

exchange¹² and (ii) require that trading in security futures products not be readily susceptible to manipulation of the price of such products or of the underlying securities or options on such securities.¹³

a. OneChicago Listing Standards

According to OneChicago, Commission staff published SLB 15, including the Sample Listing Standards (which were derived from typical listing standards used by exchanges trading options based on securities or security indices), to provide guidance as to how an exchange can comply with the foregoing requirements, but noted that different listing standards could also be consistent with the Act.

OneChicago believes that the Sample Listing Standards, as modified by the order relating to shares of exchange-traded funds, trust-issued receipts and shares of registered closed-end management investment companies,¹⁴ constitute a useful and appropriate model to be used in developing initial listing and maintenance standards for security futures products. The OneChicago Listing Standards therefore generally follow the Sample Listing Standards (as so modified), subject to the additional modifications relating to physically settled futures based on NBIs described under Item I. above. The additional modifications are (i) a function of OneChicago's providing for physical settlement of futures contracts based on NBIs, and accordingly, are limited in application to such physically settled contracts, and (ii) designed to enhance the usefulness and effectiveness of futures on NBIs in connection with hedging, arbitrage and other investment strategies.

Unlike options on security indices currently listed on national securities exchanges, all NBI futures to be listed on OneChicago are expected to be physically settled. OneChicago believes that physical settlement will effectively reduce the basis risk related to trading in these products and lead to tighter bid-ask spreads, thereby limiting the potential for market manipulation. OneChicago believes that its decision in favor of physical settlement therefore furthers the statutory objective of avoiding price manipulation of security futures products and their underlying securities.¹⁵ Physical settlement, however, makes it impracticable to have NBIs consisting of component securities in increments that are smaller than 100

shares or receipts, which corresponds to customary increments for transactions in the markets for those securities. For this reason, rounding is a necessary step in the initial index composition and any subsequent rebalancing.

If the composition of NBIs were subject to frequent or retroactive changes as a result of index rebalancings, OneChicago believes that NBI futures would lose their potential as particularly useful and effective tools in the implementation of hedging, arbitrage and other investment strategies.

The Sample Listing Standards contemplate at least quarterly rebalancings of equal dollar-weighted indices. The OneChicago Listing Standards modify this requirement by providing that an approximately equal dollar-weighted NBI underlying a physically settled security futures product is to be rebalanced annually, but only if the aggregate value of the security position with the highest value is two or more times greater than the aggregate value of the security position with the lowest value in the index for a specified time period. OneChicago believes that this test adequately balances the potential adverse consequences of too frequent changes in the composition of any NBI with the objective that an NBI should be, and remain, representative of the industry segment to which it relates. OneChicago will have the ability to rebalance any NBI on an interim basis should this become necessary as a result of exceptional changes in the relative values of the component securities. As OneChicago plans to list only contracts expiring on the next two quarterly expiration dates (based on the quarterly cycle of March, June, September and December) and the nearest two serial monthly expiration dates that are not quarterly expiration dates, OneChicago will be able to phase in contracts based on a rebalanced NBI, and thereby replace contracts with open interest based on the previous NBI composition, within a short period of time.

OneChicago believes it is critical, however, that investors with open positions in contracts based on a particular NBI be able to rely on the number of shares or receipts evidencing each component security remaining unchanged for purposes of those contracts. Accordingly, the OneChicago Listing Standards clarify that outstanding contracts will not be affected by any rebalancing.

Unlike the Sample Listing Standards (and the listing standards for options on which they are based), exchange rules and other requirements applicable to a

variety of financial instruments based on "narrowly-based" security indices or baskets contemplate modifications to a pure equal dollar-weighted composition methodology and/or do not require automatic periodic rebalancings. For example, OneChicago believes that the rules of the American Stock Exchange ("Amex") for portfolio depositary receipts¹⁶ and index fund shares¹⁷ expressly permit a "modified equal-dollar weighting methodology" and do not appear to provide for rebalancing. Similarly, no rebalancing is required for the component securities represented by any series of trust-issued receipts traded on Amex.¹⁸ Further, OneChicago notes that the offering documents for the "Holding Company Depositary Receipts (HOLDRS)" developed by Merrill Lynch & Co., Inc., another exchange-listed instrument designed to enable investors to indirectly gain exposure to equity securities of multiple issuers through a single investment, specify that the underlying trust assets will not change during the (indefinite) term of the trust unless one of several narrowly defined "reconstitution events" occurs. In this connection, OneChicago notes that single-security futures based on at least some of the aforementioned instruments are permissible under the relief granted by the Commission and the CFTC¹⁹ with respect to shares of exchange-traded funds, trust-issued receipts and shares of registered closed-end management investment companies.

The contents of the OneChicago Listing Standards, including the approximately equal dollar-weighting methodology described above, will be publicly available and fully disclosed. Finally, OneChicago believes that it is also worth noting that, despite the differences between the OneChicago Listing Standards and the Sample Listing Standards, hypothetical indices following one or the other methodology have been shown to be highly correlated.

b. Section 6(h)(3) Requirements

Section 6(h)(3) of the Act²⁰ contains detailed requirements for listing standards and conditions for trading applicable to security futures products. Set forth below is a summary of each such requirement or condition, followed by a brief explanation of how OneChicago will comply with it,

¹⁶ See Amex Rule 1000, in particular Commentary .03 thereto.

¹⁷ See Amex Rule 1000A, in particular Commentary .02 thereto.

¹⁸ See Amex Rule 1202, in particular Commentary .01 thereto.

¹⁹ See *supra* note 7.

²⁰ 15 U.S.C. 78f(h)(3).

¹² 15 U.S.C. 78f(h)(3)(C).

¹³ 15 U.S.C. 78f(h)(3)(H).

¹⁴ See *supra* note 7.

¹⁵ See 15 U.S.C. 78f(h)(3)(H).