

CFR 260 and 20 CFR 320. The notification letter sent to the individual at the time of the original action on the application informs the applicant of such right. When an individual protests a decision, the concerned bureau reviews the entire file and any additional evidence submitted and sends the applicant a letter explaining the basis of the determination. The applicant is then notified that if he or she wishes to protest further, they can appeal to the RRB's Bureau of Hearings and Appeals. The procedure pertaining to the filing of such an appeal is prescribed in 20 CFR 260.5 and 260.9 and 20 CFR 320.12 and 320.38.

The form prescribed by the RRB for filing an appeal under the RRA or RUIA is form HA-1, *Appeal Under the Railroad Retirement Act or Railroad Unemployment Insurance Act*. The form asks the applicant to furnish the basis for the appeal and what additional evidence, if any, is to be submitted. Completion is voluntary, however if the information is not provided the RRB cannot process the appeal.

The RRB proposes to add an item to Form HA-1 which requests the name, address and phone number of the applicant's representative. Minor editorial changes which include the addition of language required by the Paperwork Reduction Act of 1995 are also proposed. The completion time for the HA-1 is estimated at 20 minutes per response. The RRB estimates that approximately 1,200 Form HA-1's are completed annually.

**ADDITIONAL INFORMATION OR COMMENTS:** To request more information or to obtain a copy of the information collection justification, forms, and/or supporting material, please call the RRB Clearance Officer at (312)751-3363. Comments regarding the information collection should be addressed to Ronald J. Hodapp, Railroad Retirement Board, 844 North Rush Street, Chicago, Illinois 60611-2092. Written comments should be received within 60 days of this notice.

**Chuck Mierzwa,**

*Clearance Officer.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39660; File No. SR-BSE-97-08]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to Listing and Trading Standards for Portfolio Depositary Receipts

February 12, 1998.

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> notice is hereby given that on December 9, 1997,<sup>3</sup> the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II 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. The Commission is also granting accelerated approval of the proposed rule change.

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

The Exchange proposes to adopt new listing standards and trading rules for Portfolio Depositary Receipts ("PDRs"). The text of the proposed rule change is available at the Office of the Secretary, BSE, 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 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 III 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.

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

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

<sup>3</sup> The Exchange filed Amendment No. 1 to the proposed rule change on December 11, 1997, the substance of which is incorporated into the notice. See letter from Karen A. Aluise, Vice President, BSE, to Michael Walinkas, Senior Special Counsel, Market Regulation Commission, dated December 9, 1997 ("Amendment No. 1").

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

##### 1. Purpose

*Listing Requirements for PDRs.* The Exchange proposes to adopt new listing and delisting requirements to accommodate the trading of PDRs, *i.e.*, securities that 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 (1) closely tracks the underlying portfolio of securities, (2) trades like a share of common stock, and (3) 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 indices or securities portfolios. PDRs based on each particular stock index or portfolio will 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 will be selected by the Exchange, or by another person having 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.

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 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:

(i) 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;

(ii) If the index on which the Trust is based is no longer calculated; or

(iii) If such other event occurs or condition exists which, in the opinion of the Exchange, makes further dealings in such securities on the Exchange inadvisable.

A Trust will 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 (the "Sponsor"), following notice to PDR holders, will 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.* Dealing 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>4</sup>

With respect to trading halts, the trading of PDRs will be halted, along with trading of all other listed or traded stocks, in the event the circuit breaker thresholds are reached.<sup>5</sup> In addition, for PDRs tied to an index, while the triggering of futures price limits for the S&P 500 Composite Price Index ("S&P 500 Index"), S&P 100 Composite Price Stock Index ("S&P 100 Index") or Major Market Index ("MMI") futures contracts

will not, in themselves, result in a halt in PDR trading or a delayed opening, such an event could be considered by the Exchange, along with other factors, such as a halt in trading in S&P 100 Index Options ("OEX"), S&P 500 Index Options ("SPX"), or Major Market Index Options ("XMI"), in deciding whether to halt trading in PDRs.

The Exchange will issue a circular to its members and member organizations informing them of Exchange policies regarding trading halts in such securities. 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.* The proposed rule requires that members and member organizations provide to all purchasers of each series of PDRs a written description of the terms, characteristics and risks 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 nonmember 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 members and member organizations. The written description must be included with any sales material relating to 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 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.

