the Distributor.

Second, members and member organizations must include this written product description with any sales material relating to the series of PDRs that is provided to customers or the

<sup>28</sup> See *supra* note 12.

<sup>33</sup> The Commission notes that the exemptions granted by the Commission under the Investment Company Act that permit the secondary market trading of SPDRs and MidCap SPDRs are specifically conditioned upon the customer disclosure requirements described above. Accordingly, CHX rules adequately ensue its members must deliver the current product description to all investors in SPDRs and MidCap SPDRs.

<sup>34</sup> The Commission notes that Amex would need to file proposed rule change under Section 19(b) of the Act in the event it decides to charge a fee for supplying the SPDR of MidCap SPDR product descriptions. The Commission notes that reasonable fees would have to be imposed on the member firms rather than the customers entitled to receive the prospectus or the product description.

public. Third, any other written materials provided by a member or member organization to customers or the public referencing PDRs as an investment vehicle must include a statement, in a form specified by CHX, that a circular and prospectus are available from a broker upon request. Fourth, a member or member organization carrying an omnibus account for a non-member broker-dealer is required to inform such non-member that execution of an order to purchase a series of PDRs for such omnibus account will be deemed to constitute agreement by the non-member to make the written product description available to its customers on the same terms as member firms. Accordingly, the Commission believes that investors in PDR securities, in general, and SPDRs and MidCap SPDRs, in particular, will be provided with adequate disclosure of the unique characteristics of the PDR instruments and other relevant information pertaining to the instruments.

Finally, under CHX's proposal there will be no special account opening or customer suitability rules applicable to the trading of PDRs.<sup>35</sup> Nevertheless, pursuant to CHX Rules Article VIII, Rule 17, CHX's equity rule governing account opening will apply. In addition, the Commission notes that CHX intends to file a proposed rule change to create a rule that would require members, before recommending any transactions in securities, to use due diligence to learn the essential facts relative to every customer, every order, and every account accepted by the member. Upon adoption of this rule, it would apply to recommendations in PDRs generally, including transactions in SPDRs and MidCap SPDRs.

The Commission believes CHX has adequately addressed the potential market impact concerns raised by the proposal. First, CHX's proposal permits listing and trading of specific PDRs only after review by the Commission. Second, CHX has developed policies regarding trading halts in PDRs. Specifically, the Exchange would halt PDR trading if the circuit breaker parameters under CHX Article IX, Rule 10A were reached.<sup>36</sup> In addition, in

deciding whether to halt trading or conduct a delayed opening in PDRs, in general, and SPDRs and MidCap SPDRs, in particular, CHX represents that it will be guided by, but not necessarily bound to, relevant stock index option trading rules. Specifically, consistent with CHX Article XXXVI, Rule 19, CHX may consider whether trading has been halted or suspended in the primary market(s) for any combination of underlying stocks accounting for 20% or more of the applicable current index group value or whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

The Commission believes that the trading of PDRs in general on CHX should not adversely impact U.S. securities markets. As to the trading of SPDRs and MidCap SPDRs pursuant to UTP, the Commission notes that the corpus of the SPDR Trust is a portfolio of stocks replicating the S&P 500 Index, a broad-based capitalization-weighted index consisting of 500 of the most actively-traded and liquid stocks in the U.S.. The corpus of the MidCap SPDR Trust is a portfolio of stocks replicating the S&P MidCap 400 Index, also a broad-based, capitalization-weighted index consisting of 400 actively traded and liquid U.S. stocks. In fact, as described above, the Commission believes SPDRs and MidCap SPDRs may provide substantial benefits to the marketplace and investors, including, among others, enhancing the stability of the markets for individual stocks.<sup>37</sup> Accordingly, the Commission believes that SPDRs and MidCap SPDRs do not contain features that will make them

options, in deciding whether to halt trading in PDRs.

