

annually, to determine whether the purchases were influenced by the investment by the Trust Series in shares of the Unaffiliated Underlying Fund. The board of directors will consider, among other things, (a) whether the purchases were consistent with the investment objectives and policies of the Unaffiliated Underlying Fund; (b) how the performance of securities purchased in an Affiliated Underwriting compares to the performance of comparable securities purchased during a comparable period of time in underwritings other than Affiliated Underwritings or to a benchmark such as a comparable market index; and (c) whether the amount of securities purchased by the Unaffiliated Underlying Fund in Affiliated Underwritings and the amount purchased directly from Underwriting Affiliates have changed significantly from prior years. The board of directors shall take any appropriate actions based on its review, including, if appropriate, the institution of procedures designed to assure that purchases of securities from Affiliated Underwritings are in the best interests of shareholders.

6. An Unaffiliated Underlying Fund shall maintain and preserve permanently in an easily accessible place a written copy of the procedures described in the preceding condition, and any modifications, and shall maintain and preserve for a period not less than 6 years from the end of the fiscal year in which any purchase from an Affiliated Underwriting occurred, the first 2 years in an easily accessible place, a written record of each purchase made once an investment by a Trust Series in the securities of an Unaffiliated Underlying Fund exceeded the limits of section 12(d)(1)(A)(i) of the Act, setting forth from whom the securities were acquired, the identity of the underwriting syndicate's members, the terms of the purchase, and the information or materials upon which the board's determinations were made.

7. Prior to an investment in an Underlying Fund in excess of the limit in section 12(d)(1)(A)(i), the Trust Series and the Underlying Fund will execute an agreement stating, without limitation, that the Underlying Fund understands the terms and conditions of the order and agrees to fulfill its responsibilities under the order. At the time of its investment in shares of an Unaffiliated Fund in excess of the limit in section 12(d)(1)(A)(i), a Trust Series will notify the Unaffiliated Fund of the investment. At such time, the Trust Series also will transmit to the Unaffiliated Fund a list of the names of each Trust Series Affiliate and

Underwriting Affiliate. The Trust Series will notify the Underlying Fund of any changes to the list as soon as reasonably practicable after a change occurs. The Underlying Fund and the Trust Series will maintain and preserve a copy of the order, the agreement, and the list with any updated information for a period not less than 6 years from the end of the fiscal year in which any investment occurred, the first 2 years in an easily accessible place.

8. The Trustee will waive or offset fees otherwise payable by a Trust Series in an amount at least equal to any compensation (including 12b-1 Fees) received by the Sponsor or Trustee, or an affiliated person of the Sponsor or Trustee, from an Unaffiliated Fund in connection with the investment by a Trust Series in the Unaffiliated Fund.

9. Any sales charges, distribution-related fees and/or service fees charged with respect to units of a Trust Series, when aggregated with any sales charges, distribution-related fees and/or service fees paid by the Trust Series with respect to its acquisition, holding, or disposition of shares of a Fund, will not exceed the limits set forth in rule 2830 of the NASD Conduct Rules.

10. No Fund will acquire securities of any other investment company in excess of the limits contained in section 12(d)(1)(A) of the Act.

For the SEC, by the Division of Investment Management, pursuant to delegated authority.

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42988; File No. SR-BSE-00-05]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 by the Boston Stock Exchange, Inc. Relating to Index Fund Shares

June 28, 2000.

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 May 9, 2000, the Boston Stock Exchange, Inc. ("BSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and

II below, which Items have been prepared by the Exchange. Amendment No. 1 was filed on June 12, 2000.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons, and to approve the proposed rule change, as amended, on an accelerated basis.

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

The Exchange proposes to adopt listing standards and trading rules for Index Fund Shares, including generic listing standards which would permit the Exchange to trade, either by listing or pursuant to unlisted trading privileges ("UTP"), series of Index Fund Shares pursuant to Rule 19b-4(e) under the Act.<sup>4</sup> Once these listing standards are approved, the Exchange intends to trade SPDRs and iShares MSCI<sup>5</sup> pursuant to unlisted trading privileges. Below is the text of the proposed rule change. New language is *italicized*.

\* \* \* \* \*

#### Chapter XIV-B

#### Index Fund Shares

#### Applicability

*Section 1. (a) This Chapter is applicable only to Index Fund Shares. Except to the extent inconsistent with this Chapter, or unless the context context otherwise requires, the provisions of the Constitution and all other rules and policies of the Exchange shall be applicable to the trading on the Exchange of Index Fund Shares. Index Fund Shares are included within the definition of "security" or "securities" as such terms are used in the Constitution and Rules of the Exchange.*

#### Definitions

*Section 2. The following terms shall have the meanings specified herein:*

<sup>3</sup> In Amendment No. 1, which has been incorporated into the proposed rule change, the Exchange made certain typographical corrections, modified several aspects of the proposed rule text, and replaced references to "World Equity Benchmark Shares" ("WEBS") with references to "Morgan Stanley Capital International Index Funds" ("iShares MSCI Index Funds" or "iShares MSCI"). See Letter from Esher M. Radovsky, Listings Analyst, BSE, to Andrew Shipe, Attorney, Division of Market Regulation ("Division"), SEC, dated June 9, 2000 ("Amendment No. 1").