Two existing PDRs, Standard & Poor's Depository Receipt ("SPDRs") and Standard & Poor's MidCap 400 Depository Receipts ("MidCap SPDRs"), are traded on the American Stock Exchange ("Amex").<sup>6</sup> The Exchange is not seeking approval to list SPDRs or MidCap SPDRs at this time, but rather is requesting approval to 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, the Exchange must have rules providing for transactions in such class or type of security. The Amex has enacted listing standards for PDRs, and the Exchange's proposed rule change is designed to create similar standards for PDR listing and/or trading on the Exchange. As stated above, the Exchange proposes to trade only SPDRs and MidCap SPDRs pursuant to unlisted trading privileges upon approval of this rule filing.

If at a later time the Exchange and the issuer of the product desire to list SPDRs and MidCap SPDRs or any other PDRs on the Exchange, the Exchange will request SEC approval for that listing in a separate proposed rule change filed pursuant to Section 19(b) of the Act. Additionally, in the event a new PDR is listed on another exchange using listing standards that are different than current Exchange listing standards or the Exchange listing standards proposed in this filing, the Exchange will file a proposed rule change pursuant to Section 19(b) of the Act to adopt those listing standards before it trades that PDR pursuant to unlisted trading privileges.

With respect to the above discussion regarding disclosure issues, because SPDRs and MidCap SPDRs will be traded pursuant to unlisted trading privileges and will not be listed on the Exchange at this time, the Exchange does not intend to create its own product description to satisfy the requirements of the proposed rule, 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 Exchange 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

<sup>4</sup> Chapter VII, Section 2, will also apply to the trading of PDRs. That rule provides, in part, that every member and allied-member is required to use due diligence to learn the essential facts relative to every customer, including the possible use of a name other than that of the interested party, and to every order or account accepted by him, except when acting as agent for another member.

<sup>5</sup> See Securities Exchange Act Release No. 38221 (January 31, 1997) 62 FR 5871 (February 7, 1997) and note 7 therein.

<sup>6</sup> SPDRs and MidCap SPDRs are defined and discussed more fully below.

the SPDR and MidCap SPDR, as the case may be.<sup>7</sup> It will be the member's responsibility to obtain these materials directly from Amex for forwarding to purchasers in the time frames prescribed by Exchange and Commission rules. The Exchange will notify members and member organizations of this requirement in a notice to members.

The remainder of this section provides background information on SPDRs and MidCap SPDRs. The information, requested by BSE to have been copied from SR-AMEX-94-52 and SR-AMEX-92-18, describes the structure and mechanics of SPDRs and MidCap SPDRs.

#### *SPDRs and MidCap SPDRs*

*Generally.*<sup>8</sup> On December 11, 1992, the Commission approved Amex Rules 1000 *et seq.*<sup>9</sup> to accommodate trading on the Amex of PDRs generally. 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 Composite Stock Price Index ("S&P 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,<sup>10</sup> known as MidCap SPDRs.<sup>11</sup> The sponsor of the two Trusts has entered into trust agreements with a trustee in accordance

<sup>7</sup>The Exchange plans to notify its members in a regulatory circular that members must comply with Chapter VII, Section 2 of the Exchange Rules prior to recommending the purchase of SPDRs or MidCap SPDRs to customers. The circular will also state 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.

<sup>8</sup>The Commission has recently approved rule change proposals covering the trading of PDRs on the CHX and the CSE, including SPDRs and MidCap SPDRs. See Securities Exchange Act Release No. 39076 (September 15, 1997) 62 FR 49270 (September 19, 1997) and Securities Exchange Act Release No. 39268 (October 22, 1997) 62 FR 56211 (October 29, 1997).

<sup>9</sup>See Securities Exchange Act Release No. 31591 (December 11, 1992) 57 FR 60253 (December 18, 1992).

<sup>10</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 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>11</sup>See Securities Exchange Act Release No. 35534 (March 24, 1995) 60 FR 16686 (March 31, 1995).

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.

*SPDRs.* 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.<sup>12</sup> Therefore, SPDR holders will not be able to directly vote the shares of the issuers underlying the SPDRs.

