

HB210

HOUSE COMMITTEE REPORT

(11)

Date Referred: May 9, 1991

FURTHER REFERRALS:

Date of Committee Action: 5/13/91

The FINANCE Committee considered:

HB 210

HOUSE BILL NO. 210

REGISTRATION OF SECURITIES

"An Act amending the Alaska Securities Act of 1959 to allow fees related to registration to be established by regulation, to provide for registration, examination, and other procedures that avoid duplication, and to provide for exemption from registration for certain securities."

RECOMMENDATIONS:

the same title

be replaced with _____

a new title

have attached amendments(s)

do pass

do not pass

no recommendations

individual recommendations

additional referral to the _____ Committee

ADOPTS: _____ letter of Intent

ATTACHES NEW FISCAL NOTE(S): (Dept)

APPROVES PREVIOUS: (Dept/Date)

fiscal impact _____

fiscal note(s) DCED 3/11/91

zero fiscal note _____

zero fiscal note(s) _____

SIGNING DO PASS	DP	OTHER RECOMMENDATIONS	DNP	NR	AM
EP McLean <i>MacLean</i>	<input checked="" type="checkbox"/>	Tamara Baines <i>Baines</i>		X	
Mike Favare <i>NAVARRE</i>	<input checked="" type="checkbox"/>	Best Shog <i>SHOG</i>		L	
Taylor Brown <i>BROWN</i>	<input checked="" type="checkbox"/>	A. Ulmer <i>Ulmer</i>		X	
Mark Suter <i>Suter</i>	<input checked="" type="checkbox"/>				
Phillips <i>Phillips</i>	<input checked="" type="checkbox"/>				
Lanson <i>Lanson</i>	<input checked="" type="checkbox"/>				

NAVARRE *EP McLean*
 Mike Favare
 CO-CHAIRMAN'S SIGNATURE

FISCAL NOTE

No. 1
 Bill Version: HB 210
 (H) Publish Date: 3/11/91

STATE OF ALASKA
 1991 LEGISLATIVE SESSION

Revision Date: _____ Department Affected: Commerce & Economic Dev.
 Title: Amend the Alaska Securities Act of 1959 BRU: Banking, Securities & Corporations
 Component: Banking & Securities
 Sponsor: Rules Committee
 Requestor: Governor

COMPONENT SERIAL NO.	1	2	3	3
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Expenditures/Revenues: (Thousands of Dollars)

OPERATING	FY 92	FY 93	FY 94	FY 95	FY 96	FY 97
PERSONAL SERVICES						
TRAVEL						
CONTRACTUAL						
SUPPLIES						
EQUIPMENT						
LAND & STRUCTURES						
GRANTS, CLAIMS						
MISCELLANEOUS						
TOTAL OPERATING	0	0	0	0	0	0

CAPITAL	0	0	0	0	0	0
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REVENUE	400.0	500.0	500.0	550.0	550.0	550.0
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FUNDING: (Thousands of Dollars)

GENERAL FUND						
FEDERAL FUNDS						
OTHER						
TOTAL	0	0	0	0	0	0

POSITIONS:

FULL-TIME	0	0	0	0	0	0
PART-TIME						
TEMPORARY						

Estimate of current year impact: _____

ANALYSIS: (Attach a separate page if necessary.)

Prepared By: Willis F. Kirkpatrick, Director Phone: 465-2521
 Division: Banking, Securities & Corporations Date: 2/20/91
 Approved by Commissioner: Glenn A. Olds
 Agency: Department of Commerce & Economic Development Date: 2/20/91

Distribution (by preparer): Legislative Finance, Legislative Sponsor, Requestor, OMB, & Impacted Agency(ies).

HOUSE BILL NO. 210

IN THE LEGISLATURE OF THE STATE OF ALASKA

SEVENTEENTH LEGISLATURE - FIRST SESSION

BY THE HOUSE RULES COMMITTEE BY REQUEST OF THE GOVERNOR

Introduced: 3/11/91

Referred: Labor & Commerce, Judiciary, Finance

A BILL

FOR AN ACT ENTITLED

1 "An Act amending the Alaska Securities Act of 1959 to allow fees related to registration
 2 to be established by regulation, to provide for registration, examination, and other
 3 procedures that avoid duplication, and to provide for exemption from registration for
 4 certain securities."

5 BE IT ENACTED BY THE LEGISLATURE OF THE STATE OF ALASKA:

6 * Section 1. AS 45.55.040(c) is amended to read:

7 (c) Every broker-dealer, [APPLICANT FOR INITIAL REGISTRATION SHALL PAY
 8 A REGISTRATION FEE OF \$125. EVERY] agent, [APPLICANT] and investment adviser
 9 applicant for initial registration shall pay a registration fee established by the department by
 10 regulation [OF \$50]. Every broker-dealer, [APPLICANT FOR ANNUAL RENEWAL OF
 11 REGISTRATION SHALL PAY AN ANNUAL RENEWAL FEE OF \$75. EVERY] agent,
 12 [APPLICANT] and investment adviser applicant for annual renewal of registration shall pay an
 13 annual renewal fee established by the department by regulation [OF \$30].

14 * Sec. 2. AS 45.55.040(d) is amended to read:

1 (d) A registered broker-dealer or investment adviser may file an application for
2 registration of a successor, whether or not the successor is then in existence, for the unexpired
3 portion of the year. A broker-dealer may file a request to transfer from a previous broker-dealer
4 an agent's unexpired portion of the registration if the provisions of AS 45.55.030(b) have been
5 met. The [THERE IS A] filing fee [OF \$10] for filing applications under this subsection shall
6 be established by the department by regulation.

7 * Sec. 3. AS 45.55.040 is amended by adding a new subsection to read:

8 (g) The administrator may permit initial and renewal registration filings required under
9 this chapter to be filed with the Securities and Exchange Commission, the National Association
10 of Securities Dealers or other similar authorities. The administrator may accept uniform
11 securities examinations or other procedures designed to implement a uniform national securities
12 regulatory system or facilitate common practices and procedures among the states.

