

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39461; File No. SR-PCX-97-35]

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

December 17, 1997.

I. Introduction

On August 25, 1997, the Pacific Exchange Inc., ("PCX" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to add Commentary to Rule 5.3(b) and add Rule 8.300 of PCX's rules relating to the listing and trading of Portfolio Depositary Receipts ("PDRs").

The proposed rule change together with the substance of the proposal, was published for comment in the **Federal Register** on October 14, 1997.³ No comments were received on the proposal. This order approves the proposal.

II. Background and Description

The Exchange proposes to adopt new Commentary to Rule 5.3(b) and new Rule 8.300 to accommodate the trading of PDRs, *i.e.*, securities which are interests in a unit investment trust ("Trust") holding a 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, PCX 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. PCX is not asking for permission to list SPDRs or MidCap SPDRs at this time, but rather will trade SPDRs and MidCap SPDRs pursuant to UTP 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, PCX must have rules providing for transactions in such class or type of security. The Amex has enacted listing standards for PDRs, and PCX's proposed rule change is designed to create similar standards for PDR listing and/or trading on PCX.

If at a later time PCX 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.⁴ Additionally, in the event a new PDR is listed on another exchange using listing standards that are different than current PCX listing standards or the PCX listing standards proposed in this filing, the PCX 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 UTP, the Exchange will follow the listing exchange's determination of the appropriate minimum number.

Because the Trust operates on 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 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 39188 (October 2, 1997), 62 FR 53373.

⁴ The Commission notes that PCX, 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 22(d) and Rule 22c-1 thereunder to allow the PDR to trade in the secondary market.

priority, parity and precedence of orders and the responsibilities of specialists.⁵

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 are reached.⁶ 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.

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 Rule 7.11 the Exchange's rule governing trading halts for index options in exercising its discretion to 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 circumstance detrimental to the maintenance of a fair and orderly market are present.

Disclosure

Proposed Rule 8.300(c) 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 characteristic 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 UTP and will not be listed on PCX at this time, PCX does not intend to create its own product description to satisfy the requirements of proposed Rule 8.300(c) 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 PCX 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.⁷ It will be the member's responsibility to obtain these materials directly from Amex for forwarding to purchasers in the time frames prescribed by PCX and Commission rules. The PCX will notify members and member organizations of this requirement in a notice to members.

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.⁸ 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 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,⁹ known as MidCap SPDRs.¹⁰ The Sponsor of the two Trusts has entered into trust agreements with a trustee in accordance with Section 26 of the Investment Company Act. 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.¹¹

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.¹²

⁸ See Securities Exchange Act Release No. 31591 (December 11, 1992), 57 FR 60253 (December 18, 1992) ("Amex Approval Order").

⁹ 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.

¹⁰ See Securities Exchange Act Release No. 35534 (March 24, 1995), 60 FR 16686 (March 31, 1995) ("Amex MidCap Approval Order").

¹¹ The Commission recently approved rule change proposals covering the trading and listing of PDRs on the Chicago Stock Exchange ("CHX") and the Cincinnati Stock Exchange ("CSE"), including SPDRs and MidCap SPDRs. See Securities Exchange Act Release Nos. 39076 (September 15, 1997), 62 FR 49270 (September 19, 1997) ("CHX approval order"); 39268 (October 22, 1997), 62 FR 56211 (October 29, 1997) ("CSE approval order").

¹² To be eligible to place orders to create MidCap SPDRs as described below, an entity or person

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⁵ PCX Rule 9.2(a) will also apply to transactions in PDRs, including SPDRs and MidCap SPDRs. That rule provides, in part, that every member and member firm shall use due diligence to learn the essential facts relative to every customer, every order, every account accepted or carried by such member or member firm.

⁶ See Securities Exchange Act Release No. 38221 (January 31, 1997), 62 FR 5871 (February 7, 1997) and not 7 therein.

⁷ PCX 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 purchasers of the products and that they must provide the prospectus upon request.

Payment with respect to creation orders placed through the Distributor 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."¹³ 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.¹⁴ 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 $\frac{1}{64}$ ths. The PCX has proposed this same minimum variation for the trading of SPDRs and MidCap SPDRs on PCX.

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.¹⁵

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.¹⁶

Distribution of SPDRs and MidCap SPDRs

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

¹⁵ 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.

¹⁶ 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.

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 falling 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 fund received from the Trustee.

The MidCap SPDR Trust intends to make the DTC DRS available for use by MidCap SPDR holders through DTC participants 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.¹⁷ Any cash remaining will be distributed pro rata to participants in the dividend reinvestment.

