

the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communication 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 provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room in Washington, DC. Copies of such filing will also be available for inspection and copying at EMCC's principal office. All submissions should refer to File No. SR-EMCC-00-01 and should be submitted by January 3, 2001.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>3</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43679; File No. SR-NYSE-00-46]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the New York Stock Exchange, Inc. Regarding the Listing and Trading of Exchange Traded Funds

December 5, 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 November 21, 2000, the New York Stock Exchange, Inc. ("NYSE" 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 December 5, 2000.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change,

as amended, from interested persons and to approve the proposal, as amended, on an accelerated basis.

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

The Exchange is amending certain rules and adopting other rules relative to listing and trading of investment company units ("ICUs"), also known as exchange traded funds. The text of the proposed rule change is available at the Office of the Secretary, the Exchange or 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 Exchange 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 and is set forth in Sections A, B, and C below.

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

###### 1. Purpose

The Exchange has rules in Section 703.16, Investment Company Units, of the Listed Company Manual ("LCM") related to the listing of ICUs.<sup>4</sup> Subsequent to the adoption of those rules, the Commission determined to allow the adoption of "generic" listing standards that permit listing and trading of new derivative products pursuant to Rule 19b-4(e) under the Act.<sup>5</sup> The Exchange is proposing to amend its listing standards in Section 703.16 of the LCM to adopt generic standards to permit the trading of ICUs pursuant to Rule 19b-4(e).

The Exchange's proposed generic listing criteria are intended to ensure that a substantial portion of the weight of an index or portfolio underlying an ICU is composed of securities with substantial market capitalization and trading volume. Under the proposal, the Exchange may approve a series of ICUs

for listing or trading pursuant to Rule 19b-4(e) under the following criteria. Upon the initial listing of a series of ICUs, component stocks accounting for at least 90% of the weight of the underlying index or portfolio 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.

Under the Exchange's proposed generic listing standard, the most heavily weighted component stock 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, and 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).

To comply with generic listing standards, the Exchange proposed that the underlying index or portfolio must 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 must erect a "fire-wall" around the personnel who have access to information concerning changes and adjustments to the index or portfolio, and the index must be calculated by a third party who is not a broker-dealer.

The proposed generic listing standards specify that the current index value must be disseminated every 15 seconds over the consolidated tape, as well as an estimate of the net asset value per share of the ICU. A minimum of 100,000 shares of an ICU must be outstanding at the time trading begins. The minimum trading variation for an ICU will be  $\frac{1}{16}$ ,  $\frac{1}{32}$  or  $\frac{1}{64}$  of \$1.00, as determined by the Exchange for a specific series. The Exchange will shortly move to decimals, after which the minimum trading variation for an ICU is expected to be the same as for other stocks generally on the Exchange, which is one penny.

The Exchange will implement written surveillance procedures for the ICUs that it trades pursuant to the generic listing standards. In addition, the Exchange will comply with the record-keeping requirements of Rule 19b-4(e), and will file Form 19b-4(e) for each ICU within five business days of commencement of trading.

<sup>3</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> In Amendment No. 1, the Exchange made several technical corrections to the rule text and clarified that the Exchange will issue a circular to members highlighting the characteristics of purchases in ICUs, prior to the commencement of trading in ICUs. See Letter to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission from James E. Buck, Corporate Secretary, NYSE dated December 5, 2000 (received by facsimile) ("Amendment No. 1").

<sup>4</sup> See Securities Exchange Act Release No. 36923 (March 5, 1996), 61 FR 10410 (March 13, 1996).

<sup>5</sup> 17 CFR 240.19b-4(e). Rule 19b-4(e) permits self-regulatory organizations ("SROs") to list and trade new derivatives products that comply with existing SRO trading rules, procedures, surveillance programs and listing standards, without submitting a proposed rule change under Section 19(b). See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).

