

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41698; File No. SR-Amex-99-18]

### Self-Regulatory Organizations; American Stock Exchange LLC; Order Approving Proposed Rule Change and Amendment No. 1 Thereto Amending Amex Rule 901C

August 3, 1999.

#### I. Introduction

On May 17, 1999, the American Stock Exchange LLL ("Amex" or "Exchange") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend Amex Rule 901C. On June 8, 1999, Amex filed Amendment No. 1.<sup>3</sup> The proposed rule change and Amendment No. 1 were published for comment in the *Federal Register* on June 24, 1999.<sup>4</sup> No comments were received on the proposed proposal. This order approves the proposal.

#### II. Description of the Proposal

By adding Commentary .03 to Amex Rule 901C to establish criteria for the splitting of stock indexes, the proposed rule change will permit the Exchange to split broad and narrow-based indexes without submitting a proposed rule change to the Commission. Specifically, the proposal will require the Exchange, prior to instituting an index split, to issue an information circular to the Exchange's membership with details concerning the index split and the adjusting of position and exercise limits until the expiration of the further non-LEAP option contract. In effecting the index split, the Exchange will increase the applicable index divisor; proportionally increase the number of contracts outstanding; and increase the index option's applicable position and exercise limits. Position and exercise limits that are increased to accommodate any outstanding index option positions will revert, following

the expiration of the furthest non-LEAP option contract, to their then applicable limit.

#### 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>5</sup> Specifically, the Commission finds that the proposal is consistent with the section 6(b)(5)<sup>6</sup> requirements in that the proposed reduction in the value of an index and the associated temporary increase in the position and exercise limits should remove impediments to and perfect the mechanism of a free and open market in a manner consistent with the protection of investors and the public interest.<sup>7</sup>

By reducing the value of an index, the Commission believes that a broader range of investors will be provided with a means to hedge their exposure to the market risk associated with the stocks underlying an index. Similarly, the Commission believes that reducing the value of an index may attract additional investors, thus creating a more active and liquid trading market for the index options. The Commission notes that, before splitting an index, the Exchange will provide reasonable advance notice of the proposed index split to its membership.<sup>8</sup>

The Commission also believes that Amex's proposed adjustments to its position and exercise limits applicable to an index are appropriate and consistent with the Act. In particular, the Commission believes that the

temporary increase of the position and exercise limits is reasonable in light of the fact that the size of the options contracts on an index will be proportionally reduced and that, as a result, the number of outstanding options contracts an investor holds will be increased. The temporary increase of the position and exercise limits, therefore, will ensure that investors will not potentially be in violation of the lower existing position and exercise limits while permitting market participants to maintain, after the split of an index, their current level of investment in the option contracts.

The Commission further believes that increasing an index's divisor will not have an adverse market impact on the trading in these options. After the split, an index will continue to be composed of the same stocks with the same weightings and will be calculated in the same manner, except for the proposed change in the divisor.

Finally, in its release adopting new Rule 19b-4(e),<sup>9</sup> the Commission noted that if the trading rules, procedures and listing standards for the product class included criteria regarding splitting an index, such changes would be permitted without being considered a material change to the derivative securities product and without requiring the filing of a proposed rule change pursuant to Section 19(b) of the Act.<sup>10</sup> The proposed rule change will permit the Exchange to adjust the value of a stock index covered by Commentary .02 to Rule 901C from time to time in response to prevailing market conditions without the need to submit a rule filing to the Commission on each occasion.

#### IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>11</sup> that the proposed rule change (SR-Amex-99-18) and Amendment No. 1 are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See letter to Richard Strasser, Assistant Director, Division of Market Regulation, SEC, from Scott Van Hatten, Legal Counsel, Derivative Securities, Amex, dated June 4, 1999. In Amendment No. 1, Amex amended the text of the proposed rule.

<sup>4</sup> Securities Exchange Act Release No. 41536 (June 17, 1999), 64 FR 33941.

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>7</sup> In approving this rule and amendment, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>8</sup> From experience, the Commission finds that reasonable notice may include the Exchange providing notice to its membership at least two weeks prior to the implementation of the proposed change to the value of an index and the resulting adjustments to the outstanding options; issuing a second notice to its members just prior to implementing the index reduction setting forth the new divisor and other relevant information; and issuing a circular to its members at least one month prior to the expiration of the furthest non-LEAP options on the index that reminds its member firms that the respective position and exercise limits will revert to their original levels. Although not exclusive, the Commission believes that these proposed time frames should allow for adequate notice to the holders of all open positions in options on an index proposed to be split.

<sup>9</sup> 17 CFR 240.19b-4(e).

<sup>10</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) ("New Products Release").

<sup>11</sup> 15 U.S.C. 78s(b)(2).

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