<sup>37</sup> Even though PDR transactions may serve as substitutes for transactions in the cash market, and possibly make the order flow in individual stocks smaller than would otherwise be the case, the Commission acknowledges that during turbulent market conditions the ability of large institutions to redeem or create PDRs could conceivably have an impact on price levels in the cash market. In particular, if a PDR is redeemed, the resulting long stock position could be sold into the market, thereby depressing stock prices further. The Commission notes, however, that the redemption or creation of PDRs likely will not exacerbate a price movement because PDRs will be subject to the equity margin requirements of 50% and PDRs are non-leveraged instruments. In addition, as noted above, during turbulent market conditions, the Commission believes PDRs and SPDRs and MidCap SPDRs, in particular, will serve as a vehicle to accommodate and "bundle" order flow that otherwise would flow to the cash market, thereby allowing such order flow to be handled more efficiently and effectively. Accordingly, although PDRs and SPDRs and MidCap SPDRs could, in certain circumstances, have an impact on the cash market, on balance we believe the product will be beneficial to the marketplace and can actually aid in maintaining orderly markets.

likely to impact adversely the U.S. Securities markets, and that the addition of their trading on CHX pursuant to UTP could produce added benefits to investors through the increased competition between other market centers trading the product.

Finally, the Commission notes that CHX has submitted surveillance procedures for the trading of PDRs, specifically SPDRs and MidCap SPDRs, and believes that those procedures, which incorporate and rely upon existing CHX surveillance procedures governing equities, are adequate under the Act.

The Commission finds that CHX's proposal contains adequate rules and procedures to govern the trading of PDR securities, including trading SPDRs and MidCap SPDRs pursuant to UTP. Specifically, PDRs are equity securities that will be subject to the full panoply of CHX rules governing the trading of equity securities on CHX, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of specialists. In addition, CHX has developed specific listing and delisting criteria for PDRs that will help to ensure that the markets for PDRs will be deep and liquid. As noted above, CHX's proposal provides for trading halt procedures governing PDRs. Finally, the Commission notes that CHX has stated its intention to file a rule requiring members, prior to recommending a transaction in any security, to use due diligence to learn the essential facts relative to the customer, every order, and every account accepted by the member.

As mentioned earlier, the trading of SPDRs and MidCap SPDRs will not be subject to ITS for a brief period of time until ITS can accommodate trading in increments of 1/64ths. In most instances, the Commission would predicate the trading of an equity product on more than one exchange on application of relevant ITS rules and procedures. In this instance, however, the delay in ITS implementation will be very brief.<sup>38</sup> The Commission believes that the procedures specified by CHX to replace the ITS trade-through rule during this brief period will help ensure that a customer receives the best price for a transaction in SPDRs or MidCap SPDRs among the market centers that

<sup>35</sup> This reflects the fact that PDRs are equity products and not an options product, and, therefore, do not necessitate the imposition of options-like rules.

<sup>36</sup> In addition, for PDRs tied to an index, the triggering of futures price limits for the S&P 500 Index, S&P 100 Index, or MMI futures contracts will not, in itself, result in a halt in PDR trading or a delayed opening. However, the Exchange could consider such an event, along with other factors, such as a halt in trading in OEX, SPX, or MMI

<sup>38</sup> The ITS Operating Committee has indicated that it will be able to accommodate 64ths after its September 18, 1997 meeting. Consequently, the discussion regarding alternatives to ITS will only need to be used for an extremely short period of time. If ITS cannot handle 64ths after the next meeting, the Commission still expects ITS to be made available for SPDRs for messages in increments of 16ths or greater until ITS can accommodate 64ths.



trade the products. In particular, CHX's BEST Rule, which will apply to the trading of SPDRs and MidCap SPDRs, guarantees the execution of agency orders from 100 shares up to 2099 shares at the best bid or offer on any ITS market center that trades SPDRs and MidCap SPDRs. In addition, CHX specialists will have the ability to monitor the current SPDR and MidCap SPDR quotations disseminated by Amex through the Consolidated Quotation System. Finally, CHX specialists will have the ability to place limit orders on the Amex specialist's book or send market orders to the Amex specialist for execution against the Amex specialist's quote, through Amex's PER System (although through a correspondent firm). Though not as efficient as full ITS access, these alternative procedures are reasonable given the very short time until ITS accepts 64ths.

