

include all predictable risks¹ related to the business of the Columbia; (2) that Columbia establish one or more direct or indirect subsidiaries to engage in the proposed re-insurance activities; and (3) that Columbia provide additional support to CICL and the to-be-formed subsidiaries in the form of equity, guarantees, letters of credit or other credit support in an aggregate amount of up to \$50 million at any one time outstanding.

CICL and Columbia state their proposal will be subject to certain safeguards. Specifically, CICL, and any subsidiaries to be formed to engage in the proposed reinsurance activities, propose to participate as reinsurers only: (1) Where a direct commercial insurer underwrites the risk; (2) for a permitted business activity engaged in by a member of the Columbia holding company system; (3) where captive reinsurance would be reasonably expected to save the Columbia member a portion of the risk premium it would otherwise have paid; and (4) where the captive reinsurer can obtain, as appropriate, excess or stop-loss coverage.

For the Commission, by the Division of Investment Management, under delegated authority.

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41557; File No. SR-Amex-99-09]

Self-Regulatory Organizations; American Stock Exchange LLC; Order Granting Approval to Proposed Rule Change and Amendment No. 1 to the Proposed Rule Change Amending Amex Rule 901C To Allow Modified Equal-Dollar and Modified Capitalization Weighting Calculation Methodologies for Narrow-Based Index Options

June 24, 1999.

On March 1, 1999, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change pursuant to Section 19(b)(1)

of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² The filing was amended on March 12, 1999 to provide additional information on modified weighting methodologies.³ The proposed rule change would amend Commentary .02 to Amex Rule 901C to add modified equal-dollar weighting and modified capitalization weighting as acceptable weighting calculation methodologies for the construction of narrow-based index options.⁴ Notice of the proposed rule change, as amended, was published in the **Federal Register** on April 20, 1999.⁵ The Commission did not receive any comment letters on the filing. This Order approves the proposed rule change.

I. Introduction and Background

The Exchange proposes to amend Amex Rule 901C to add modified equal-dollar weighting and modified capitalization weighting as acceptable weighting calculation methodologies for the construction of narrow-based index options. Commentary .02 to Amex Rule 901C permits the Exchange to list options on stock industry index groups if the index meets certain criteria. Presently, the criteria require the index to be calculated using the capitalization, price, or equal-dollar weighting methodologies. Several other indexes which use a modified capitalization weighting methodology, however, including the Inter@ctive Week Internet Index, the Nasdaq-100 Index, and the Amex Eurotop 100 Index, were individually approved by the Commission as indexes that may underlie index options.⁶ The Amex Mexico Index and the Amex Networking Index, which use a modified equal-dollar weighting index calculation methodology, were also approved by the

Commission as indexes that may underlie index options.⁷

II. Description of the Proposal

The Exchange proposes to include modified capitalization and modified equal-dollar weighting calculation methodologies in Commentary .02 to Amex Rule 901C. Increasingly, the Exchange receives requests to construct new indexes using the modified capitalization or modified equal-dollar weighting methodologies to enable the proposed indexes to meet the generic criteria for narrow-based indexes, to provide for the timely trading of options on newly proposed indexes, or similar reasons. The Exchange wishes to accommodate these requests, and proposes to add these methodologies to the existing narrow-based criteria set forth in Commentary .02 of Amex Rule 901C that permits the listing of options on stock index groups pursuant to Rule 19b-4(e) under the Act.⁸ Use of these methodologies should allow the Exchange greater flexibility in developing indexes and facilitate the listing of options on stock industry index groups that more accurately reflect the industry represented by the index.