<sup>4</sup> 15 U.S.C. 78s(b).

<sup>5</sup> The BSE represents that the American Stock Exchange LLC ("AMEX") has renamed all Index Shares based in individual foreign countries from "World Equity Benchmark Shares" to "Morgan Stanley Capital International Index Funds" ("iShares MSCI Index Funds" or "iShares MSCI"). This proposal extends only to those iShares MSCI that were formerly termed "WEBS." The BSE represents that there has been no substantive change to this product. See Amendment No. 1, *supra*, note 3.

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

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

(a) The term "Index Fund Share" means a security (i) that is issued by an open-end management investment company based on a portfolio of stocks that seeks to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic stock index; (ii) that is issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified numbers of shares of stock and/or a cash amount with a value equal to the next determined net asset value; and (iii) that, when aggregated in the same specified minimum number, may be redeemed at a holder's request by such open-end investment company which will pay to the redeeming holder the stock and/or cash with a value equal to the next determined net asset value.

(b) The term "Reporting Authority" with respect to a particular series of Index Fund Shares means the Exchange, or an institution or reporting service designated by the Exchange, as the official source for calculating and reporting information relating to such series, including, but not limited to, any current index or portfolio value; the current value of the portfolio of any securities required to be deposited in connection with issuance of Index Fund Shares; the amount of any dividend equivalent payment or cash distribution to holders of Index Fund Shares, net asset value, or other information relating to the issuance, redemption or trading of Index Fund Shares. Nothing in this section shall imply that an institution or reporting service that is the source for calculating and reporting information relating to Index Fund Shares must be designated by the Exchange, the term "Reporting Authority" shall not refer to an institution or reporting service not so designated.

#### Disclosure

Section 3. The Exchange requires that members and member organizations provide to all purchasers of newly issued Index Fund Shares a prospectus for the series of Index Fund Shares.

#### Designation

Section 4. The trading of Index Fund Shares based on one or more securities, whether by listing or pursuant to unlisted trading privileges, shall be considered on a case-by-case basis. Each issue of Index Fund Shares shall be based on each particular stock index or portfolio shall be designated as a separate series and shall be identified by a unique symbol. The securities that are included in a series of Index Fund

Shares shall be selected by the Exchange or its agent, a wholly-owned subsidiary of the Exchange, or by such other person, as shall have authorized use of such index. Such index may be revised from time to time as may be deemed necessary or appropriate to maintain the quality and character of the index.

#### Initial and Continued Listing and/or Trading

Section 5. Each series of Index Fund Shares will be traded on the Exchange, whether by listing or pursuant to unlisted trading privileges, subject to application of the following criteria:

(a) Commencement of Trading. For each Series, the Exchange will establish a minimum number of Index Fund Shares required to be outstanding at the time of commencement of trading on the Exchange.

(b) Continued Trading. Following the initial twelve month period following commencement of trading on the Exchange of a series of Index Fund Shares, the Exchange will consider the suspension of trading, the removal from listing, or termination of unlisted trading privileges for such series under any of the following circumstances:

(i) If there are fewer than 50 beneficial holders of the series of Index Fund Shares for 30 or more consecutive trading days;

(ii) If the value of the index or portfolio of securities on which the series of Index Fund Shares is based is no longer calculated or available; or

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

Upon termination of an open-end management investment company, the Exchange requires that Index Fund Shares issued in connection with such entity be removed from Exchange Listing.

(c) Voting. Voting rights shall be as set forth in the applicable open-end management investment company prospectus.

#### \* \* \* Interpretation and Policies:

.01 The Exchange may approve a series of Index Fund Shares for listing pursuant to Rule 19b-4(e) under the Securities Exchange Act of 1934 provided each of the following criteria is satisfied:

(a) Eligibility Criteria for Index Components. Upon the initial listing of a series of Index Fund Shares each component of an index or portfolio underlying a series of Index Fund Shares shall meet the following criteria as of the date of the initial deposit of securities to the fund in connection with

the initial issuance of shares of such fund:

(i) Component stocks that in the aggregate account for at least 90% of the weight of the index or portfolio shall have a minimum market value of at least \$75 million;

(ii) The component stocks shall have a minimum monthly trading volume during each of the last six months of at least 250,000 shares for stocks representing at least 90% of the weight of the index or portfolio;

(iii) The most heavily weighted component stock cannot exceed 25% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot exceed 65% of the weight of the index or portfolio;

(iv) The underlying index or portfolio must include minimum of 13 stocks; and

(v) All securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq Stock Market (including the Nasdaq SmallCap Market).

(b) Index Methodology and Calculation. (i) The index underlying a series of Index Fund Shares will be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology; (ii) If the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer; and (iii) The current index value will be disseminated every 15 seconds over the Consolidated Tape Association's Network B.

(c) Disseminated Information. The Reporting Authority will disseminate for each series of Index Fund Shares an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities and cash amount to permit creation of new shares of the series or upon the index value.

(d) Initial Shares Outstanding. A minimum of 100,000 shares of a series of Index Fund Shares is required to be outstanding at commencement of trading.