13 * Sec. 4. AS 45.55.110(b) is amended to read:

14 (b) Every person filing a registration statement shall pay a filing fee [OF \$50] and a
15 registration fee in amounts established by the department by regulation [OF ONE-TENTH
16 OF ONE PER CENT OF THE MAXIMUM AGGREGATE OFFERING PRICE AT WHICH
17 THE REGISTERED SECURITIES ARE TO BE OFFERED IN THIS STATE, BUT THE
18 REGISTRATION FEE SHALL IN NO CASE BE LESS THAN \$50 OR MORE THAN \$1,500].
19 When a registration statement is withdrawn before the effective date or a pre-effective stop order
20 is entered under AS 45.55.120, the administrator shall retain the [\$50] filing fee.

21 * Sec. 5. AS 45.55.140(a)(10) is amended to read:

22 (10) a security listed or approved for listing upon notice of issuance on the New
23 York Stock Exchange, the American Stock Exchange, the Midwest Stock Exchange, [OR] the
24 Pacific Coast Stock Exchange, the Chicago Board Options Exchange, or any other securities
25 exchange designated by order of the administrator, or any security designated or approved
26 for designation upon notice of issuance as a national market system security on the National
27 Association of Securities Dealers Automated Quotation National Market System or on any
28 other quotation system designated by order of the administrator, or any other security of the
29 same issuer which is of senior or substantially equal rank; a security called for by subscription
30 rights or warrants so listed or approved; or a warrant or right to purchase or subscribe to any of
31 the foregoing;

1 * Sec. 6. AS 45.55.140(f) is amended to read:

2 (f) The administrator shall by regulation prescribe a schedule of fees for the application
3 for or the examination or investigation of a claimed exemption.



Nancy L. Nielsen
Assistant Corporate Secretary

LaSalle at Van Buren
Chicago, Illinois 60606 312 786-7468

May 10, 1991

Federal Express

Representative Mike Navarre
Co-Chairman
House Finance Committee
State Capitol
P.O. Box V
Juneau, AK 99811-0101

Re: House Bill 210

Dear Representative Navarre:

We understand House Bill 210 was reported out of the Judiciary Committee on May 8th and that a Finance Committee hearing may be scheduled early next week. In connection with the hearing, we thought you might be interested in the enclosed report of the Ad Hoc Marketplace Committee of the North American Securities Administrators Association (NASAA). The Committee conducted a due diligence study of the Chicago Board Options Exchange, the results of which are summarized in the report. As noted in Nancy Crossman's letter of April 26th, the Report, which recommended that the states accord CBOE a marketplace exemption, was delivered at the April NASAA Conference.

We respectfully request that you and your colleagues favorably report this bill. If you have any questions, please call me at (312) 786-7466.

Sincerely,

A handwritten signature in cursive script that reads 'Nancy L. Nielsen'.

Nancy L. Nielsen
Assistant Corporate Secretary

Enclosures

cc: Lawrence P. Carroll

January 1991

SUMMARY OF CBOE REGULATORY AND LEGAL FUNCTIONS

The following memoranda provide profiles of the regulatory, legal and enforcement programs of the Chicago Board Options Exchange ("Exchange" or "CBOE"), primarily as these programs relate to the disciplinary process.

REGULATORY STRUCTURE

The Exchange is a self-regulatory organization ("SRO"), subject to the oversight authority of the Securities and Exchange Commission ("SEC"). The Exchange is responsible to enforce compliance by its members with SEC rules, provisions of the Securities Exchange Act of 1934 (the "Act"), Federal Reserve Board credit requirements, and the rules of the Exchange. The Regulatory Services Division, which is separate from the Legal Division, performs the surveillance, examination and investigative functions of the self-regulatory process. The Division also plays a vital role in the development of new, and the modification of existing, rules and policies to ensure reasonable and effective regulation of the options markets.

When it is the Division's belief that probable cause exists for determining that a violation of Exchange or other relevant rules has occurred, the Division presents a written case to the Business Conduct Committee ("BCC"), along with a recommendation that a Statement of Charges, or some lesser action, be authorized by the BCC. Should the BCC authorize Charges, the Division supports the efforts of the Legal Division's Office of Enforcement in its settlement negotiations, and generally acts as the expert witness for the Enforcement staff in a hearing.

Both the Regulatory Services Division and the Office of Enforcement are subject to routine inspections by the SEC's Division of Market Regulation, which oversees Exchange effectiveness as an SRO. The SEC staff review and comment upon the procedures used in the regulatory and enforcement process, as well as the results of cases brought before the BCC.

There are four departments in the Regulatory Services Division. The breakdown of the regulatory areas, by function and personnel is as follows:

REGULATORY SERVICES DIVISION - DEPARTMENT OF FINANCIAL COMPLIANCE

The Department of Financial Compliance is responsible for enforcing the financial, margin, books and records requirements of the SEC, Federal Reserve Board and the Exchange, with respect to those broker-dealers for which CBOE is the designated examining authority ("DEA"). This is accomplished through financial monitoring, routine examinations and special investigations.

The financial monitoring program includes a daily net capital computation for clearing members, to insure that the net capital is sufficient to meet SEC and Exchange minimum requirements. The Department also monitors deficit market maker accounts to determine that appropriate notification has been received or liquidation is proceeding. The Department reviews on a monthly basis, the financial statements and net capital computations (the FOCUS Report) submitted by members subject to the SEC net capital rule. Additionally, the Department reviews the haircut methodologies used by member firms and monitors the risk analysis procedures of market maker clearing firms.

The Department conducts routine annual examinations which focus on the following areas: net capital, status of the books and records, customer protection, margin, financial reporting, proprietary trading, risk control and operational efficiency. Additional inspections are performed if problems arise at a particular firm. The Department conducts joint examinations with the NYSE and cooperates with the CME and CBOT in their exam programs. The Department also conducts exams on a contract basis for other SRO's which have no examining authority.