Modified Capitalization Weighting

To determine an index value using the capitalization weighting calculation methodology, the following calculation applies: Multiplying the primary exchange regular way last sale price of each component security by the number of shares outstanding; adding the products; and dividing the result by the current index divisor. The index value for a modified capitalization weighted index is calculated in a similar manner. However, instead of using the actual number of shares outstanding, an adjusted number of shares outstanding is used in the calculation (*i.e.*, multiplying the primary exchange regular way last sale price of each component security by the adjusted number of shares outstanding; adding the products; and then dividing the result by the current index divisor). The modified capitalization weighting methodology uses an adjusted number of shares outstanding to prevent components with relatively large market capitalizations from representing an inordinately large portion of an index's value. For example, inclusion of a large

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Letter from Scott G. Van Hatten, Legal Counsel, Amex, to Nancy Sanow, Senior Special Counsel, Commission, dated March 11, 1999.

⁴ The Exchange refers to narrow-based index options as options on a "stock index industry group." A stock index industry group is defined in the Amex Rules as a group of stocks representing a particular industry or related industries. See Amex Rule 900C(b)(1).

⁵ Securities Exchange Act Release No. 41276 (April 12, 1999) 64 FR 19393.

⁶ Securities Exchange Act Release No. 41124 (March 1, 1999) 64 FR 11520 (March 9, 1999) (File No. SR-Amex-99-04) (Inter@ctive Internet Index); Securities Exchange Act Release No. 40642 (November 5, 1998) 63 FR 63759 (November 16, 1998) (File No. SR-CBOE-98-43) (Nasdaq-100 Index); Securities Exchange Act Release No. 30463 (March 11, 1992) 57 FR 9284 (March 17, 1992) (File Nos. SR-Amex-90-25 and SR-Amex-91-01) (Amex Eurotop 100 Index).

⁷ Securities Exchange Act Release No. 34500 (August 8, 1994) 59 FR 41534 (August 12, 1994) (File No. SR-Amex-94-20) (Amex Mexico Index); Securities Exchange Act Release No. 37017 (March 22, 1996) 61 FR 14168 (March 29, 1996) (File No. SR-Amex-96-03) (Amex Networking Index).

⁸ 17 CFR 240.19b-4(e).

¹ CICL states that it will retain only that portion of the risk assumed from the primary insurer, a direct commercial insurer, that is relatively predictable on a basis of claim frequency and severity. CICL proposes to reinsure the more volatile/less predictable portion of the risk with other commercial insurers.

capitalization company in an index along with a number of smaller capitalization companies may result in the larger capitalization company's representation in the index exceeding 25% of the index's value. Thus, options on these indexes could not be listed on the Amex. However, since use of the modified capitalization methodology permits a reduction in the large capitalization company's representation in the index to an amount less than 25% of the index's value, the listing criteria of Amex rule 901C, Commentary .02(a)(7) are satisfied.

Modified Equal-Dollar Weighting

Use of the equal-dollar weighting calculation methodology to determine an index value is accomplished by establishing an initial dollar representation (e.g., \$100,000); determining the number of shares of each component representing this amount; and then multiplying the primary exchange regular way last sale price of each component security by its predetermined fixed number of shares. The equal-dollar weighted methodology can be used to provide more equitable representation of each component in a particular index. Modified equal-dollar weighting methodology is useful when the capitalization of companies within an index varies widely, by permitting larger capitalized companies to represent a larger portion of an index's value.

In effect, the modified equal-dollar weighting methodology is the mirror image of the modified capitalization weighting methodology. While the modified capitalization weighting methodology prevents large capitalization companies from skewing an index, the modified equal-dollar weighting methodology guards against small capitalized companies from doing so. Determining an initial index value for modified equal-dollar weighted indexes uses two or more fixed dollar values for different groups of the index components instead of using the same fixed dollar value for each component. In this way, the modified equal-dollar weighted method allows for similar component stocks to be weighted similarly, while differentiating among dissimilar groups (e.g., large capitalization stocks versus small capitalization stocks). For example, a ten stock index, calculated under this method, that has five components with capitalizations of approximately \$1 billion (or \$5 billion in aggregate) and five components with capitalizations of approximately \$500 million (or \$2.5 billion in aggregate), allows the larger capitalization components to account

for twice the amount of the smaller capitalized components, rather than having each component account for 10% of the index (as would be the case in a pure equal-dollar weighted index). Thus, the modified structure can be used to provide a more accurate representation of the market capitalization composition of the underlying industry for which the index is designed to measure.