(e) Minimal Fractional Trading Variation. The minimum fractional trading variation may vary among different series of Index Fund Shares but will be set at  $\frac{1}{16}$ th,  $\frac{1}{32}$ nd or  $\frac{1}{64}$ th of \$1.00.

(f) Hours of Trading. Trading will occur between 9:30 a.m. and either 4:00

p.m. or 4:15 p.m. for each series of Index Fund Shares, as specified by the Exchange.

(g) *Surveillance Procedures.* The Exchange will utilize existing surveillance procedures for Index Fund Shares.

(h) *Applicability of Other Rules.* The provisions of Chapter XXIV-B et seq. will apply to all series of Index Fund Shares.

02. The following paragraphs only apply to series of Index Fund Shares that are the subject of an order by the Securities and Exchange Commission exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940. The Exchange will inform members and member organizations regarding application of these provisions to a particular series of Index Fund Shares by means of an Information Circular prior to commencement of trading in such series.

The Exchange requires that members and member organizations provide to all purchasers of a series of Index Fund Shares a written description of the terms and characteristics of such securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members and member organizations shall include such a written description with any sales material relating to a series of Index Fund Shares that is provided to customers or the public. Any other written materials provided by a member or member organization to customers or the public making specific reference to a series of Index Fund Shares as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of Index Fund Shares] has been prepared by the [open-end management investment company name] and is available from<sup>6</sup> your broker or the Exchange. It is recommended that you obtain and review such circular before purchasing [the series of Index Fund Shares]. In addition, upon request you may obtain from your broker a prospectus for [the series of Index Fund Shares]."

A member of 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 Index Fund Shares for such omnibus account will be deemed to constitute 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 under this rule.

Upon request of a customer, member or member organization shall also provide a prospectus for the particular series of Index Fund Shares.

03 The Exchange will trade, pursuant to unlisted trading privileges, Index Fund Shares of Select Sector SPDR Funds, which are known as "Select Sector SPDRs."

04 The Exchange will trade, pursuant to unlisted trading privileges, Index Fund Shares based on Morgan Stanley Capital International (MSCI) Index Funds, which are known as "iShares MSCI."

05 The minimum fractional trading variation will be  $\frac{1}{16}$ th of \$1.00 for iShares MSCI and  $\frac{1}{64}$ th of \$1.00 for Select Section SPDRs.

\* \* \* \* \*

## Chapter XV

### Specialists

#### Section 11. Restrictions on Transactions by Specialist

\* \* \* Interpretation and Policies:

01 Specialists may only redeem and create Index Fund Shares on the same terms and conditions as any other investor and only at the net asset value ("NAV").

02 Nothing in Section 11 shall be deemed to restrict a specialist registered in a security issued by an investment company from purchasing and redeeming the listed security, or securities that can be subdivided or converted into the listed security, from the issues as appropriate to facilitate the maintenance of a fair and orderly market in the subject security.

\* \* \* \* \*

## 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 Exchange included statement 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 Exchange 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

#### a. Listing Requirements for Index Fund Shares

The Exchange proposes to adopt new listing and delisting requirements to accommodate the trading of Index Fund Shares, i.e., securities issued by an open-end management investment company ("Fund") that seek to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic equity market index ("Index Fund Shares" or "Fund Shares"). Once the listing standards for Index Funds Shares are approved, the Exchange intends to trade Select Sector SPDRs and iShares MSCI<sup>7</sup> pursuant to UTP.

Index Fund Shares will be issued by an entity registered with the Commission as an open-end management investment company, and which may be organized as a series fund providing for the creation of separate series of securities, each with a portfolio consisting of some or all of the component securities of a specified securities index. Issuances of Index Fund Shares by a Fund will be made only in minimum size aggregations or multiples thereof ("Creation Units"). The size of the applicable Creation Unit size aggregation will be set forth in the Fund's prospectus, and will vary from one series of Index Fund Shares to another, but generally will be of substantial size (e.g., value in excess of \$450,000 per Creation Unit). It is expected that a Fund will issue and sell Index Fund Shares through a principal underwriter on a continuous basis at the net asset value per share next determined after an order to purchase Index Fund Shares in Creation Unit size aggregations is received in proper form. Index Fund Shares will be traded on the Exchange like other equity securities, and Exchange equity trading rules will apply to the trading of Index Fund Shares.

The Exchange expects that Creation Unit size aggregations of Index Fund Shares generally will be issued in exchange for the "in kind" deposit of a specified portfolio of securities, together with a cash payment representing, in part, the amount of dividends accrued up to the time of issuance. The Exchange anticipates that such deposits will be made primarily by institutional investors, arbitrageurs, and the Exchange

<sup>6</sup> The Exchange changed the word "for" to "from" in the proposed rule text. Telephone conversation between Esther M. Radovsky, Listings Analyst, BSE, and Heather Traeger and Andrew Shipe, Attorneys, Division, SEC, on June 28, 2000.

<sup>7</sup> See *supra* note 5.

specialist. Redemption of Index Fund Shares generally will be made "in kind", with a portfolio of securities and cash exchanged for Index Fund Shares that have been tendered for redemption. Issuances or redemptions also could occur for cash under specified circumstances (e.g., if it is not possible to effect delivery of securities underlying the specific series in a particular foreign country) and at other times in the discretion of the Fund.