The Department works with staff members of the SEC and Federal Reserve Board to interpret and develop financial regulations and to seek relief where appropriate. Interpretive advice is provided to members and non-members on a regular basis.

The Department provides input to the Exchange's Clearing Procedures Committee and provides support for the administration of the Business Conduct Committee. It also participates in the Securities Industry Association's Net Capital Committee and Credit Division, and the Intermarket Financial Surveillance Group, which includes all U.S. securities and commodities exchanges.

REGULATORY SERVICES DIVISION - DEPARTMENT OF COMPLIANCE

The Department of Compliance is responsible for monitoring adherence to sales practice rules by member firms and their associated persons. The Department's main tasks in enforcing the sales practice rules (set forth in Chapter 9 of the Exchange's rules) are as follows:

Ensure sales practice compliance by conducting periodic examinations of main and branch offices of member firms for whom CBOE is the Designated Options Examining Authority ("DOEA"). CBOE is one of four authorized DOEA's.

Participate in the Options Self-Regulatory Council, to allocate sales practice regulatory responsibilities among self-regulatory organizations, and to insure uniform sales practice rules.

Conduct sales practice investigations of member firms and persons associated with member firms, including investigations initiated by complaints, matters discovered during examinations, referrals, and notifications of terminations and claims (i.e., U-5, RE-3 notifications). Major areas of concern are unsuitable recommendations, inappropriate risk disclosure, unauthorized trading, improper use of discretion, excessive trading, lack of supervision.

Ensure compliance with rules relating to options communications, including sales literature, advertising, and option "program" descriptions. The function includes the review of sales literature as well as providing informal guidance to member firms and their associated persons.

Participate in development of appropriate examinations to assure minimum level of competency of registered representatives, including development and maintenance of examination Series 4, 5, 7, 8, 15.

Provide informal interpretive advice to member firms on rules compliance, including assistance in devising appropriate supervisory structures and compliance with Exchange rules and provisions of the Act.

REGULATORY SERVICES DIVISION - DEPARTMENT OF MARKET SURVEILLANCE

The purpose of the Department of Market Surveillance is to detect virtually all types of trading-related violations, both on and off the floor, including improper activity involving related market places. Major areas of effort are discussed below.

Stock and option activity are compared and evaluated to detect stock\option manipulation, notably capping, pegging and manipulation, as well as to detect possible front-running. Trading of index options, index futures and stock program trades are monitored to detect potential manipulation or misuse of non-public information.

Trading-floor related abuses which are monitored include, but are not limited to, pre-arranged trading, abuse of error accounts, marking, failure to adhere to market-maker obligations, market-makers entering orders from off-floor, book executions of firm and market-maker orders, dual representation of orders/market-maker in

crowd while floor broker representing order, joint account participants trading with the joint accounts, and improper use of adjustments.

The Department examines significant activity in customer, firm and market-maker accounts prior to important news announcements in order to detect possible insider trading. As most such suspicious activity occurs in customer accounts, such activity is generally referred to the SEC for further review.

Most types of potential violations are referred to the Department of Market Regulation for formal investigation. However, the Department has complete responsibility for detection and presentation to the Committee of position limit, exercise limit, and index exercise advice violations. In addition, the department spearheaded development, and is responsible for administration, of a recently adopted summary fine program for failure to record accurate times of trades or failure to submit trades to price reporting. The Department will present egregious and recidivist violations to the Committee.

In addition to its violation-detection role, The Department provides staff support to the Exemption Committee, administers the customer index hedge exemption program, and helps administer registration of joint accounts, including RAES group accounts. Furthermore, the Department, along with the Systems Division, continues to develop new computer applications to increase efficiency and effectiveness.

The Department also provides the Exchange representation to the Intermarket Surveillance Group.

REGULATORY SERVICES DIVISION - DEPARTMENT OF MARKET REGULATION

The Department of Market Regulation investigates all regulatory complaints and referrals relating to possible violations of rules concerning conduct of business on the trading floor including the following: complaints and/or referrals from individual members, member firms, customers, the SEC, other self-regulatory organizations, Exchange employees and floor officials.

Complaints and referrals are investigated by the use, as appropriate, of document review, interviews of witnesses, and analysis of data.

The primary areas of concern are noted above in the discussion of market surveillance functions concerning trading floor related abuses.

The Department also performs the following functions:

Provides informal rule interpretations to members, the public and Exchange staff.

Acts as primary support to the Equity Floor Procedure and Floor Officials Committees.

Prepares educational materials concerning rules which are used to introduce new rules and interpret existing rules.

Prepares tests and study guide materials for the New Member Orientation Program.

LEGAL AND MEMBERSHIP DIVISION

Counsel to the Business Conduct Committee is provided by the Legal and Enforcement Departments. The Legal Division, which is headed by the General Counsel, is divided into four departments which perform the following functions.

1. Corporate

General

- Provides legal counsel regarding corporate matters. Includes drafting or reviewing contracts and agreements. Advising on new products, procedures and policies with emphasis on overcoming legal obstacles and avoiding placing the Exchange at risk of litigation.

Regulatory

- Formulates, drafts and files rule changes with SEC. Issues regulatory bulletin and oversees circulars distributed to membership. Monitors and comments on applications and rule changes proposed by other exchanges. Advises and assists other departments regarding interpretations of rules and other matters.

Committees

- Provides general support including attendance at meetings and advising on proposed actions.

Stock List

- Processes and approves listing applications. Interprets equity rules. Seeks to obtain exchange exemptions from state securities commissioners.

Appeals and

Litigation

- Represents Exchange committees or other bodies at appeals hearings and represents the Exchange in arbitration matters. Engages and works with outside counsel on litigation matters.