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.<sup>13</sup> An investor making a Portfolio Deposit into the Trust will receive a "Creation Unit" composed of 50,000 SPDRs.<sup>14</sup> The price of SPDRs will be based on a current bid/offer market. The Amex has designated 1/64's as the minimum increment for trading in SPDRs. The Exchange is proposing this same minimum variation for the trading of SPDRs on the Exchange. SPDRs will not be redeemable individually, but may be redeemed in Creation Unit size (*i.e.*, 50,000 SPDRs). Specifically, a Creation Unit may be redeemed for an in-kind distribution of securities identical to a Portfolio Deposit.<sup>15</sup>

*MidCap SPDRs.* All orders to create MidCap SPDRs in Creation Unit size aggregations (which has been set at 25,000) must be placed with the Distributor, and it will be the

<sup>12</sup>The Trustee will abstain from voting if the stocks held by the Trust cannot be voted in the same proportion as all other shares of the securities are voted.

<sup>13</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 S&P 500 Index caused by, among other things, the fact that a Portfolio Deposit cannot contain fractional shares.

<sup>14</sup>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.

<sup>15</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 Trust 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 S&P 500 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.

responsibility of the Distributor to transmit such orders to the Trustee. To be eligible to place orders to create MidCap SPDRs as described below, an entity or person 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 Trust 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.

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 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."

*Issuance of MidCap SPDRs.* 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 MidCap SPDRs, which aggregate number is referred to as a "Creation Unit." A Creation Unit is made up of 25,000 MidCap SPDRs.<sup>16</sup> Individual 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 Exchange specialists.

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 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 MidCap SPDR.

<sup>16</sup>PDRs may be created in other than Creation Unit size aggregations in connection with the DTC Dividend Reinvestment Service ("DRS").

The Amex has set the minimum fractional trading variation for MidCap SPDRs at 1/64 of \$1.00. The Exchange is proposing this same minimum variation for MidCap SPDRs.

*Redemption of MidCap SPDRs.*

MidCap SPDRs in Creation Unit size aggregations will be redeemable in kind by tendering them to the Trustee. While holders may sell MidCap SPDRs in the secondary market at any time, they must accumulate at least 25,000 (or multiples thereof) to redeem them through the Trust. 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.

*Distributions for MidCap SPDRs.* The MidCap SPDR Trust will pay dividends quarterly. The regular quarterly ex-dividend date for MidCap SPDRs will be 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 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 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 will have to consult his or her broker to ascertain the availability of dividend reinvestment through that broker. The Trustee will use cash proceeds of MidCap SPDR holders participating in the reinvestment to obtain the Index securities necessary to create the requisite number of SPDRs.<sup>17</sup> Any cash remaining will be distributed pro rata to participants in the dividend reinvestment.

*Equity Requirements for PDRs.*

Because of the potential risk associated with PDRs, the Exchange is raising the minimum equity for the trading of PDRs by specialists and competing specialists to \$1,000,000. Corresponding increases are also being made to the Early Warning Alert and caretaker provisions of the equity rule,<sup>18</sup> to \$875,000 and \$800,000 respectively. In addition, PDRs will not be eligible for alternate account trading.

The Exchange requests the Commission to find good cause, pursuant to Section 19(b)(2) of the Act, for approving the proposed rule change prior to the thirtieth day after publication in the **Federal Register**. The Exchange believes that such action is appropriate, in that the listing standards proposed closely mirror the listing standards of the primary market for SPDRs MidCap SPDRs, as well as the standards approved for the regional exchanges currently trading PDRs. In addition, substantially the same trading rules and procedures exist on several of the exchanges.

**2. Statutory Basis**

The Exchange believes that the statutory basis for the proposed rule change is Section 6(b)(5) of the Act,<sup>19</sup> in that it is designed to promote just and equitable principles of trade; to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities; to remove impediments to and perfect the mechanism of a free and

open market and a national market system; and, in general, to protect investors and the public interest; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers. Specifically, the proposed rule change will increase competition in PDR markets by permitting Exchange members to compete for PDR order flow. By adopting the proposed rule change, the Exchange will bring the benefits of competition, including increased efficiency and price competition, to those markets.

*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*

No written comments were either solicited or received.