III. Discussion

Under the Act, self-regulatory organizations ("SROs") like the Amex are assigned rulemaking and enforcement responsibilities to perform their role in regulating the securities industry for the protection of investors and other related purposes. This role has particular importance in the context of the listing of narrow-based stock index options under Rule 19b-4(e), since the Exchange is the only regulatory authority reviewing such securities before their trading begins. The Commission recently adopted new Rule 19b-4(e),⁹ eliminating the requirement that an SRO file a proposal under Section 19(b)(3)(A)¹⁰ to list and trade options on narrow-based indexes, provided that the SRO relying on Rule 19b-4(e) has generic listing criteria approved by the Commission and meets certain other requirements. With the approval of the proposed rule change, Amex will be permitted under Rule 19b-4(e) to introduce new options that are based on narrow-based stock indexes using modified capitalization or equal-dollar weightings, but without the Exchange having to file a proposal under Section 19(c)(3)(A) of the Act.

Pursuant to Section 19(b)(2) of the Act,¹¹ the Commission is required to approve an SRO's proposed rule change if the Commission determines that the proposal is consistent with the applicable statutory standards. The Commission finds that the proposal is consistent with the requirements of Section 6(b) of the Act¹² in general, and particularly furthers the objectives of Section 6(b)(5) of the Act,¹³ in that it is designed to promote just and equitable principles of trade and further the protection of investors and the public interest by increasing flexibility in developing an index by allowing an index to more accurately reflect an

underlying industry sector. This enhanced flexibility and accuracy should also foster cooperation and coordination with persons engaged in facilitating transactions in securities, and remove impediments to, and perfect the mechanisms of, a free and open market and a national market system. As represented by the Exchange, modifying the capitalization amounts or dollar values of the securities underlying an index can prevent an individual stock from inappropriately skewing the performance of an entire index. The Commission therefore believes that market accuracy and transparency should be correspondingly enhanced by use of the modified capitalization and modified equal-dollar weighting methods, and approves them for use in the context of Commentary .02 to Amex Rule 901C concerning eligibility criteria for index components of a narrow-based stock index.

The Commission notes that the Exchange has represented that it will review the component weightings of indexes employing the modified capitalization weighting methodology quarterly, and if necessary, adjust them to ensure that the index continues to meet the weighting guidelines. In addition, the Exchange has further represented that adjustments will be made on an intra-quarterly basis, as necessary, to reflect corporate actions, share issuances and repurchases, and other events of significance.

With regard to the use of the modified equal-dollar weighting methodology, the Commission notes that the Exchange has represented that the number of shares of each component security will be examined and, if necessary, adjusted quarterly, so that the members of each weighting group are set to the appropriate index weight to ensure compliance with the criteria. The number of shares of each component stock in the index portfolio will remain fixed between quarterly reviews, except in the event of corporate actions such as the payment of a dividend other than an ordinary cash dividend, stock distribution, reorganization, recapitalization, or similar event with respect to the component stocks. In the event of a merger or consolidation of an issuer of a component stock, if the stock remains in the index, the number of shares of that security in the portfolio may be adjusted to the nearest whole share, to maintain the component's relative weight in the index at the level immediately prior to the corporate action. In the event of a stock addition or replacement, the average dollar value of the remaining components in the same weighting group will be

⁹ See Securities Exchange Act Release No. 40761 (December 8, 1998) 63 FR 70952 (December 22, 1998) (amending Rule 19b-4 with respect to rule filing requirements for SROs listing and trading a new derivative securities product).

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 15 U.S.C. 78s(b)(2).

¹² 15 U.S.C. 78f(b).

¹³ 15 U.S.C. 78f(b)(5).

calculated, and that amount invested in the stock of the new component to the nearest whole share. In all cases, the divisor will be adjusted, if necessary, to ensure index continuity.