The Exchange expects that a Fund will make available on a daily basis a list of the names and the required number of shares of each of the securities to be deposited in connection with issuance of Index Fund Shares of a particular series in Creation Unit size aggregations, as well as information relating to the required cash payment representing, in part, the amount of accrued dividends.

A Fund may make periodic distributions of dividends from net investment income, including net foreign currency gains, if any, in an amount approximately equal to accumulated dividends on securities held by the Fund during the applicable period, net expenses and liabilities for such period.

Index Fund Shares will be registered in book entry form through the Depository Trust Company. Trading in Index Fund Shares on the Exchange may be effected until either 4 p.m. or 4:15 p.m. (New York time) each business day.

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

The Exchange believes that the listing criteria proposed in its new rule are generally consistent with the listing standards for "Hybrid Securities", currently found in Chapter XXVII of the Exchange Rules, as well as the Index Fund Shares listing criteria currently used by the Amex.<sup>8</sup>

**Initial Listing.** If Index Fund Shares are to be listed on the Exchange, the Exchange will establish a minimum number of Index Fund Shares that must be outstanding at commencement of Exchange trading, and such minimum number will be included in any required submission under Rule 19b-4.

**Continued Listing.** In connection with continued listing, the Exchange will consider the suspension of trading in, or removal from listing of, an Index upon which a series of Index Fund Shares is based when any of the following circumstances arise: (1) There are fewer

than 50 beneficial holders of the series of Index Fund Shares for 30 or more consecutive trading days; (2) the value of the index or portfolio of securities on which the series of Index Fund Shares is based is no longer calculated or available; or (3) such other event shall occur or condition exists which, in the opinion of the Exchange, makes further dealings on the Exchange inadvisable. The Exchange will not, however, be required to suspend or delist from trading, based on the above factors, any Index Fund Shares for a period of one year after the initial listing of such Index Fund Shares for trading on the Exchange. The Exchange will require that Index Fund Shares be removed from listing upon termination of the Fund that issued such shares.

b. Standards to Permit Trading, Either by Listing or Pursuant to UTP, of Index Fund Shares Pursuant to Rule 19b-4(e) under the Act

The Exchange proposed to adopt generic listing and delisting standards to permit the trading, either by listing or pursuant to UTP, of Index Fund Shares pursuant to Rule 19b-4(e) under the Act.<sup>9</sup> Rule 19b-4(e) permits self-regulatory organizations ("SROs") to list and trade new derivative products that comply with existing SRO trading rules, procedures, surveillance programs and listing standards, without submitting a proposed rule change under Section 19(b). Accordingly, the Exchange proposes to approve a series of Index Fund Shares for listing or trading, either by listing or pursuant to UTP, pursuant to Rule 19b-4(e) under the following criteria.

Upon the initial listing of a series of Index Fund Shares, component stocks that in the aggregate account for at least 90% of the weight of the underlying index or portfolio must have a minimum market value of at least \$75 million. In addition, the component stocks representing at least 90% of the weight of the index or portfolio must have a minimum monthly trading volume during each of the last six months of at least 250,000 shares. Moreover, the most heavily weighted component stocks in an underlying index or portfolio cannot exceed 25% of the weight of the index or portfolio, and the five most heavily weighted component stocks cannot together exceed 65% of the weight of the index or portfolio. The index or portfolio must include a minimum of 13 stocks.<sup>10</sup> All

securities in an underlying index or portfolio must be listed on a national securities exchange or The Nasdaq Stock Market (including the Nasdaq SmallCap Market). Finally, any series of Index Fund Shares must meet these eligibility criteria as of the date of the initial deposit of securities and cash into the trust or fund.

The index underlying a series of Index Fund Shares will be calculated based on either the market capitalization, modified market capitalization, price, equal-dollar or modified equal-dollar weighting methodology. In addition, if the index is maintained by a broker-dealer, the broker-dealer shall erect a "fire wall" around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer.

The current index value will be disseminated every 15 seconds over the Consolidated Tape Association's Network B. The Reporting Authority will disseminate for each series of Index Fund Shares an estimate, updated every 15 seconds, of the value of a share of each series. This may be based, for example, upon current information regarding the required deposit of securities plus any cash amount to permit creation of new shares of the series or upon the index value.

A minimum of 100,000 shares of a series of Index Fund Shares is required to be outstanding at commencement of trading. Trading will occur between 9:30 a.m. and either 4:00 p.m. or 4:15 p.m. for each series of Index Fund Shares, as specified by the Exchange. The provisions of BSE Chapter XXIV-B *et seq.*, will apply to all series of Index Fund Shares.

#### *c. Exchange Rules Applicable to the Trading of Index Fund Shares*

Index Fund Shares are considered "securities" under the Rules of the Exchange and are subject to all applicable trading rules, including the provisions of BSE Chapter XXXI, Section 4, Trade-Throughs and Locked Markets, which prohibit Exchange members from initiating trade-throughs for Intermarket Trading System securities, as well as rules governing priority, parity and precedence of

<sup>8</sup> The Amex's listing criteria were approved by the Commission on March 8, 1996. See Securities Exchange Act Release No. 36947 (March 8, 1996), 61 FR 10606 (March 14, 1996).