**III. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-BSE-97-08 and should be submitted by March 16, 1998.

**IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change**

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

<sup>17</sup> The Creation of PDRs in connection with DTC DRS represents the only circumstances under which PDRs can be created in other than Creation Unit size aggregations.

<sup>18</sup> Chapter XXII, Sections 2(f)(ii), (iii) and (iv).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

requirements of Section 6(b)(5).<sup>20</sup> The Commission believes that providing for the exchange-trading on BSE 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 BSE 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>21</sup> 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.<sup>22</sup>

As the Commission noted in the orders approving SPDRs, and MidCap SPDRs for listing and trading on Amex,<sup>23</sup> the Commission believes that the trading on BSE 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>24</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 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 BSE 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>25</sup> In contrast, pursuant to Investment Company Act Rule 22c-1,<sup>26</sup> holders and prospective holders of open-end mutual fund shares are limited to purchasing or

<sup>24</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>25</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, 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.

<sup>26</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 an exemption from this provision in order to allow them to trade at negotiated prices in the secondary market. The Commission notes that BSE 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.

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>27</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 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,<sup>28</sup> the Commission believes BSE adequately addresses these concerns.

The Commission believes that the BSE 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, BSE 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 BSE. As discussed above, BSE's filing states that SPDRs and MidCap SPDRs product descriptions should be obtained from Amex.<sup>29</sup> The

<sup>27</sup> *Id.*

<sup>28</sup> See *supra* note 8.

<sup>29</sup> The Commission notes that, in the context of a proposed rule change by CHX to add rules for listing and trading of PDRs in general, and to trade

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</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>22</sup> 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).

<sup>23</sup> See *supra* notes 8 and 10.

Commission believes that it is reasonable under the Act to allow BSE to require its members to obtain the product description for SPDRs and MidCap SPDRs from Amex.<sup>30</sup> Amex might decide to impose a reasonable charge for this service.<sup>31</sup>

Second, BSE members 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 BSE, that a circular and prospectus are available from a broker upon request. Fourth, a BSE member 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, BSE's Chapter VII, Section 2, Investigation of Accounts, will apply to the trading of PDRs, including transactions in SPDRs and MidCap SPDRs.

The Commission believes BSE has adequately addressed the potential market impact concerns raised by the proposal. First, BSE's proposal permits

SPDRs and MidCap SPDRs pursuant to UTP, 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. See CHX Approval Order, *supra* note 7.

<sup>30</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, BSE rules adequately ensure its members must deliver the current product description to all investors in SPDRs and MidCap SPDRs.

<sup>31</sup> 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.

listing and trading of specific PDRs only after review by the Commission. Second, BSE has developed policies regarding trading halts in PDRs. Specifically, the Exchange would halt PDR trading if the circuit breaker parameters under BSE Chapter II, Section 34A were reached.<sup>32</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, BSE represents that it will be guided by, but not necessarily bound to, 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 BSE 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>33</sup>

<sup>32</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 options, in deciding whether to halt trading in PDRs.

<sup>33</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

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 BSE 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 BSE 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 BSE surveillance procedures governing equities, are adequate under the Act.

The Commission finds that BSE'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 BSE rules governing the trading of equity securities on BSE, including, among others, rules governing the priority, parity and precedence of orders and the responsibilities of specialists. In addition, BSE 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, BSE's proposal provides for trading halt procedures governing PDRs. Finally, the Commission notes that BSE has stated that Chapter VII, Section 2, Investigation of Accounts, will apply to the trading of PDRs in general, and SPDRs and MidCap SPDRs, in particular.

The Commission finds good cause for approving the proposed rule change prior the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission believes that accelerated approval of the proposal is appropriate because it is very similar to CHX's and CSE's previously approved proposals covering the listing and trading of PDRs in general, and SPDRs and MidCap SPDRs, in particular.<sup>34</sup> As such, the Commission believes that the proposed rule change does not raise any new regulatory concerns or issues.

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.

<sup>34</sup> See *supra* note 7.

*It is therefore ordered*, pursuant to Section 19(b)(2)<sup>35</sup> that the proposed rule change is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>36</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-39665; File No. SR-NASD-98-10]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the National Association of Securities Dealers, Inc. To Postpone the Effective Date of Recently-Approved Amendments to Rules 3010 and 3110

February 13, 1998.