III. 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).¹⁸ The Commission believes that providing for the exchange-trading on PCX 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

¹⁷ 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.

¹⁸ 15 U.S.C. 78f(b)(5).

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.

¹³ 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.

¹⁴ 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.

Commission believes that the trading on PCX of PDRs, in general, and SPDRs and MidCap SPDRs pursuant to UTP, 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.¹⁹ Accordingly, as discussed below, the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act that Exchange rules facilitate transactions in securities while continuing to further investor protection and the public interest.²⁰

As the Commission noted in the orders approving SPDRs and MidCap SPDRs for listing and trading on Amex,²¹ the Commission believes that the trading on PCX 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.²²

An individual SPDR has a value approximately equal to one-tenth of the value of the S&P 500 Index, and an

individual MidCap SPDR 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 PCX 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.²³ In contrast, pursuant to Investment Company Act Rule 22c-1,²⁴ 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.²⁵ 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 price 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 that must be addressed adequately. As discussed in more detail below, and in the Amex Approval Order,²⁶ the Commission believes PCX adequately addresses these concerns.

The Commission believes that the PCX 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, PCX 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 PCX. As discussed above, PCX's filing states that SPDRs and MidCap SPDRs product descriptions should be obtained from Amex.²⁷ The

¹⁹ 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.

²⁰ In approving this rule, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²¹ See supra notes 8 and 10.

²² 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.

²³ 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, arbitrage activity likely will be minimal. In addition, the Commission believes the 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 in kind, thereby enabling the Trust to invest virtually all of its assets in securities comprising the underlying index.

²⁴ 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 an exemption from this provision in order to allow them to trade at negotiated prices. In the secondary market. The Commission notes that PCX 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.

²⁵ *Id.*

²⁶ See supra note 8.

²⁷ The Commission notes that, in the context of a proposed change by the Chicago Stock Exchange ("CHX") to add rules for listing and trading of PDRs in general, and to trade SPDRs and MidCap SPDRs pursuant to UTP, Amex commented on CHX's proposed method regarding the delivery of the SPDR and the 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. See CHX Approval Order, supra note 11.

Commission believes that it is reasonable under the Act to allow PCX to require its members to obtain the product description for SPDRs and MidCap SPDRs from Amex.²⁸ Amex might decide to impose a reasonable charge for this service.²⁹ 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 PCX 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 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 PCX, 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, PCX's rule 9.2(a), Diligence as to Accounts, will apply to the trading of PDRs, including transactions in SPDRs and MidCap SPDRs.³⁰

The Commission believes PCX has adequately addressed the potential market impact concerns raised by the

proposal. First, PCX's proposal permits listing and trading of specific PDRs only after review by the Commission. Second, PCX has developed policies regarding trading halts in PDRs. Specifically, the exchange would halt PDR trading if the circuit breaker parameters under PCX Rule 7.11 were reached.³¹ In addition, in deciding whether to halt trading or conduct a delayed opening in PDRs, in general, and SPDRs and MidCap SPDRs, in particular, PCX represents that it will be guided by, but not necessarily bound to, relevant stock index option trading rules. Specifically, consistent with PCX Rule 7.11, PCX 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 PCX 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.³²

³¹ 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 options, in deciding whether to halt trading in PDRs.

³² 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

Accordingly, the Commission believes that SPDRs and MidCap SPDRs do not contain features that will make them likely to impact adversely the U.S. securities markets, and that the addition of their trading on PCX 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 PCX 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 PCX surveillance procedures governing equities, are adequate under the Act.

The Commission finds that PCX'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 PCX rules governing the trading of equity securities on PCX, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of specialists. In addition, PCX 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, PCX's proposal provides for trading halt procedures governing PDRs. Finally, the Commission notes that PCX has stated that Rule 9.2(a), Diligence as to Accounts, will apply to the trading of PDRs in general, and SPDRs and MidCap SPDRs, in particular.

IV. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,³³ that the proposed rule change (SR-PCX-97-35) is approved.

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

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.

³³ 15 U.S.C. 78s(b)(2).

³⁴ 17 CFR 200.30-3(a)(12).

²⁸ 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, PCX rules adequately ensure its members must deliver the current product description to all investors in SPDRs and MidCap SPDRs.

²⁹ The Commission notes that Amex would need to file a proposed rule change under Section 19(b) of the Act in the event it decides to charge a fee for supplying the SPDR or 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.

³⁰ See *supra* note. 5.