The Commission further notes that the Exchange has represented that the terms of any modified capitalization or modified equal-dollar weighting calculation methodology will be clearly defined, and will consist of objective standards that permits any newly developed narrow-based index initially to meet, and subsequently, to continue to be maintained, in accordance with the generic criteria set forth in Commentary .02 to Amex Rule 901C. In addition, the Exchange has represented that these terms will be discussed in marketing materials describing the index and in the Information Circulars the Exchange will distribute to members upon the launch of new index options.

IV. Conclusion

The Commission finds that the proposed rule change is consistent with the Act, and in particular, with Section 6(b)(5).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposal, SR-Amex 99-09, be and hereby is approved.¹⁵

For the Commission, by the Division of Market Regulations, pursuant to delegated authority.¹⁶

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41562; File No. SR-Amex-99-22]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change by the American Stock Exchange LLC Relating to Rule 1006

June 25, 1999.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ notice is hereby given that on June 22, 1999, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the

self-regulatory organization. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend Rule 1006 which governs disclaimers of liability relating to the Nasdaq-100 Index.[®] Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in [brackets].

Nasdaq-100 Index[®]

Rule 1006. The Nasdaq Stock Market, Inc. ("Nasdaq") has licensed the use of the Nasdaq-100 Index[®] for certain purposes in connection with trading in a particular series of Portfolio Depositary Receipts on the Exchange. Nasdaq *and its affiliates* [does] do not guarantee the accuracy and/or completeness of the Nasdaq-100 Index[®] or any data included therein. Nasdaq [and], the Exchange *and their affiliates* make no warranty, express or implied, as to results to be obtained by any person or entity from the use of the Nasdaq-100 Index or any data included therein in connection with the rights licensed or for any other use. Nasdaq [and], the Exchange *and their affiliates* make no express or implied warranties, and disclaim all warranties of merchantability or fitness for a particular purpose with respect to the Nasdaq-100 Index or any data included therein. Without limiting any of the foregoing, in no event shall Nasdaq [and], the Exchange *and their affiliates* have any liability for any lost profits or special, punitive, incidental, indirect, or consequential damages, even if notified of the possibility of such damages. In addition, Nasdaq [and], the Exchange *and their affiliates* shall have no liability for any damages, claims, losses or expenses caused by any errors or delays in calculating or disseminating the Nasdaq-100 Index.

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

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The self-regulatory organization has prepared summaries, set forth in

sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

On February 26, 1999,² the Commission approved the listing and trading under Amex Rules 1000 *et seq.* of Nasdaq-100 Shares,SM units of beneficial interest in the Nasdaq-100 Index[®] Trust, Series 1, a unit investment trust based on the Nasdaq-100 Index.[®] The Commission also approved in the Nasdaq-100 Shares Order Amex Rule 1006, which provides for disclaimers of liability with respect to the Nasdaq-100[®] by the Nasdaq and the Exchange in connection with the trading of Nasdaq-100 Shares. This provision is similar to other Exchange rules relating to disclaimers of liability with respect to Portfolio Depositary Receipts (e.g., Amex Rule 1004 (S&P 500 Index) and Amex Rule 1005 (Dow Jones Indexes) as well as index options (e.g., Amex Rule 902C). The Exchange is amending Amex Rule 1006 to state that the disclaimers of liability, specified in the rule, extend to affiliates of Nasdaq and the Exchange. The Exchange believes that such an amendment is appropriate to clarify and make explicit that the disclaimers of liability specified in Amex Rule 1006 also apply to affiliates of Nasdaq and Amex, which include the National Association of Securities Dealers, Inc. and NASD Regulation, Inc.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act³ in general and furthers the objectives of Section 6(b)(5)⁴ in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

The Exchange does not believe that the proposed rule change will impose

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ In approving the proposal, the Commission has considered the rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁶ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² Securities Exchange Act Release No. 41119 (February 26, 1999), 64 FR 11510 (March 9, 1999) ("Nasdaq-100 Shares Order").

³ 15 U.S.C. 78f(b).

⁴ 15 U.S.C. 78f(b)(5).