2. Enforcement

General

- Prepares statements of charges authorized by Business Conduct Committee and handles all such cases to their conclusion. Includes negotiating with all respondents, preparing settlement offers, and representing the Exchange at hearings and on appeal.

Prepares summaries of completed cases for dissemination.

3. Arbitration and Appeals - Administers Exchange's arbitration facility which is available to members, member firms, associated persons, and public customers. Determines whether matters qualify for arbitration, selects arbitration panels, and prepares written decisions. Performs similar functions for appeals of Exchange actions by members or member organizations.
4. Membership
General - Handles applications for membership, changes in status, and other matters. Administers the seat sale market and operates the Members Library.
- Office of
Secretary - Records minutes of board and executive meetings and carries out other duties of the Secretary of the Exchange.

MEMORANDUM

TO: NASAA Board of Directors
NASAA Members

FROM: Ad Hoc Marketplace Committee

DATE: March 8, 1991

RE: CBOE Exemption Request

In April, 1990, the Chicago Board Options Exchange ("CBOE") began contacting state administrators to request that it be treated as an exempt marketplace for purposes of the "exchange exemption." Subsequently, the NASAA Board established the Ad Hoc Marketplace Exemption Committee and directed it to review the request for an exemption for CBOE-listed securities, to make recommendations to the states with respect to that request, and to determine the appropriateness of entering into the Memorandum of Understanding Regarding a Model Marketplace Exemption with the CBOE. This document sets forth the findings and recommendations of the committee.

CRITERIA FOR MARKETPLACE EXEMPTIONS

In dealing with the CBOE request, the committee quickly recognized that in light of initiatives in other United States marketplaces and the globalization of the markets, it was necessary to consider the matter of marketplace exemptions from a broader perspective. Accordingly, the committee determined that its first task should be to establish criteria to apply to any marketplace seeking an exemption from state registration requirements.

The committee initially focused on the MOU which NASAA entered into with the NASD. That document essentially contains quantitative and qualitative listing criteria for issuers, plus a commitment to cooperate and share information. The Committee perceived this to be an excellent starting point, but has since developed additional minimum standards which deal with other aspects of a marketplace's operation.

As a result of the process briefly described above, the committee formulated the following four-part test which it believes a marketplace should be required to meet to qualify for a marketplace exemption:

1. Listing criteria. The marketplace should be willing to execute a Memorandum of Understanding with NASAA, which contains listing criteria at least as high as those included in the MOU which NASAA executed with the NASD.

2. Products. Except for products which are subject to listing criteria in the MOU, the marketplace should only include products which are not of significant regulatory concern from a corporate finance perspective.

3. Customer protection. The marketplace should provide an adequate level of customer protection. This would include mechanisms for handling customer complaints, reviewing sales practices, and implementing disciplinary measures for violations. Rules and institutional mechanisms should be in place to protect customers from sales and trading abuses.

4. Surveillance. The marketplace should provide for minimum levels of surveillance. This standard will be deemed to have been met if Securities and Exchange Commission oversight exists, and there is satisfactory compliance with SEC standards. The Committee does not propose, at this time, that NASAA make an independent analysis of the surveillance systems of a marketplace, but rather that it review SEC concerns and compliance.

EVALUATION OF CBOE

In order to apply these criteria to CBOE, as required by its charge, the committee took a number of steps. First, Susan Bryant and Craig Goettsch visited the CBOE headquarters on November 29, 1990. In the course of that visit, they toured the floor of the exchange and met some of its officers, its legal counsel, and key members of its Regulatory Services Division. The visiting committee members subsequently delivered a report of their observations to the full committee. Second, the committee received considerable written information from CBOE concerning its operations and procedures, as well as the products it intends to list. Indeed, much of the discussion in this memorandum of the more technical aspects of the CBOE's operation is taken from the information provided by the exchange. Third, the committee reviewed an SEC examination report on CBOE procedures.

With respect to the committee's evaluation of CBOE, it is important to note the Committee's expertise is in state corporate finance matters. Monitoring the operation of securities marketplaces is not a traditional state function, a fact which the committee does not propose to change. Similarly, state regulators generally have limited involvement with certain types of products which CBOE intends to list. Thus, to some extent, the recommendations set forth in this memorandum rest on the existence of SEC oversight and on the belief that some of the more exotic products to be listed on CBOE are not likely to involve individual investors in general, and small investors in particular.

The format for the rest of this memorandum will be as follows. There will be a brief background discussion of CBOE, to be followed by a section outlining the current status, in terms of state registration requirements, of the exchange and the options which trade there. After that, CBOE will be analyzed against each of the standards set forth above, namely: listing criteria, products, customer protection, and surveillance. Finally, the memorandum will summarize the committee's conclusions and set forth its recommendations.

CBOE - BACKGROUND

CBOE is a national securities exchange registered as such under the Securities Exchange Act of 1934 and regulated by the SEC. CBOE was created in 1973 by members of the Chicago Board of Trade, but it has always been an entity wholly independent of the Board of Trade. Prior to 1973, the only available stock options were non-standardized, unregistered options guaranteed by individual brokerage firms and traded "over-the-counter." CBOE introduced trading in options with standardized terms that are issued and guaranteed by a registered clearing agency and registered and regulated under the federal securities laws. Today standardized options are traded on five national securities exchanges including the New York Stock Exchange and the American Stock Exchange.

In 1980, CBOE acquired the Midwest Stock Exchange's options business. CBOE now lists options on over 200 widely-traded stocks. During 1990, over 60 percent of all U.S. listed securities options trading took place at CBOE. CBOE also developed options on broad-based stock indexes, a major innovation in the securities markets. The first such index, now known as the Standard and Poor's 100 Index (ticker symbol OEX), was introduced on March 11, 1983. OEX has become the most active index product on the market, trading an average of over 275,000 contracts per day during fiscal 1990. CBOE also trades options on the Standard and Poor's 500 Index (SPX), the index that many U.S. money managers use as a benchmark for portfolio performance. During 1990, trading in these two indexes at CBOE represented more than 91 percent of the total U.S. index option market.