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

<sup>10</sup> Thirteen stocks is the minimum number to permit qualification as a regulated investment company under Subchapter M of the Internal

Revenue Code. Under Subchapter M of the Internal Revenue Code, for a fund to qualify as a regulated investment company, the securities of a single issuer can account for no more than 25% of a fund's total assets, and at least 50% of a fund's total assets must be comprised of cash (including government securities) and securities of single issuers whose securities account for less than 5% of such fund's total assets.

orders, market volatility-related trading halt provisions and responsibilities of the assigned specialist firm.<sup>11</sup> Exchange equity margin rules will apply.

The Exchange also intends to utilize its existing surveillance procedures, including procedures adopted for portfolio depositary receipts, to surveil trading in Index Fund Shares. The Exchange will also surveil specialist compliance with BSE Chapter XV, Section 11, "Restrictions on Transactions by Specialist," and proposed interpretation and policies .01 and .02 to Chapter XV, Section 11, which contemplate specialists engaging in transactions with the issuer of Index Fund Shares under certain circumstances.

#### d. Notice to Members

Prior to the commencement of trading in Index Fund Shares, the Exchange will issue a circular to members highlighting the characteristics of purchases in Index Fund shares. The circular will discuss the special characteristics and risks of trading this type of security. Specifically, the circular, among other issues, will discuss what Index Fund Shares are, how they are created and redeemed, the requirement that members and member firms deliver a prospectus to investors purchasing Index Fund Shares prior to or concurrently with the confirmation of a transaction, applicable Exchange Rules, dissemination information, trading information, and the applicability of suitability rules.

In addition, the circular will inform members of Exchange policies about trading halts in such securities. First, the circular will advise that trading will be halted in the event the market volatility trading halt parameters set forth in BSE Chapter II, Section 34B have been reached. Second, the circular will advise that, in addition to other factors that may be relevant, the Exchange may consider factors such as the extent to which trading is not occurring in a deposited security(s) and whether other unusual conditions or circumstances detrimental to the maintenance of a fair and orderly market are present.

#### e. Disclosure

The Exchange will require its members to provide all purchasers of

newly issued Index Fund Shares with a Fund prospectus. Because the Units will be in continuous distribution, the prospectus delivery requirements of Section 5(b)(2) of the Securities Act of 1933 (the "1933 Act")<sup>12</sup> will apply to all investors in Index Fund Shares, including secondary market purchases on the Exchange in Index Fund Shares.

With respect to series of Index Fund Shares that are the subject of an order by the SEC exempting such series from certain prospectus delivery requirements under Section 24(d) of the Investment Company Act of 1940 ("1940 Act"),<sup>13</sup> the Exchange will inform members and member organizations regarding disclosure obligations with respect to a particular series of Index Fund Shares by means of an Information Circular prior to commencement of trading in such series.

For these exempted series, the Exchange requires that members and member organizations provide to all purchasers of a series of Index Fund Shares a written description of the terms and characteristics of such securities, in a form prepared by the open-end management investment company issuing such securities, not later than the time a confirmation of the first transaction in such series is delivered to such purchaser. In addition, members and member organizations shall include such a written description with any sales material relating to a series of Index Fund Shares that is provided to customers or the public. Any other written materials provided by a member or member organization to customers or the public making specific reference to a series of Index Fund Shares as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of Index Fund Shares] has been prepared by the [open-end management investment company name] and is available from your broker or the Exchange. It is recommended that you obtain and review such circular before purchasing [the series of Index Fund Shares]. In addition, upon request you may obtain from your broker a prospectus for [the series of Index Fund Shares]."

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 Index Fund Shares for such omnibus account will be deemed to constitute 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 under this rule.

Upon request of a customer, a member or member organization shall also provide a prospectus for the particular series of Index Fund Shares.

#### f. Minimum Fractional Change

The Index Fund Shares are currently traded on the Amex at a minimum of variation of  $\frac{1}{16}$ th or  $\frac{1}{64}$ th of \$1.00. The Exchange proposes the minimum fractional change for Index Fund Shares on the Exchange will be  $\frac{1}{16}$ th,  $\frac{1}{32}$ nd or  $\frac{1}{64}$ th of \$1.00 depending on the series of Index Fund Shares. Thus, the Exchange is proposing the same minimum fractional increments for the trading of Index Fund Shares on the BSE, until such time as decimal increments are approved. It is anticipated that some time after August, 2000, the industry minimum-price variations will be converted from fractions to decimals.

#### g. Description of iShares MSCI and Select Sector SPDRs

Seventeen series of iShares MSCI based on Morgan Stanley Capital International foreign stock indices.<sup>14</sup> and nine investment series of Select SPDRs offered by the Select Sector SPDR Trust are traded on the Amex.<sup>15</sup> The Exchange is not seeking approval to list these iShares MSCI<sup>16</sup> or Select Sector SPDRs<sup>17</sup> at this time, but rather is requesting approval to trade these iShares MSCI and Select Sector SPDRs pursuant to UTP once these listing standards are approved.

Pursuant to Rule 12f-5 under the Act,<sup>18</sup> to trade a particular class or type of security pursuant to UTP, the Exchange must have rules providing for transactions in such class or type of security. The Amex has enacted listing

<sup>14</sup> See *supra* note 5.