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> notice is hereby given that on February 10, 1998, the NASD Regulation, Inc. ("NASDR") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASDR. 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 NASDR proposes to indefinitely postpone the effective date of recently-approved amendments to the National Association of Securities Dealers, Inc. ("NASD" or "Association") Rules 3010, "Supervision," and 3110, "Books and Records," to allow the NASDR an opportunity to consider comment letters received from the public.

#### 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 NASDR 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 NASDR 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

On April 11, 1997, a proposed rule change to amend NASD Rules 3010 and 3110 was filed with the SEC.<sup>3</sup> The purpose of the amendments was to allow firms to develop flexible procedures for the review of correspondence with the public. In that filing, the NASD stated that it would make the proposed rule change effective within 45 days of Commission approval. Amendment No. 1, containing a draft Notice to Members to be issued following approval of the proposed rule change, was filed with the SEC on December 4, 1997.<sup>4</sup> The Notice to Members described the new rules and provided guidance to NASD members on the implementation of the new rules. The SEC approved the proposed rule change and Amendment No. 1 to the proposed rule change on December 31, 1997.<sup>5</sup> Notice to Members 98-11 announced approval of the proposed rule change and stated that the amendments to Rules 3010 and 3110 would be effective on February 15, 1998.

Subsequent to approval of the proposed rule change by the SEC, several commenters filed letters with the SEC raising issues regarding Amendment No. 1 to the proposed rule change and its accompanying Notice to Members.<sup>6</sup> NASDR believes that their letters raise important issues that should be fully addressed before the rule change becomes effective.

<sup>3</sup> The proposed rule change (SR-NASD-97-24) was published for comment in the *Federal Register* on May 2, 1997. See Securities Exchange Act Release No. 38548 (April 25, 1997), 62 FR 24147.

<sup>4</sup> See Letter from Mary N. Revell, Associate General Counsel, NASDR, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission, dated December 1, 1997 ("Amendment No. 1").

<sup>5</sup> See Securities Exchange Act Release No. 39510 (December 31, 1997) 63 FR 1131 (January 8, 1998) (order approving File No. SR-NASD-97-24) ("Release No. 39510").

<sup>6</sup> See letters from Carl B. Wilkerson, American Council of Life Insurance, to Jonathan G. Katz, Secretary, SEC, dated January 9, 1998; Richard V. Silver, The Equitable Life Assurance Society of the United States, to Jonathan G. Katz, Secretary, SEC, dated January 29, 1998; and Michael L. Kerley, MML Investors Services, Inc. to Secretary, SEC, dated January 26, 1998.

The proposed rule change indefinitely postpones the effective date of the amendments to Rules 3010 and 3110 approved in Release No. 39510. An extension of the effective date will allow NASDR an opportunity to consider comments on these and other issues raised by the rule and the accompanying Notice to Members. NASDR will submit a further proposed rule change to the SEC announcing the new effective date. Because this rule proposal has been made in conjunction with a similar proposal by the New York Stock Exchange ("NYSE"), which has been approved by the SEC<sup>7</sup> and immediately became effective,<sup>8</sup> and is designed to complement that proposal, joint members of the NYSE and NASD would be permitted to rely on the procedures provided by NYSE Rules 342, 440, and 472 and NYSE Interpretation 342.16/01 pending the effective date of the proposed rule change.

##### 2. Statutory Basis

The NASDR believes the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that the Association's rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The NASDR believes that delaying the effective date of the new rules to allow for consideration of member views will not be inconsistent with these requirements.

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

NASDR does not believe that the proposed rule change will impose a burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act, as amended.

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

No written comments were solicited or received with respect to the proposed rule change.

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

The foregoing rule change constitutes a stated policy, practice, or interpretation with respect to the

<sup>7</sup> See Securities Exchange Act Release No. 39511 (December 31, 1997) 63 FR 1135 (January 8, 1998) (order approving File No. SR-NYSE-96-26).

<sup>8</sup> See NYSE Information Memo 98-3 (January 14, 1998).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

<sup>35</sup> 15 U.S.C. 78s(b)(2).

<sup>36</sup> 17 CFR 200.30-3(a)(12).

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

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