Due to increased volume in the early 1980s, CBOE outgrew its original trading facilities and in 1984 moved into its own building which it had designed and built. Trading takes place in a 45,000 square foot space (the world's largest exchange trading floor) with another floor of the same size in reserve. CBOE also appears to be well-capitalized. Total members' equity at June 30, 1990 stood at \$58,070,000, with a working capital of almost \$35,000,000.

CURRENT STATUS

CBOE is currently exempt as a marketplace in 21 states pursuant to statute or rule. Only a few states would need a statutory amendment to provide for an exemption for CBOE.

The standardized options currently listed on CBOE, like standardized options listed on the four other national securities exchanges that trade options, are issued by The Options Clearing Corporation ("OCC"), a clearing agency registered under the Securities Exchange Act of 1934. OCC-issued options are currently registered in Alabama, Maryland, Ohio and Virginia. In the remaining jurisdictions, options are sold in reliance upon one or more exemptions from registration.

In 21 states, CBOE is an approved exchange and options traded thereon are accordingly exempt under the exchange exemption. The exchange exemption is also applicable to OCC-issued options traded on CBOE in most states where CBOE is not currently a recognized exchange. This is so because the typical exchange exemption applies to "any security listed or approved for listing upon notice of issuance on [certain approved exchanges, which always include NYSE and AMEX]; any other security of the same issuer which is of senior or substantially equal rank." OCC-issued options listed on CBOE are of equal rank with other OCC-issued options that are listed on NYSE and AMEX. Accordingly, CBOE-listed options are exempt under the "equal rank" provision of the exemption.

The RUSA option exemption or some other form of option exemption is applicable to OCC-listed options in states having such an exemption; and OCC-issued options listed on CBOE are generally eligible for the "blue chip" exemption in states having a "blue chip" exemption. Unique exemptions or special exemptive orders are applicable in three states.

LISTING CRITERIA

At the time that CBOE initiated its current effort to expand the number of states in which CBOE is recognized under the exchange exemption, CBOE had just filed with the SEC proposed rule changes that would permit CBOE to list common stocks and other securities in addition to standardized options. The listing criteria for stocks and other securities were substantially identical to the corresponding criteria of AMEX. CBOE has indicated that it originally patterned its listing criteria after AMEX in part because it was aware that AMEX is an approved exchange in virtually every state and therefore thought that AMEX criteria were acceptable to state securities administrators.

Largely in response to subsequent comments and concerns expressed by state administrators, CBOE amended its proposed standards to: (i) insure that CBOE standards would be at least equal to those of the NASDAQ/NMS in every respect and (ii) make clear that CBOE's listing criteria are strict minimum standards and not simply "guidelines." As originally filed, CBOE's listing criteria were referred to as "guidelines" which "will be considered in evaluating listing eligibility together with all other pertinent data." The final rules approved by the SEC state that "the Exchange has established certain numerical and other criteria (Rules 31.9 through 31.36), which issuers will be required to meet." CBOE's listing criteria for each type of security that it proposes to list are attached as Appendix 1 to this report.

CBOE has informed us that it has never waived or made exceptions to its criteria for the listing of options and that it has no committee for the purpose of considering such exceptions. CBOE has also said that it does not intend to make exceptions to its criteria for the listing of other securities and that, as noted above, its rules would not permit it to do so.

CBOE's listing standards also require delisting if the minimum maintenance criteria are not met. Delisting proceedings would be initiated promptly and would take about 20 days.

CBOE has agreed to enter into a Memorandum of Understanding ("MOU") with NASAA substantially identical to the MOU between NASAA and the NASD except that CBOE has agreed to an additional condition, which is described below, relating to new products. NASAA's purpose would be to "lock in" minimum uniform listing criteria for a marketplace exemption.

CBOE PRODUCTS

CBOE currently lists only standardized put and call options. It has also obtained unlisted trading privileges in 500 stocks listed on NYSE, AMEX and NASDAQ/NMS for the purpose of trading in "baskets" comprised of such stocks, although trading in such baskets has been discontinued. CBOE is the only options exchange that does not also trade stocks and other securities. CBOE has accordingly adopted listing standards for equity securities and certain other securities referred to below. CBOE cannot predict what proportion of its trading activity will be represented by any of the specific types of securities because that will depend upon its success in attracting issuers. CBOE has stressed that the availability of the exchange exemption for its listed securities is an important factor in attracting issuers. Its principal competitors, NYSE and AMEX, are able to offer exempt status in nearly every state.

CBOE's new listing standards, which were approved by the SEC in October of 1990, cover common stock, preferred stock, debt securities, stock warrants and currency and index warrants. Listing standards covering certain unit investment trusts are pending SEC approval. Listing standards covering "other securities" were approved by the SEC in November, 1990. The "other securities" category corresponds to identical rules of NYSE and AMEX and is intended to cover "hybrid" securities having characteristics of more than one of the other categories of securities. The numerical listing criteria for "other securities" are generally higher than for equity securities and are similar to, and in some respects higher than, the standards applicable to index warrants. Although the rule gives the exchange some flexibility in listing securities with unique combinations of features, the SEC made clear in its approval order that "the listing of securities that raise significant new regulatory issues would require a separate filing with the Commission." At the request of the Committee, CBOE has agreed to furnish to NASAA and/or the states a copy of all its SEC filings seeking to list new products, and this agreement will be set forth in the MOU.

Common Stocks. The exchange has prepared and printed a listing application and related informational materials to be distributed to prospective listed companies. CBOE has sent out four such packets to date. CBOE anticipates that the most likely source for stock listings would be Midwestern companies.

