UNITED STATES OF AMERICA

COMMODITY FUTURES TRADING COMMISSION

2033 K Street, N.W.

Washington, D.C. 20581

December 13, 1988

Shirley E. Hollis
Assistant Secretary
Securities and Exchange Commission
450 Fifth Street NW, Rm. 6183
Washington, D.C. 20549

Dear Ms. Hollis:

The Commodity Futures Trading Commission is writing in response to your open invitation to comment on amendments to the proposed rule changes by the Philadelphia Stock Exchange, Inc. ("PHLX") to trade CIP contracts, the American Stock Exchange, Inc. ("Amex") to trade EIP contracts and the Chicago Board Options Exchange, Inc. ("CBOE") to trade VIP contracts.[1] This letter supplements our letters to the Commission on CIPs of April 28, 1988, EIPs of June 1, 1988 and VIPs of July 8, 1988.

The first amendment to the CIP proposal is to substitute the Standard & Poor's 500 Index for the PHLX Stock Market Index. The CIP contract also will be offered on the PHLX Blue Chip Index.

The second amendment to the CIP contract concerns the "cash-out" provisions. PHLX originally proposed to allow cash-outs once each quarter on the "third Friday" of March, June, September and December. The exchange now proposes to extend this feature to every business day. Holders of CIPs may choose to receive the CIP closing index value less one half of one percent of that value on any day. However, holders of CIPs electing cash-outs on the "third Fridays" of March, June, September and December will receive the full CIP index value based on the opening prices of each of the securities in the underlying CIP index on those respective "third Fridays."

The Commission is of the view that the amendments to the proposed CIP contract do not alter the economic nature of the contract; the CIP contract continues to be a cash-settled futures contract on a stock index. In this regard, the first amendment simply changes the underlying

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[1] The amendments to the CIP contract are described in proposed rule change submissions to the Securities and Exchange Commission labeled Amendments 1, 2 and 3 to File No. SR-PHLX 88-7 and a Federal Register notice (53 F.R. 40814, October 18, 1988). The amendments to the EIP contract are described in proposed rule change submissions to the SEC labeled Amendments No. 1 and 2 to File No. SR-Amex-88-10 and a Federal Register notice (53 F.R. 45407, November 9, 1988). The amendments to the VIP contract are described in a Federal Register notice (53 F.R. 45833, November 14, 1988).

stock index. Currently, cash-settled futures contracts for approximately seven different indices based on U.S. listed equities are being traded.

The second amendment concerns the cash-settlement procedures of the proposed contract. PHLX is proposing daily cash-settlement for the CIP contract. The exact cash-settlement provisions do not affect the economic nature of the contract. Most stock index futures contracts contain quarterly cash-settlement provisions, but the Chicago Board of Trade's Major Market Index futures contract lists a spot month so cash settlement is available on a monthly basis on that contract. More importantly, daily cash settlement does not convert the proposed CIP contract into a cash spot contract. As the exchange has stated, the CIP contract is not an actual purchase of stock:

> Since an investment in a CIP will not constitute an actual purchase of any of the component stocks of the underlying index, such ownership interest will not confer any voting rights or right to receive actual dividends associated with ownership of those stocks. 53 FR 10314, March 30, 1988.

The proposed CIP contract remains a futures contract on a stock index.

The first amendment to the Amex EIP contract also is to substitute the S&P 500 Index for the Amex Institutional Index originally proposed. The exchange also will offer EIPs on the Amex Major Market Index.

The second amendment to the EIP contract is to add provisions for physical delivery of the underlying stocks on the "third Friday" of March, June, September and December. The minimum "delivery unit" proposed is 50,000 EIPs per unit for the S&P 500 Index and 25,000 EIPs per unit for the Major Market Index. Amex will announce the number of shares of each stock to be delivered in satisfaction of physical delivery after the close of the market on the business day preceding the "third Friday." Partial shares of stock, stocks failing to open on Friday and stocks in the S&P 500 requiring delivery of less than 10 shares will be settled for cash. The long demanding delivery will be required to pay a fee for the privilege. The exchange also will use a "physical delivery facilitator" (initially, the specialist for each class of EIPs) to provide the securities being delivered by certain shorts and to receive compensation based on the cash-settlement value for the stocks from the shorts.

It is the Commission's opinion that these amendments do not alter the economic nature of the EIP contract; the contract remains a futures contract on a stock index. The first amendment, the change in the underlying stock index, has been discussed above. The second amendment to add provisions for physical delivery once each quarter of the year changes the EIP contract from a cash-settled future to a physical delivery future. In this regard, many futures contracts contain provisions for physical delivery and many are cash-settled. One is no less a futures contract than the other. Physical delivery and cash settlement are simply two procedures to aid convergence of cash and futures prices. Physical delivery provisions alone do not convert a futures contract into a cash spot contract. Moreover, as you are aware, Section 2(a)(1)(B) of the Commodity Exchange Act requires stock index futures contracts to provide for cash settlement.

The amendments to the CBOE VIP contract are to drop the proposed short exercise fee and to change the proposed quarterly cash-out periods to semi-annual periods. The effect of altering the timing of cash-out provisions has been discussed above. The effect of eliminating the short exercise fee does not affect the economic nature of the contract. Thus, neither amendment leads the Commission to change its position that CBOE VIP contracts are futures contracts.

Accordingly, the trading of CIPs, EIPs and VIPs may lawfully occur only on a contract market designated by this Commission. 7 USC Section 6(a). Any such designation, of course, would depend upon the exchanges' proposals meeting the relevant criteria under the Commodity Exchange Act, including the specific standards for futures on stock indices, and would be subject to the SEC's role in the designation process.

As stated in the Commission's letter of April 28, 1988, the Commission has no objection in principle to the trading of a cash market instrument that involves a market basket of securities, and the Commission continues to offer to work with the Securities and Exchange Commission and the relevant exchanges on appropriate design features of cash market instruments that would not be contrary to the Commodity Exchange Act. Alternatively, if the relevant exchanges maintain the subject contracts as presently proposed, we would appreciate an opportunity to discuss any perceived or actual regulatory disparities that may have motivated the exchanges to file the subject contracts with the Securities and Exchange Commission.

Very truly yours,

Jean A. Webb
Secretary of the Commission