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 97-33712 Filed 12-24-97; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39469; File No. SR-PCX-97-45]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Pacific Exchange, Inc. Relating to ASAP Membership Requirements

December 19, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on November 10, 1997,³ the Pacific Exchange, Inc. ("PCX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the self-regulatory organization. The Exchange has designated this proposal as non-controversial pursuant to Rule 19b-4(e)(b) under the Act.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On November 3, 1997, the Exchange filed with the Commission a proposed rule change (PCX-97-42) containing the same substance as the present filing. That filing was submitted pursuant to Section 19(b)(3)(A)(iii) of the Act and Rule 19b-4(6) thereunder. The filing was withdrawn on November 6, 1997. See letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX, to Michael A. Walinskas, Division of Market Regulation, SEC, dated November 6, 1997. Regarding the present filing (PCX-97-45), on November 21, 1997, the Exchange filed Amendment No. 1 with the Commission. Amendments No. 1 constitute a substantive change in the proposal in that it redesignates the proposal as a "non-controversial" rule filing under Rule 19b-4(e)(6) rather than Rule 19b-4(e)(5). See letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX, to Victoria Berber-Doumar, Division of Market Regulation, Commission, dated November 21, 1997. On December 17, 1997, the Exchange filed Amendment No. 2 with the Commission. Amendment No. 2 modified the text of the rule to clarify the proposed change.

⁴ The Exchange has represented that the proposed rule change will not significantly affect the protection of investors or the public interest, and will not impose any significant burden on competition. See, letter from Michael D. Pierson, Senior Attorney, Regulatory Policy, PCX, to Victoria Berber-Doumar, Division of Market Regulation, SEC, dated December 17, 1997.

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

PCX is proposing to amend its rules on Automated System Access Privilege ("ASAP") Memberships.⁵ The text of the proposed rule change is available at the Office of Secretary, Amex, and at the Commission.

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

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of the 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 modify Rule 1.14 in two respects. First, Rule 1.14(a)(3) currently provides that telephone access is prohibited to ASAP Members, except by special exemption granted by the Board of Governors. The Exchange is proposing to eliminate this provision, so that ASAP Members may place orders over the telephone with Floor Brokers without first obtaining an exemption from the Board of Governors.

Second, the Exchange is proposing to add a provision to Rule 1.14 stating that at least 80% of an ASAP Member's total PCX trade (per calendar quarter) and at least 80% of an ASAP Member's total PCX volume (per calendar quarter) must be executed electronically through POETS on P/COAST. The 80% requirements will apply to option contracts and equity securities individually. The proposed rule further states that the Board of Governors may

grant exemptions to the 80% requirements on a case-by-case basis.

Currently, under PCX Rules. 1.14(a)(3) and (1)(5), as ASAP Member may receive access to P/COAST and POETS (and other systems approved by the Board of Governors), but may not have telephone access to the Trading Floors without and exemption from the Board of Governors. Thus, currently, the only orders that an ASAP Member may send directly to the Trading Floors are orders entered electronically (unless and exemption has been granted). The rule change will codify a limited exemption to the current requirement that, in general ASAP Members may only enter orders electronically. Specifically, it will allow up to 20% of an ASAP Member's PCX orders to be executed by telephone. The Exchange believes that codifying this limited exemption will make the ASAP Membership program more attractive to investors and thus will promote a greater use of electronic entry orders on the Exchange. It will also assure that Members holding "electronic" memberships are entering the vast majority of their PCX trades electronically.

The Exchange believes the proposal will make the Exchange's program for electronic membership more viable, and as such, will allow the Exchange to be more competitive in attracting order flow to the Exchange.

2. Statutory Basis

The proposal is consistent with Section 6(b) of the Act, in general, and Section 6(b)(4), in particular, in that it is designed to facilitate in securities and promote just and equitable principles of trade.

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

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

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

Written comments on the proposed rule change were neither solicited nor received.

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

The Exchange has asserted that the proposed rule change (i) will not significantly affect the protection of investors or the public interest, (ii) will not impose any significant burden on competition, and (iii) will not become operative for 30 days after the date of

⁵ ASAP Memberships are governed by PCX Rule 1.14. Rule 1.14 sets for the terms and conditions of the Exchange's program for Electronic Access Membership. The rule provides that ASAP Members must be registered broker-dealers subject to the Exchange's disciplinary jurisdiction, and must pay an annual fee. The Rule further provides that such Members are entitled to access to Pacific Computerized Order Access System ("P/COAST"), Pacific Options Exchange Trading System ("POETS"), and other systems approved by the Board of Governors.