Hybrid Debt Securities. CBOE currently expects to approve an application to list zero-coupon S&P 500-Linked Notes that meet its listing criteria for bonds and debentures as well as the stricter criteria for "other securities." The securities are repayable at the option of the holder after 6 months at a repurchase price linked to the S&P 500 Index. At maturity, the issuer is obligated to redeem the notes at the greater of their par value or the index-linked repurchase price. These notes are intended to provide the holder a potential participation in any appreciation of the S&P 500 index over a five year period. These securities are an example of the hybrid securities intended to be covered by CBOE's "other securities" category. In general, hybrid securities allow the investor to obtain in a single transaction risk and reward characteristics that would otherwise be obtainable only by the purchase or sale of a combination of traditional securities.

Index Warrants. CBOE anticipates that among the first securities that it expects to list under its new listing criteria will be warrants. The Exchange is preparing to begin trading in various domestic and foreign stock index warrants. The Exchange has filed for, or obtained, SEC approval to trade warrants on the following stock indexes:

Compagnie des Agents de Change (CAC 40)
Deutscher Aktien Index (DAX)
Financial Times - Stock Exchange (FT-SE 100)
Standard and Poors 100 (S & P 100)
Standard and Poors 500 (S & P 500)

Index warrants are securities based on the movement in a stock market index. Warrant holders are entitled to receive an amount of cash determined by the difference between the current value of the index at the time the warrant is exercised and the fixed exercise price of the warrant. There has been much recent growth in the trading of index warrants. Warrants on several foreign indexes are now listed on AMEX, and NYSE has also proposed to list index warrants. AMEX-listed warrants are also traded on other exchanges pursuant to unlisted trading privileges, and CBOE itself has been trading one such warrant on a UTP basis since January in order to test its systems. CBOE believes that it is in a good position to attract listings of index warrants because of their similarity to standardized options. CBOE believes that these warrants have the characteristics of options, and will require that investors in index warrants meet the same suitability requirements applicable to options customers. Risk disclosure and suitability requirements similar to those applicable to options trading are also being required by the SEC, and approval to trade warrants on domestic indexes will not be granted until the risk disclosure procedures have been approved.

CBOE's listing standards for index warrants are the same as those of the AMEX and are actually higher than the listing standards for issuers of common stock. They require that: (1) the issuer shall have assets in excess of \$100,000,000 and otherwise substantially exceed the Exchange's size and earnings requirements; (2) the term of the 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 have an aggregate market value of \$4,000,000.

Index warrants have been issued primarily by sovereign governments such as the Kingdom of Denmark and the Republic of Austria, and by investment banking firms such as Saloman, Paine Webber, and Merrill Lynch. Other entities could issue index warrants so long as they meet CBOE's listing standards.

Unit Investment Trusts. CBOE also has proposed listing standards for unit investment trusts. CBOE has indicated to the committee that these standards are intended primarily to permit the listing of "Super Shares", a product which they have been developing for some time. Super Shares are securities consisting of four components that may be traded separately: Appreciation Super Shares, which provide leveraged participation in market advances; Priority Super Shares, which provide additional income in flat or declining markets; Protection Super Shares, which provide protection for a stock portfolio in a market decline of up to 30 percent; and Income and Residual Super Shares which provide additional income in flat or rising markets. Super Shares are intended to allow sophisticated investors to separate (and to retain or dispose of) specific elements of the risk and return characteristics of a portfolio of stocks that replicates the S&P 500. Applications to register Super Shares have been filed in many states, and they are still under review at the SEC.

CBOE has emphasized that its listing standards for unit investment trusts are intended to provide only for the listing of Super Shares and perhaps other innovative products of a generally similar nature. CBOE has emphasized that it does not intend to list traditional unit investment trusts of the type that are now registered in large numbers in many jurisdictions.

It should be noted that innovative products such as index warrants and unit investment trusts are not only subject to the disclosure requirements under the Securities Act of 1933, but they are also subject to substantive review by the SEC under the Securities Exchange Act of 1934. The products are intended for sophisticated investors with specific investment objectives, and they will be subject to the same suitability requirements that apply to trading in standardized options. CBOE's listing standards for these products are the same as those of the AMEX and require the issuer to meet financial requirements that are generally higher than the requirements applicable to issuers of common stocks. CBOE believes that there is demand for innovative products and that it is a preferred marketplace for such instruments. CBOE also believes, however, that potential issuers of these securities as well as issuers of stock and debt securities will likely list on NYSE or AMEX if

listing on CBOE involves the expense and potential delay of numerous state registrations when the securities would be exempt if listed on those exchanges.

TRADING SYSTEMS AND CUSTOMER PROTECTION

Most option classes listed at CBOE are traded in an open outcry system where certain members of the Exchange may trade as market-makers. Market-makers provide liquidity in option trading by risking their own capital for personal trading, and are the backbone of CBOE's trading system. They take the opposite side of public orders by competing in an open outcry auction market. Floor brokers, on the other hand, act only as agents, executing orders for others. "Dual trading," which refers to a member simultaneously trading for his own account and for customers, is prohibited at the CBOE in that a market-maker may not also act as a floor broker in the same or a related class of options on the same business day.

Although institutional participation has increased in recent years, the principal users of the securities options markets are retail customers. CBOE's rules provide special protections for the transactions of those customers. For example, CBOE recently developed the RAES system, which provides for computerized and automatic execution of smaller customer orders on a priority basis. RAES acts much like the NASD's SOES system. The Retail Automatic Execution System (RAES) automatically executes 10-contracts or less customer market orders and marketable limit orders at the prevailing market quote in the most active series. RAES provides retail customers with a guaranteed firm quote, instantaneous turnaround time to the originating branch office, and reduces member firms' execution, fill reporting and trade match costs. It makes CBOE's price reporting more timely and efficient while facilitating an accurate time and sales audit trail. RAES executes one in five customer orders at CBOE.