The Commission believes that Amex's statements in its comment letter regarding the trading of SPDRs and MidCap SPDRs through ITS should be resolved, as the Amex letter suggests, through the proper ITS committee, not through Commission action on the CHX proposal. Otherwise, the ITS process could be used to prevent action on the CHX's proposal for competitive reasons.<sup>39</sup>

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>40</sup> that the proposed rule change (SR-CHX-97-6) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>41</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 97-24968 Filed 9-18-97; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39070; File No. SR-DTC-97-10]

### Self-Regulatory Organizations; the Depository Trust Company; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to the Certificate of Deposit Early Redemption Service

September 12, 1997.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 3, 1997, the Depository Trust Company ("DTC") 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 primarily by DTC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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

The proposed rule change will modify DTC's existing Certificate of Deposit Early Redemption Service ("CERR") to allow participants to transmit certificate of deposit ("CD") early redemption instructions by electronic delivery rather than by delivery of hardcopy forms (*i.e.*, paper).

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

In its filing with the Commission, DTC 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. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

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

Currently, DTC participants redeeming CDs prior to maturity must process such transactions through DTC's Voluntary Offering Program. These participants submit early redemption instructions to DTC by way of a

hardcopy Voluntary Offering Instruction Form ("VOI Form") which must be accompanied by any additional required documentation.<sup>3</sup> Upon receipt of early redemption instructions, DTC debits the participant's general free account and enters a corresponding credit in the same account using a contra-CUSIP number. When DTC receives the proceeds of an early redemption from the issuer, DTC credits the principal amount and any accrued interest minus any applicable penalty for early redemption to the participant's settlement account.

DTC proposes to modify CERR by offering participants the ability to transmit early redemption instructions to DTC electronically through DTC's Participant Terminal System ("PTS"). DTC will modify its already existing PTS function, the Reorganization Inquiry for Participants System ("RIPS"), to offer information regarding early redemption<sup>4</sup> such as: (i) a CD's eligibility for processing through CERR; (ii) the last date prior to maturity on which an issuer will accept a CD for early redemption; and (iii) whether or not an issuer requires the immediate submission of documents supporting an exempt early redemption. In addition, DTC will add a CERR function to PTS through which participants will be able to transmit early redemption instructions electronically to DTC.

In order to submit an early redemption instruction to DTC electronically, a participant will input information into CERR, including (i) the quantity of the eligible securities to be

<sup>3</sup> When a CD is redeemed prior to maturity, the beneficial owner of the CD is charged an early withdrawal fee unless the beneficial owner is deceased or has been adjudicated incompetent (or for any other reason listed in the applicable trust agreement or bond indenture). If the early withdrawal request is based on one of those circumstances, the early withdrawal fee is waived, and the early redemption is considered "exempt." Some issuers require owners seeking an exempt early redemption to submit documentation substantiating the exemption. Such documentation presently is submitted to DTC by participants with the VOI form.

<sup>4</sup> DTC has advised the Commission that the RIPS procedures currently contain the following provision which will also be applicable to CD early redemption information on RIPS:

The information provided by means of the RIPS function is based upon communications (whether oral or written) received by DTC from a variety of sources, and DTC does not represent that such information is accurate, or adequate or fit for any particular purpose. DTC shall not be liable for (1) any loss resulting directly or indirectly from mistakes, omissions, interruptions, delays, errors or defects arising from or related to the information provided on the RIPS function, and (2) any special, consequential, exemplary, incidental, or punitive damages. The information provided in the RIPS function with respect to a particular reorganization activity is subject to change at any time without prior notice.

<sup>39</sup> The Commission does not want to suggest that Amex's concerns are unfounded, but only that the proper venue for their resolution is the proper ITS committee, not the Rule 19b-4 process.

<sup>40</sup> 15 U.S.C. 78s(b)(2).

<sup>41</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> The Commission has modified the text of the summaries prepared by DTC.