Outside of the proposed generic listing standards, the rules will specify that a fund will be required to have such number of units outstanding on listing as determined by the Exchange in connection with the specific fund. ICUs will also be permitted to be in book-entry-only format, without certificates, to bring them in line not only with ICUs listed on other marketplaces, but with ordinary open-end mutual funds as well.

In addition to the proposed generic rules, the Exemption is proposing other ICU rules under proposed NYSE Rule 1100. A discreet section in the rulebook will centralize certain ICU-related rules and provide cross references to other related rules. Under proposed NYSE Rule 1100, specific limitations of liability are provided to protect the Exchange, index proprietors, calculators and vendors. The proposed rules also state that there are no express or implied warranties with respect to ICUs. These provisions are based on similar provisions already contained in the rules of the Exchange regarding other similar activities, such as those that were enacted a number of years ago in connection with Exchange trading in standardized options and Exchange Stock Baskets.<sup>6</sup>

Furthermore, prior to the commencement of trading in ICUs, the Exchange will issue a circular to members highlighting the characteristics of purchases in ICUs.<sup>7</sup> The circular will discuss the special characteristics and risks of trading this type of security. Specifically, the circular, among other issues, will discuss what ICUs are, how they are created and redeemed, the requirement that members and member firms deliver a prospectus to investors purchasing ICUs prior to or concurrently with the confirmation of a transaction, applicable Exchange Rules, dissemination information, trading information, and the applicability of suitability rules.<sup>8</sup>

The Exchange also will require its members to provide all purchasers of newly issued ICUs with a prospectus. For those ICUs that will be in continuous distribution, the prospectus delivery requirements of the Securities Act of 1993<sup>9</sup> applies to all investors in ICUs, including secondary market purchases on the Exchange in ICUs.

With respect to series of ICUs that are the subject of an order by the Commission exempting such series from certain prospectus delivery

requirements under section 24(d) of the Investment Company Act of 1940,<sup>10</sup> the proposal provides that the Exchange will inform members and member organizations regarding disclosure obligations with respect to a particular series of ICUs by means of an Information Circular prior to commencement of trading in such series.

The proposal provides that the Exchange will require that members and members organizations provide to all purchasers of a series of ICUs a written description of the terms and characteristics of such securities, in a form prepared or approved by the Exchange, 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 ICUs 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 ICUs as an investment vehicle must include a statement in substantially the following form: "A circular describing the terms and characteristics of [the series of Investment Company Units] has been prepared or approved by the New York Stock Exchange and is available from your broker or the Exchange. It is recommended that you obtain and review such circular before purchasing [the series of Investment Company Units]. In addition, upon request you may obtain from your broker a prospectus for [the series of Investment Company Units]."

A member or member organizations 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 ICUs 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 ICUs.

The Exchange also proposes to retain the authority to prescribe trading hours that extend until 4:15 p.m. for particular ICUs. This will be done in all probability only for those ICUs that are based on indexes that are also the subject of a futures contract. In those

cases the Exchange believes it is appropriate to match the trading hours of the related futures contract.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6 of the act<sup>11</sup> in general and furthers the objectives of section 6(b)(5) of the Act<sup>12</sup> in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, 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.

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

The Exchange has neither solicited nor received written comments on the proposed rule change.

## 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 NW., Washington, DC 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 persons, 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 in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the above-mentioned self-regulatory organization. All submissions should refer to File No.

<sup>6</sup> See NYSE Rule 702(b) and Rule 814.

<sup>7</sup> See *supra* note 3.

<sup>8</sup> *Id.*

<sup>9</sup> 15 U.S.C. 77a, *et seq.*

<sup>10</sup> 15 U.S.C. 80a-24(d).

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

SR-NYSE-00-46 and should be submitted by January 3, 2001.