<sup>15</sup> Further information regarding Select Sector SPDRs and iShares MSCI is available at the principal office of the Exchange, and at the Commission's Public Reference Room, as detailed in III, below.

<sup>16</sup> Specifically, the MSCI Australia, MSCI Austria, MSCI Belgium, MSCI Canada, MSCI France, MSCI Germany, MSCI Hong Kong, MSCI Italy, MSCI Japan, MSCI Malaysia, MSCI Mexico, MSCI Netherlands, MSCI Singapore, MSCI Spain, MSCI Sweden, MSCI Switzerland, and MSCI United Kingdom Indices.

<sup>17</sup> Specifically, the Basic Industries Select Sector SPDR, the Consumer Services Select Sector SPDR, the Consumer Staples Select Sector SPDR, the Cyclical/Transportation Select Sector SPDR, the Energy Select Sector SPDR, the Financial Select Sector SPDR, the Industrial Select Sector SPDR, the Technology Select Sector SPDR and The Utilities Select Sector SPDR.

<sup>18</sup> 17 CFR 240.12f-5.

<sup>11</sup> BSE Chapter VII, Section 2, will also apply to the trading of Index Fund Shares. 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>12</sup> 15 U.S.C. 77e(b)(2).

<sup>13</sup> 15 U.S.C. 80a-24(d).

standards for Index Fund Shares, and the BSE's proposed rule change is designed to create similar standards for Index Fund Shares listing and/or trading on the BSE. As stated above, the Exchange proposes to only trade iShares MSCI and Select Sector SPDRs pursuant to UTP upon approval of this rule filing.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with 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 securities transactions, 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.

### *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 that is not necessary or appropriate in furtherance of the purposes of the Act.

### *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, as amended, 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. 20549-0609. 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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-BSE-00-05 and should be

submitted by [insert date 21 days from date of publication].

## 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 requirements of Section 6(b)(5).<sup>20</sup> Specifically, the Commission finds that the BSE's proposal to establish generic standards to permit the trading of Index Fund Shares pursuant to Rule 19b-4(e) furthers the intent of that rule by facilitating commencement of trading in these securities without the need for notice and comment and Commission approval under Section 19(b) of the Act. Thus, by establishing generic standards, the proposal should reduce the Exchange's regulatory burden, as well as benefit the public interest, by enabling the Exchange to bring qualifying products to the market more quickly. Accordingly, the Commission finds that the Exchange's proposal will promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, and, in general, protect investors and the public interest consistent with Section 6(b)(5) of the Act.<sup>21</sup>

Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by an SRO shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4, if the Commission has approved, pursuant to Section 19(b) of the Exchange Act, the SRO's trading rules, procedures and listing standards for the product class that include the new derivative securities product and the SRO has a surveillance program for the product class.<sup>22</sup> The Commission's approval of the proposed generic listing standards for Index Fund Shares will allow those series of Index Fund Shares that satisfy those standards to start trading under Rule 19b-4(e), without the need for notice and comment and Commission approval. The Exchange's ability to rely on Rule 19b-4(e) for these products potentially reduces the time

frame for bringing these securities to the market and thus enhances investors' opportunities. The Commission notes that while the proposal reduces the Exchange's regulatory burden, the Commission maintains regulatory oversight over any products listed under the generic standards through regular inspection oversight.

The Commission previously concluded that Index Fund Shares and like products that it approved for trading under similar rules on other Exchanges would allow investors to: (1) respond quickly to market changes through intra-day trading opportunities; (2) engage in hedging strategies similar to those used by institutional investors; and (3) reduce transactions costs for trading a portfolio of securities.<sup>23</sup> The Commission believes, for the reasons set forth below, that the product classes that satisfy the proposed standards for Index Fund Shares should produce the same benefits to the BSE and to investors.

The Commission finds that the Exchange's proposal contains adequate rules and procedures to govern the trading of Index Fund Shares under Rule 19b-4(e). All series of Index Fund Shares listed under the proposed standards will be subject to the full panoply of BSE rules and procedures that now govern the trading of existing securities on the BSE.<sup>24</sup> Accordingly, any new series of Index Fund Shares listed and traded on the Exchange, or pursuant to UTP, will be subject to BSE rules governing the trading of equity securities, including, among others, rules and procedures governing trading halts, disclosures to members, responsibilities of the specialist, account opening and customer suitability requirements, and margin. These criteria allow the BSE to consider the suspension of trading and the delisting of a series if an event occurred that made further dealings in such securities inadvisable. This will give the

<sup>23</sup> See Securities Exchange Act Release No. 42975 (June 22, 2000); Securities Exchange Act Release No. 42833 (May 26, 2000), 65 FR 35679 (June 5, 2000); Securities Exchange Act Release No. 42787 (May 15, 2000), 65 FR 33598 (May 24, 2000); Securities Exchange Act Release No. 36947 (March 8, 1996), 61 FR 10606 (March 14, 1996).

<sup>24</sup> The Commission notes that although Index Fund Shares are not leveraged instruments, and, therefore, do not possess any of the attributes of stock index options, their prices will be derived and based upon the securities held in their respective Funds. Accordingly, the level of risk involved in the purchase or sale of Index Fund Shares is similar to the risk involved in the purchase or sale of traditional common stock. Nevertheless, the Commission believes there are unique aspects to trading Index Fund Shares, which the Exchange has sufficiently and adequately addressed in this proposal.