Another development took effect in July, 1989, when the SEC approved a CBOE rule filing which codified the "Firm Quote" program, a policy which had been in effect since June, 1988. Under this rule, which applies only to non-broker/dealer orders for options which expire in the two near-term trading months, the trading crowd (made up of "market-makers") is required (except during trading rotations and fast markets) to fill at least 10 contracts of a customer order at the posted bid or offer when the order reaches the crowd. In conjunction with the firm quote rule, CBOE instituted rule changes that narrowed the bid/ask spreads that are allowed under normal market conditions. Additionally, public customer limit orders that are not close to the current market quote are routed to the "public limit order" book. The public limit order book is available only to public customers at CBOE. Market orders that arrive prior to the opening and limit orders are the only types of orders accepted in the book and have priority over all other similar orders from the trading crowd at a given price. Exchange-employed order book officials execute the orders in the book and are prohibited from trading for their own account. The book's highest bid, lowest offer and the size of those orders

are displayed to market-makers on the trading floor. Orders on the book are executed on a first-in/first-out basis at each price, regardless of the order's size.

CBOE has informed us that during the "mini crash" of October, 1989 CBOE honored all orders on the public customer order book at the opening prices even though the large number of orders placed on the book at the opening could not be sorted and effected at the opening in an orderly manner. In so doing, CBOE incurred a loss of over \$2.5 million from assigning opening prices to such orders as if they had been effected at the opening prices when in fact the orders had to be executed in the rising market after the opening. CBOE has continued to automate its systems by expanding the use of the electronic order book in order to avoid another such loss in the future.

SEC OVERSIGHT

Prior to our visit, the Committee reviewed the most recent SEC inspection report of CBOE surveillance and the response of CBOE to that inspection. The SEC had raised two areas of critical concern. Firstly, they asked whether the implementation of the CBOE's Comprehensive Automated Surveillance System, termed The Market Surveillance Systems ("MSS"), was on track. Management of CBOE reported to us that the MSS is on track with all three areas mentioned by the SEC after their November, 1988 inspection being completed within time lines promised by the CBOE. "Front running" was completed in December of 1989; "Mini-manipulation" and "capping and pegging" were operational in March and May of 1990 respectively, and it is expected that MSS will be operational for index options surveillance by May of 1991.

The second SEC concern pertained to audit trails. CBOE has responded to this concern by adopting a new rule providing for summary fines. On page three of their response letter to the SEC there is a chart of these fines. There has also been a recidivism provision added to this system to escalate fines for repeat offenders. A rule was adopted in December, 1989 which imposes a fine if fewer than 70% of a trader's reported times are accurate. Another provision of the rule imposes a \$1000 fine if fewer than 50% of a trader's OEX trades are reported with the required degree of accuracy. More stringent parameters are being added for all classes of options. From September 21st to October 20th, 69 people were fined pursuant to this rule. From October 21st to November 20th, only 27 people were fined. CBOE has more recently received a letter from the SEC which says they are doing well, but could continue to improve. The letter was not pursuant to an audit but was limited to a review of accuracy rates. CBOE has filed rules requiring that the percentage of mistakes go down from 30 percent to 25 percent. They later cut that figure to 20 percent.

SURVEILLANCE AND REGULATION

The Regulatory Services Division of CBOE consists of 89 people. A current summary of the structure and functions of the Regulatory Services Division was provided to us by the exchange and is attached as Appendix 2.

CBOE's Department of Compliance investigates sales practice violations and terminations. The most frequent complaints involve suitability or unauthorized use of discretion. The exchange receives approximately 30 notifications of termination per month, of which about 10% involve customer complaints. Complaints of sales practice abuses are responded to immediately in writing. The customer is advised that the complaint is under review and that the exchange cannot award compensation to customers, although the exchange's arbitration facilities are available to customers seeking to recover losses. Sales practice cases average 7 to 12 months from the beginning of the investigation before going to the Business Conduct Committee.

CBOE is an active participant in the Options Self Regulatory Council. Other participants in the Council include representatives of the American Stock Exchange, Midwest Stock Exchange, National Association of Securities Dealers, New York Stock Exchange, Philadelphia Stock Exchange and Pacific Stock Exchange. The Council facilitates an equitable distribution of regulatory responsibilities for all aspects of the sales practices of organizations that are members of more than one exchange or the NASD. The Council also acts as a forum for the development, revision or interpretation of rules and regulations in an effort to ensure consistent enforcement of such rules and regulations. The council coordinates yearly examinations and investigations of such matters as terminations for cause and customer complaints. For such purposes, each firm is assigned to one of four Designated Options Examining Authorities (CBOE, AMEX, NASD, or NYSE) and it is reassigned every two years. Routine examinations are performed primarily at the firm's main office, extending to the branch office level on an "as needed" basis. Routine examinations include such matters as supervision of branch offices by the main office, account approvals, and suitability of trading.

The exchange's Department of Market Regulation investigates possible violations of exchange and SEC rules governing business conduct on the trading floor, supports exchange committees which deal with floor policies to insure compliance with the rules, and educates the exchange membership and the public regarding trading floor rules and policies. At February 12, 1991 the total number of open investigations was 164. The average number of customer complaints received per month during 1990 was 10. As in the case of sales practice violations, customers are sent an acknowledgment letter immediately upon receipt of the complaint advising them of the exchange's procedures. Customer complaints in which the staff determines there is no apparent rule violation are generally closed within two weeks of receipt. Cases in which the staff believes that there may be a rule violation take an average of about 8 months before they are reviewed by the Business Conduct Committee. The SEC's August 23, 1989 inspection letter states: "The 1988 inspection found that, overall, the CBOE surveillance, investigatory and disciplinary programs for trading abuses continue to function effectively."

The exchange's Business Conduct Committee is similar to that of the NASD. This committee determines, based on staff investigations and recommendations, when probable cause exists to bring charges of rule violations, authorizes charges against members, and either settles or holds hearings with regard to those violations. For sales practice violations it

can take up to a maximum of two years from initiation to resolution of the problems. The Business Conduct Committee has used consent procedures very successfully to expedite a resolution. A chart favorably comparing the number of actions taken and sanctions imposed by CBOE with other SROs was provided.

