

CBOE may approve for listing warrants on established foreign and domestic market indexes. The Commission previously has approved the listing and trading on the CBOE of certain foreign index warrants based on the FT-SE 100 Index,¹⁰ the FT-SE Eurotrack 200 Index,¹¹ and the CAC-40 Index,¹² all listed in accordance with Rule 31.5(E).

The CBOE represents that the Index warrant issues will conform to the index warrant listing guidelines contained in Rule 31.5(E). Specifically, the listing guidelines of the CBOE will require that (1) the issuer thereof shall have assets in excess of \$100,000,000 and otherwise substantially exceed the size and earnings requirements of CBOE Rule 31.5(A);¹³ (2) the term of warrants shall be for a period ranging from one to five years from the date of issuance; and (3) the minimum public distribution of such issues shall be 1,000,000 warrants, together with a minimum of 400 public holders, and a minimum aggregate market value of \$4,000,000. The CBOE has proposed applying the same margin treatment as it requires for CBOE-listed options to the purchase of Index warrants.¹⁴

The CBOE also proposes that Nikkei 300 Index warrants will be direct obligations of their issuer, subject to cash settlement in U.S. dollars, and either exercisable throughout their life (*i.e.*, American style) or exercisable only on their expiration date (*i.e.*, European style). Upon exercise, or at the warrant expiration date (if not exercisable prior to such date), the holder of a warrant structured as a "put" would receive payment in U.S. dollars to the extent that the Index has declined below a pre-stated cash settlement value. Conversely, holders of a warrant structured as a "call" would, upon exercise or at expiration, receive payment in U.S. dollars to the extent that the Index has increased above the pre-stated cash settlement value. If "out-

protection and margin requirements for stock index warrants, currency index warrants and currency warrants. As proposed, these standards will apply only to warrants issued after the new framework goes into effect.

¹⁰ See Securities Exchange Act Release No. 28627 (November 19, 1990), 55 FR 49357 (November 27, 1990) (File No. SR-CBOE-90-17).

¹¹ See Securities Exchange Act Release No. 30462 (March 11, 1992), 57 FR 9290 (March 17, 1992) (File No. SR-CBOE-91-13).

¹² See Securities Exchange Act Release No. 28587 (October 30, 1990), 55 FR 46595 (November 5, 1990) (File No. SR-CBOE-90-16).

¹³ Rule 31.5(A) requires the issuer to have net worth of at least \$4,000,000 and pre-tax income of at least \$750,000 in its last fiscal year, or in two of its last three fiscal years and net income of \$400,000.

¹⁴ See Amendment No. 1, *supra*, note 3.

of-the-money" at the time of expiration, the warrants would expire worthless.

Because warrants are derivative in nature and closely resemble index options, the CBOE has proposed safeguards that are designed to meet the investor protection concerns raised by the trading of index options. First, the Exchange represents that it will require that Index warrants only be sold to investors whose accounts have been approved for options trading pursuant to CBOE Rule 9.7.¹⁵ Second, pursuant to CBOE Rule 30.50, Interpretation .02, the Exchange's options suitability standards contained in Rule 9.9 shall apply to recommendations in Index warrants. Third, pursuant to Rule 30.50, Interpretation .04 and Rule 9.10(a), discretionary orders in Index warrants must be approved and initialled on the day entered by a Senior Registered Options Principal or a Registered Options Principal. Finally, the CBOE, prior to commencement of trading in Index warrants, will distribute a circular to its membership to call attention to certain compliance responsibilities when handling transactions in Index warrants.¹⁶

D. Surveillance

The Exchange will use the same surveillance procedures currently utilized for each of the Exchange's other index warrants to monitor trading in Index warrants.

III. Commission Findings and Conclusions

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, the requirements of Section 6(b)(5) of the Act.¹⁷ Specifically, the Commission finds that the trading of warrants based on the Nikkei 300 Index will serve to protect investors, promote the public interest, and help to remove impediments to a free and open securities market by providing investors with a means to hedge exposure to market risk associated with the Japanese equity market and provide a surrogate instrument for trading in the Japanese securities market.¹⁸ The trading of

¹⁵ See Amendment No. 1, *supra*, note 3.

¹⁶ See Amendment No. 1, *supra*, note 3.

¹⁷ 15 U.S.C. 78f(b)(5) (1988).

¹⁸ Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new securities product upon a finding that the introduction of such product is in the public interest. Such a finding would be difficult with respect to a warrant that served no hedging or other economic function, because any benefits that might

warrants based on the Nikkei 300 Index should provide investors with a valuable hedging vehicle that should reflect accurately the overall movement of the Japanese equity market.

In addition, the Commission believes, for the reasons discussed below, that the CBOE has adequately addressed issues related to customer protection, index design, surveillance, and market impact of Nikkei 300 Index warrants.

A. Customer Protection

Due to the derivative nature of index warrants, the Commission believes that Nikkei 300 Index warrants should only be sold to investors capable of evaluating and bearing the risks associated with trading in such instruments and that adequate risk disclosure be made to investors. In this regard, the Commission notes that the rules and procedures of the Exchange that address the special concerns attendant to the secondary market trading of index warrants will be applicable to the Nikkei 300 Index warrants. In particular, by imposing the special suitability, account approval, disclosure, and compliance requirements noted above, the CBOE has adequately addressed potential public customer problems that could arise from the derivative nature of Nikkei 300 Index warrants. Moreover, the CBOE will distribute a circular to its members identifying the specific risks associated with warrants on the Nikkei 300 Index.¹⁹ Pursuant to the CBOE's listing guidelines, only substantial companies capable of meeting their warrant obligations will be eligible to issue Nikkei 300 Index warrants.

B. Index Design and Structure

The Commission finds, as it did in approving Nikkei 300 Index options, that it is appropriate and consistent with the Act to classify the Index as a broad-based index. Specifically, the Commission believes the Index is broad-based because it reflects a substantial segment of the Japanese equity market, and, among other things, contains a large number of stocks that trade in that market. First, the Index consists of 300 actively-traded stocks traded on the first section of the TSE, representing 36 different industry groups in Japan. Second, the market capitalizations of the stocks comprising the Index are very

be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns.

¹⁹ The CBOE has agreed to submit a draft of the circular to the Commission staff for approval prior to distribution. See Amendment No. 1, *supra*, note 3.