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

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

<sup>21</sup> 15 U.S.C. 78f(b)(5). 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>22</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).

BSE flexibility to delist Index Fund Shares if circumstances warrant such action.

The Commission believes that the Exchange's proposal will ensure that investors have information that will allow them to be adequately apprised of the terms, characteristics, and risks of trading Index Fund Shares. Members and member organizations will be required to provide to all purchasers of Index Fund Shares a written description of the terms and characteristics of these securities, to include their description in sales materials provided to customers or the public, to include a specific statement relating to the availability of the description in other types of materials distributed to customers or the public, and to provide a copy of the prospectus, when requested by the customer. The proposal also requires a member or member organization carrying an omnibus account for a non-member broker-dealer, to notify the non-member that execution of an order to purchase Index Fund Shares constitutes an agreement by the non-member to provide the product description to its customers.

The Commission also notes that upon the initial listing, or trading pursuant to UTP, of any Index Fund Shares, the Exchange will issue a circular to its members explaining the unique characteristics and risk of this particular type of security. The circular also will note the Exchange members' prospectus or product description delivery requirements, and inform members of their responsibilities under BSE Rules in connection with customer transactions in these securities. The Commission believes that these requirements ensure adequate disclosure to investors about the terms and characteristics of a particular series, and is consistent with Section 6(b)(5) of the Act.<sup>25</sup>

In addition, the BSE has developed specific listing criteria for series of Index Fund Shares qualifying for Rule 19b-4(e) treatment that will help to ensure that a minimum level of liquidity will exist to allow for the maintenance of fair and orderly markets. Specifically, the proposed generic listing standards require that a minimum of 100,000 shares of a series of Index Fund Shares be outstanding as of the start of trading. The Commission believes that this minimum number of securities is sufficient to establish a liquid Exchange market at the commencement of trading.

The Commission believes that the proposed generic listing standards ensure that the securities composing the

underlying indexes and portfolios are well capitalized and actively traded. These capitalization and liquidity criteria serve to prevent fraudulent or manipulative acts, and are therefore consistent with Section 6(b)(5) of the Act.

Furthermore, the Commission finds that the Exchange's proposal to trade Index Fund Shares in increments of 1/16th, 1/32nd, or 1/64th, of \$1.00 is consistent with the Act.

The Exchange also represents that the Reporting Authority will disseminate for each series of Index Fund Shares an estimate, updated every 15 seconds, of the value of a share of each series. The Commission believes that the information the Exchange proposes to have disseminated will provide investors with timely and useful information concerning the value of each series.

The Commission also notes that certain concerns are raised when a broker-dealer is involved in both the development and maintenance of a stock index upon which products such as Index Fund Shares are based. The proposed requires that, in such circumstances, the broker dealer must have procedures in place to prevent the misuse of material, non-public information regarding changes and adjustments to the index, and that the index value be calculated by a third party who is not a broker-dealer. The Commission believes that these requirements should help address concerns raised by a broker-dealer's involvement in the management of such an index.

In its proposed generic listing standards, the BSE represents that it will rely upon its existing surveillance procedures for supervision of trading in Index Fund Shares listed or traded pursuant to Rule 19b-4(e). The Commission believes that these surveillance procedures are adequate to address concerns associated with listing and trading Index Fund Shares, including those listed or traded under the generic standards. Accordingly, the Commission believes that the rules governing the trading of such securities provide adequate safeguards to prevent manipulative acts and practices and to protect investors and the public interest, consistent with Section 6(b)(5) of the Act.<sup>26</sup> The Commission further notes that the Exchange has represented that it will file Form 19b-4(e) with the Commission within five business days of commencement of trading a series under the generic standards, and will

comply with all Rule 19b-4(e) recordkeeping requirements.

The BSE has stated that it intends to trade SPDRs and iShares MSCI<sup>27</sup> pursuant to UTP once this proposal has been approved. The Commission believes that the Exchange's proposal to trade these series to Index Fund Shares could produce added benefits to investors through the increased competition between other market centers trading the product. Specifically, the Commission believes that by increasing the availability of SPDRs and iShares MSCI as an investment tool, the BSE's proposal should help provide investors with increased flexibility in satisfying their investment needs, by allowing them to purchase and sell a single security replicating the performance of a broad portfolio of stocks at negotiated prices throughout the business day.

The Commission finds good cause for approving the proposed rule change (SR-BSE-00-05) prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that the trading requirements of Index Fund Shares at the BSE will be substantially similar to the trading requirements of Index Fund Shares at the Amex, Index Portfolio Shares at the Chicago Board Options Exchange, and Investment Company Units at the Chicago Stock Exchange, which the Commission approved in the past.<sup>28</sup> The Commission also observes that the proposed rule change concerns issues that previously have been the subject of a full comment period pursuant to Section 19(b) of the Act.<sup>29</sup> The Commission does not believe that the proposed rule change raises novel regulatory issues that were not addressed in the previous filings. Accordingly, the Commission finds that there is good cause, consistent with Section 6(b)(5) of the Act,<sup>30</sup> to approve the proposal on an accelerated basis.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> that the proposed rule change (SR-BSE-00-05), as amended, is hereby approved on an accelerated basis.