CBOE also participates in the Intermarket Surveillance Group ("ISG"), which is comprised of the major national securities exchanges with the major commodities exchanges and certain foreign exchanges as affiliated members. The ISG was created originally to serve as a forum to negotiate routine sharing of information between exchanges for regulatory purposes. It also serves as a forum for negotiating uniform rules and regulatory policies when appropriate. The CFTC and SEC staff also attend these meetings.

CBOE has worked actively with Florida, California and Wisconsin, as well as with NASAA, to provide training for securities department staff. CBOE is currently assisting the Colorado Securities Department in connection with a large case involving options trading by an investment advisor (over whom the CBOE had no jurisdiction). CBOE has indicated its willingness to share complaint information with the states as it is authorized under its rules to do and otherwise to cooperate with the regulatory activities of the states. It should also be noted that CBOE disciplinary decisions are reported on the CRD system on Form U-6.

CONCLUSIONS

The committee developed a four-part test to determine whether to recommend that NASAA execute an MOU with CBOE and whether states should accord the exchange a marketplace exemption. After applying that test, we are satisfied that an MOU should be executed and that the exchange should be granted the exemption.

CBOE's listing criteria match those of NASDAQ-NMS, and CBOE is more than willing to enter into an MOU and to include a notice requirement in the event it takes steps to list new products. Most of the products currently listed or planned for listing are not subject to state registration review. Moreover, those products, particularly options and index warrants, raise market regulation, rather than traditional corporate finance issues.

From a regulatory perspective, CBOE operates much like the NASD, with a business conduct committee and a separate regulatory division. Restrictions on certain types of trading practices, along with systems like the SOES, provide further consumer protection. In addition, the regulatory and surveillance systems are subject to SEC audit and oversight. Finally, CBOE welcomes visits by state administrators to examine its operations and it is prepared to cooperate with the states in handling investigations and customer complaints.

For the reasons stated above, the committee recommends that:

1. NASAA execute an MOU with CBOE; and
2. States accord CBOE a marketplace exemption

APPENDIX ONE
CBOE
LISTING CRITERIA

APPENDIX TWO
REGULATORY SERVICES DIVISION

Booklets will be provided at the Spring Conference.

May 9, 1991

National Association of
Securities Dealers, Inc.
1735 K Street, N.W.
Washington, D.C. 20006
(202) 728-8000

BY FAX

The Honorable Mike Navarre, Co-Chair
House Finance Committee
Alaska State Legislature
State Capitol
Box V
Juneau, Alaska 99811

RE: House Bill 210

Dear Representative Navarre:

On behalf of the National Association of Securities Dealers, Inc. (NASD), I am writing to urge your support of House Bill 210 to amend the Alaska Securities Act. The NASD is charged with the responsibility of regulating both the National Association of Securities Dealers Automated Quotation System (NASDAQ), which is the second largest securities market in the United States, and the over-the-counter securities markets. This task encompasses both regulation of virtually every broker/dealer firm in the country that conducts business with the public and the regulation and operation of the NASDAQ system.

The NASD strongly supports passage of HB 210 since it includes an important provision to exempt from state registration those securities that are listed on the NASDAQ National Market System (NMS). This legislation recognizes the equality of securities listed on NMS, like National Bancorp of Alaska, MCI and Apple Computer, with those listed on the New York and American Stock Exchanges. Passage of HB 210 also promotes uniformity with the 45 states that have already provided this exemption for securities listed on NMS.

We respectfully request that you schedule a hearing on HB 210 and urge you to favorably report the bill. If you have any questions, please feel free to call me at (202) 728-8289.

Sincerely,



Frank J. Formica
Vice President
Office of Congressional and
State Liaison

cc: Mr. Larry Carroll

WALTER J. HICKEL
GOVERNOR



STATE OF ALASKA
OFFICE OF THE GOVERNOR
JUNEAU

March 11, 1991

The Honorable Ben Grussendorf
Speaker of the House
P.O. Box V
Juneau, AK 99811

Dear Speaker Grussendorf:

Under the authority of art. III, sec. 18 of the Alaska Constitution, I am transmitting a bill to amend the Alaska Securities Act of 1959. The bill addresses three administrative problems.

First, the bill would change existing statutes to allow the Department of Commerce and Economic Development (department) to set securities registration-related fees by regulation. Sections 1, 2, 4, and 6. Currently, almost all registration-related fees are expressly set by statute. Because those statutes have not been updated for many years, the fees are significantly below those charged by other jurisdictions and are inadequate to pay for the services provided. The intent of the department is to set the fees by regulation at an amount consistent with that charged by other states.

Second, in an effort to reduce the amount of duplicate filings and unnecessary paperwork handled by the department, the bill provides that the administrator of securities (the director of the division of banking, securities and corporations) may arrange with the National Association of Securities Dealers or the Securities and Exchange Commission to have coordinated national filings, and may accept certain uniform registration-related procedures. Section 3.

Third, the bill provides for new exemptions from the registration requirement for securities. At present, securities listed under a number of national stock exchanges are exempt from registration. AS 45.55.140(a)(10). The bill will add to that list two other recognized exchanges, the Chicago Board Options Exchange and the National Association of Securities Dealers Automated Quotation National Market System (NASDAQ/NMS). Additionally, the administrator would have the flexibility to add to that list as conditions dictated. Most jurisdictions have a similar form of administrator exemption approval.

The Honorable Ben Grussendorf -2-

The bill updates the Alaska Securities Act to bring it in line with current practice and to permit coordination with national enforcement authorities. I urge your support of this measure.

Sincerely,

A handwritten signature in cursive script, reading "Walter J. Hickel". The signature is written in dark ink and is positioned above the typed name.

Walter J. Hickel
Governor