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

After careful consideration, the Commission finds that the proposed rule change, as amended, 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) of the Act.<sup>13</sup> The Commission believes that the Exchange's proposal to amend its rules relative to the listing and trading of ICUs will provide investors with a convenient and efficient way of participating in the securities markets. The Exchange's proposal should also provide investors with increased flexibility in satisfying their investment needs by allowing them to purchase and sell a single security, at negotiated prices throughout the business day that replicates the performance of an index or a portfolio of stocks. In addition, the Commission finds that the Exchange's proposal to establish generic standards to permit the trading of ICUs 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.<sup>14</sup> Accordingly, as discussed below, 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>15</sup>

In general, ICUs represent an interest in a registered investment company that could be organized as a unit investment trust, an open-end management investment company, or similar entity.

ICUs represent interests in a registered investment company that typically holds security which comprise or are otherwise based on or represent an investment in an index or portfolio. Each ICU is intended to provide investors with an instrument that closely tracks the underlying securities index or portfolio, that trades like a share of common stock, and that pays holders a periodic cash payment proportionate to the dividends paid, on the underlying portfolio of securities, less certain expenses, as described in the applicable prospectus. As noted above, the Commission has previously approved NYSE Section 703.16, Investment Company Units, of the LCM that permit the listing and trading of ICUs.<sup>16</sup> In approving these securities for trading, the Commission considered the structure of these securities, their usefulness to investors and to the markets, and the NYSE rules that govern their trading.

The Commission previously concluded that ICUs trading under the existing Exchange rules 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>17</sup> The Commission believes, for the reasons set forth below, that the product classes that satisfy the proposed additional listing standards and the proposed generic listing standards for ICUs, in proposed NYSE Rule 1100 and Section 703.16 of the LCM, should produce the same benefits to investors.

The Commission notes that certain concerns are raised when a broker-dealer is involved in both the development and maintenance of a stock index upon which an ICU is based. The proposal 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.

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 ICUs. ICUs listed under the generic standards will be subject to a prospectus delivery requirement or, for series that have been granted relief from the prospectus delivery requirements of the Investment Company Act of 1940,<sup>18</sup> a product description delivery requirement. The requirement extends to a member or member organization carrying an omnibus account for a non-member broker-dealer, who must notify the non-member to make the product description available to its customers on the same terms as are directly applicable to members and member organizations. Finally, a member or member organization must deliver a prospectus to a customer upon request.

The Commission also notes that upon the initial listing, or trading of ICUs, the Exchange will issue a circular to its members explaining the unique characteristics and risks of this particular type of security. The circular also will note the Exchange members' prospectus or product description delivery requirements, and highlight the characteristics of purchases of ICUs. The circular also will inform members of their responsibilities under the Exchange's rules in connection with customer transactions in these securities. The Commission believes that these requirements ensure adequate disclosure to investor about the terms and characteristics of a particular series and is consistent with section 6(b)(5) of the Act.<sup>19</sup>

The proposal also provides that the Exchange can prescribe that the trading hours for a particular ICU extend until 4:15 p.m.; ICUs be entered in book-entry-only format; and the Exchange can determine the number of units required to be outstanding on listing a specific ICU. The Commission believes each of these requirements afford investors flexibility in satisfying their investment needs in purchasing and selling ICUs, while providing for a fair and orderly market. Further, the proposal would establish certain limitations related to liability and warranties. The Commission believes that such provisions are reasonable and foster cooperation and coordination in facilitating transactions in securities.

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 Act, the SRO's trading rules, procedures and listing standards for the product class

<sup>13</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>14</sup> 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.

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

<sup>16</sup> See *supra* note 4.

<sup>17</sup> See *supra* note 4.

<sup>18</sup> 15 U.S.C. 80a-1, *et seq.*

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

that include the new derivative securities product and the SRO has a surveillance program for the product class.<sup>20</sup> The Commission believes that the NYSE' proposal contains adequate rules and procedures to govern the trading of ICUs under Rule 19b-4(e).