<sup>27</sup> See *supra* note 5.

<sup>28</sup> See *supra* note 5.

<sup>29</sup> 15 U.S.C. 78s(b).

<sup>30</sup> 15 U.S.C. 78f(b)(6).

<sup>31</sup> 15 U.S.C. 78s(b)(2).

<sup>25</sup> 15 U.S.C. 78f(b)(5).

<sup>26</sup> 15 U.S.C. 78f(b)(5).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>32</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 00-17148 Filed 7-6-00; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42985; File No. SR-CHX-00-19]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to Execution of Odd-Lot Limit Orders for Nasdaq/NM Securities

June 27, 2000.

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 hereby is given that on June 9, 2000, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") 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 Exchange. 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 Article XXXI, Rule 9 of the Exchange's rules relating to execution of odd-lot limit orders for Nasdaq/NM Securities. The text of the proposed rule change is as follows. New text is *italicized*.

#### Article XXXI

\* \* \* \* \*

#### Rule 9. Execution of Odd-Lot Orders

(a)-(b) No change in text.

(c)(i-iii) No change in text.

(c)(iv) Buy Limit Orders. Buy limit orders in *Dual Trading System* issues shall be executed at the limit price only after there has been a full lot transaction in the primary market at a price at or below the limit price. *A buy limit order in Nasdaq/NM Securities shall be executed at the limit price, on a share-for-share basis, based on the first to occur of (A) a reported full round lot transaction in any marketplace at a price at or below the limit price, or (B) odd lot transactions on the Exchange at a price at or below the limit price, provided however, that (1) if an odd lot or round lot transaction on*

*the Exchange would cause an execution of a portion of the next odd-lot limit order in the specialist's limit order book, the entire next odd-lot limit order shall be executed; (2) an incoming round lot limit order will only cause execution of a "resting" round lot order (i.e., a round lot order in the specialist's limit order book) if the size of the incoming limit order is greater than or equal to the size of the resting round lot order plus the aggregate size of any odd lot orders that were executed at the limit price; and (3) if the auto-execution threshold is set at 0, odd lot orders shall continue to execute automatically in accordance with the foregoing but round lot orders shall be treated manually in accordance with Article XX, Rule 43(d).*

(c)(v) Sell Limit Orders, Marked "Long." Sell limit orders in *Dual Trading System* issues marked "long" shall be executed at the limit price, only after there has been a full lot transaction in the primary market at a price at or above the limit price. *A sell limit order in Nasdaq/NM Securities marked "long" shall be executed at the limit price, on a share-for-share basis, based on the first to occur of (A) a reported full round lot transaction in any marketplace at a price at or above the limit price, or (B) odd lot transactions on the Exchange at a price at or above the limit price, provided, however, that (1) if an odd lot or round lot transaction on the Exchange would cause an execution of a portion of the next odd-lot limit order in the specialist's book, the entire next odd-lot limit order shall be executed; (2) an incoming round lot limit order will only cause execution of a "resting" round lot order (i.e., a round lot order in the specialist's limit order book) if the size of the incoming limit order is greater than or equal to the size of the resting round lot order plus the aggregate size of any odd lot orders that were executed at the limit price; and (3) if the auto-execution threshold is set at 0, odd lot orders shall continue to execute automatically in accordance with the foregoing but round lot orders shall be treated manually in accordance with Article XX, Rule 43(d),*

#### 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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received regarding 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 proposes to amend Article XXXI, Rule 9 of the Exchange's rules relating to execution of odd-lot limit orders for Nasdaq/NM Securities. The proposed rule change is intended to place the Exchange's rules in line with existing market pattern and practice relating to the trading of Nasdaq/NM Securities, by reflecting certain distinctions between transactions in Nasdaq/NM Securities and transactions in Dual Trading system securities, i.e., listed issues.

Under the Exchange's current version of Article XXXI, Rule 9, which governs execution of odd-lot limit orders, execution of an odd-lot limit order is conditioned on a full round-lot execution in the primary market. Because a primary market trigger is only available in the case of Dual Trading System securities (for which the New York Stock Exchange generally serves as the primary market), the Exchange proposes a rule change providing that in the case of Nasdaq/NM Securities, automatic execution of odd-lot limit orders would be triggered by the first to occur of a reported full round-lot transaction in any marketplace or an odd-lot transaction on the Exchange. The proposed rule change also contemplates that a round-lot limit order in a specialist's book would only be triggered if an incoming order is of sufficient size to "take out" the entire resting round lot.

The Exchange believes that the net effect of this rule change will be to dramatically increase the number of odd-lot limit orders for Nasdaq/NM securities that are executed on the Exchange. The Exchange contends that this enhancement will be to the benefit of the Exchange's order-sending firms and their investors.

##### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b)<sup>3</sup> of the Act in general and furthers the objectives of Section 6(b)(5) of the Act in particular,<sup>4</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and, in

<sup>32</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.

<sup>3</sup> 15 U.S.C. 78f(b).

<sup>4</sup> 15 U.S.C. 78f(b)(5).