All series of ICUs listed under the generic standards will be subject to the full panoply of NYSE rules and procedures that now govern the trading of existing ICUs on the Exchange. In addition, the Exchange has established that upon initial listing, component stocks that in the aggregate account for at least 90% of the weight of the index or portfolio must have a minimum market value of at least \$75 million. Further the component stocks in the index must 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. 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. The index or portfolio must include a minimum of 13 stocks, and all securities in an underlying index or portfolio must be listed on a national securities exchange or the Nasdaq Stock Market.

Moreover, any series seeking to list under the generic standards must meet these eligibility criteria as of the date of the initial deposit of securities and cash into the trust or fund. The Commission believes that these criteria should serve to ensure that the underlying securities of these indexes and portfolios are well capitalized and actively traded, which will help to ensure that U.S. securities markets are not adversely affected by the listing and trading of new series of ICUs under Rule 19b-4(e). These listing criteria also will make certain that new ICUs do not contain features that are likely to impact adversely the U.S. securities markets.

In addition, the Exchange has developed specific listing criteria for ICUs 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 ICUs are 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.

In addition, as previously noted, all series of ICUs listed or traded under the generic standards will be subject to the Exchange's existing continuing listing criteria under Section 703.16 of the LCM. This requirement allows the Exchange to consider the suspension of trading and the delisting of a series if an event occurs that makes further dealings in such securities inadvisable. The Commission believes that this will give the Exchange flexibility to delist ICUs if circumstances warrant such action.

Furthermore, the Commission finds that the Exchange's proposal to trade ICUs in minimum fractional increments of  $\frac{1}{16}$ ,  $\frac{1}{32}$ , or  $\frac{1}{64}$  of \$1.00 is consistent with the Act. The Commission believes that such trading should enhance market liquidity, and should promote more accurate pricing, tighter quotations, and reduced price fluctuations, all of which benefit the investor. The Commission also believes that such trading should allow customers to receive the best possible execution of their transactions in ICUs, thereby protecting customers and the public interest consistent with section 6(b)(5) of the Act.<sup>21</sup>

The Exchange represents that the current underlying index value as well as an estimate of the value per share of the ICU will be disseminated over the consolidated tape every 15 seconds. 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 Exchange has developed surveillance procedures for the ICUs listed under the generic standards that incorporate and rely upon existing surveillance procedures governing ICUs and equities. The Commission believes that these surveillance procedures are adequate to address concerns associated with listing and trading ICUs under the generic standards. The Exchange further represents 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) record keeping requirements. 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>22</sup>

The Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register** pursuant to section 19(b)(2) of the Act. The Commission notes that the proposed rule change is based on the listing standards of several other exchanges, which the Commission previously approved after soliciting public comment on the proposals pursuant to section 19(b) of the Act.<sup>23</sup> The Commission does not believe that the proposed rule change raises novel regulatory issues that were not addressed in the other filings. Accordingly, the Commission believes it is appropriate to permit investors to benefit from the flexibility afforded by these new instruments by trading them as soon as possible. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act,<sup>24</sup> to approve the proposal, as amended, on an accelerated basis.

## V. Conclusion

*It is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>25</sup> that the proposed rule change (SR-NYSE-00-46), is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>26</sup>

**Margaret H. McFarland**

*Deputy Secretary*

[FR Doc. 00-31679 Filed 12-11-00; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43664; File No. SR-NYSE-00-50]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the New York Stock Exchange, Inc., To Revise Its Fee Schedule for Equity Transaction Fees

December 4, 2000.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

<sup>22</sup> 15 U.S.C. 78f(b)(5).

<sup>23</sup> See e.g., Securities Exchange Act Release No. 42787 (May 15, 2000), 65 FR 33598 (May 24, 2000) (approval of American Stock Exchange generic listing standards).

<sup>24</sup> 15 U.S.C. 78s(b)(5).

<sup>25</sup> 15 U.S.C. 78s(b)(2).

<sup>26</sup> 17 CFR 200.30-3(a)(12).

<sup>20</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).

<sup>21</sup> 15 U.S.C. 78f(b)(5).