



DIVISION OF
MARKET REGULATION

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

September 1, 1998

Mr. Wesley G. Nissen
Katten Muchin & Zavis
525 West Monroe Street, Suite 1600
Chicago, Illinois 60661-3693

Re: Mercato Italiano dei Derivati - IDEM Equity and Index Options

Dear Mr. Nissen:

In your letter dated August 31, 1998, on behalf of the Board of Directors (the "Board of Directors") of the Borsa Italiana S.p.A. (the "Stock Exchange"), the organization responsible for the management and surveillance of the Stock Exchange and its equity derivatives division referred to as the Mercato Italiano dei Derivati (the Italian Derivatives Market, or the "IDEM"),¹ you seek relief similar to that previously granted by the Division of Market Regulation (the "Division") to other non-U.S. exchanges.² You request advice that, based on the circumstances stated in this letter, the Division will not recommend to the Securities and Exchange Commission (the "Commission") enforcement action (1) against the Board of Directors, the Stock Exchange or the IDEM (the Stock Exchange and IDEM being referred to herein collectively as the "Exchange"), or their respective officers, directors or members under Section 5 of the Securities Exchange Act of 1934 (the "1934 Act"), by reason of the Stock Exchange and IDEM not registering under Section 6 of the 1934 Act as a national securities exchange; (2) against the Board of Directors, the Stock Exchange or IDEM members³ under Section 15 of the 1934 Act, by reason of the Stock Exchange and IDEM members not registering under the 1934 Act as broker-dealers; or (3) against the Stock Exchange or the Cassa di Compensazione e Garanzia (the Italian Futures and Options Clearing House, or the "Cassa") under Section

¹ The Stock Exchange includes, as its principal objects, the following: the stock market and all related facilities, the IDEM, the Mercato Ristretto, and other markets currently being developed.

² See, SEC No-Action Letter to the Société de Compensation des Marchés Conditionnels, available June 17, 1996; SEC No-Action Letter to the Hong Kong Futures Exchange, available September 26, 1995; SEC No-Action Letter to the London International Financial Futures Exchange, available May 1, 1992.

³ Although the two markets require different authorizations, any person authorized to trade on the Stock Exchange generally may also trade on the IDEM. In December, 1997, 93 Stock Exchange members were trading on the IDEM, of which 54 were securities firms, 25 were banks, and 14 were registered stockbrokers.

17A of the 1934 Act, by reason of their not registering under the 1934 Act as a clearing agency, if the Stock Exchange and IDEM members act as described below to familiarize certain registered broker-dealers and large financial institutions in the United States with the IDEM and the equity and index options traded on the IDEM.⁴

We understand the facts to be as follows:

Regulatory Background

The Stock Exchange was founded in 1808. The IDEM was organized in 1994 under the laws of Italy as a division of, and the equity derivatives market of, the Stock Exchange. The IDEM commenced trading operations on November 28, 1994 with the introduction of the MIB 30 Index Futures Contract.⁵ The IDEM is the sole equity derivatives exchange in Italy. Trading on the IDEM is conducted through an electronic trading system based on the Swedish OM system.⁶ Two types of options are traded on the IDEM: options on the individual stocks that are listed and traded on the Stock Exchange ("Equity Options") and options on the MIB 30 stock index⁷ ("Index Options") (Equity Options and Index Options may be referred to herein collectively as "Options").

The regulatory framework of the Exchange is governed by two laws: (1) Law 216 of June 7, 1974, which among other things, led to the establishment of the Commissione Nazionale per le Società e la Borsa (the National Commission for Companies and the Stock Exchange, or "Consob"), which sets the guidelines for corporate disclosure,⁸ and (2) Legislative Decree 415 of July 23, 1996, which established the regulation of: (a) investment services activities; (b) both European Union ("EU") and non-EU investment firms; and (c) markets and clearing and settlement of transactions on such markets.

⁴ Reference is made to five letters from Katten Muchin & Zavis to the Division dated September 19, 1997, November 24, 1997, February 19, 1998, May 19, 1998, and August 4, 1998 on behalf of the Stock Exchange. This letter supersedes and replaces the previously submitted letters.

⁵ The MIB 30 Index Futures Contract may be offered in the U.S. as permitted by the "no action letter" issued by the Commodity Futures Trading Commission on August 30, 1995.

⁶ The OM system has been implemented on several other exchanges, including options markets in Stockholm, London, Vienna and Hong Kong.

⁷ The MIB 30 stock index consists of the 30 stocks that are the most liquid and highly capitalized issues quoted on the Stock Exchange. The calculation of the index is managed and supervised by the Board of Directors.

⁸ Law 216 also introduced savings shares, requirements for prospectuses, and the certification of financial statements, and provided the guidelines for the organization and operation of stock exchanges and the admission of new listings.

Pursuant to this Legislative Decree, the Stock Exchange has been privatized and assumed many of the responsibilities previously held by Consob.⁹ As of the date of this letter, the Board of Directors is responsible for: (a) organizing and creating rules governing the markets; (b) creating and maintaining supervisory procedures to ensure proper functioning of the markets; (c) certain surveillance functions with respect to the markets (including the management of price limits for cash markets, the handling of any technical defaults in the electronic trading system which occur, and the management of procedural errors); (d) approving the types of derivative contracts to be traded and the trading methods; (e) the approval and listing of new securities; (f) the dissemination of market and listed company information; and (g) the calculation and management of all stock indices.

In addition to the supervisory activities conducted by the Stock Exchange, the Bank of Italy and Consob also exercise certain supervisory powers over investment firms and banks. Specifically, with respect to investment firms and banks, the Bank of Italy regulates: (a) capital adequacy; (b) risk management procedures; (c) permissible holdings; (d) administrative and accounting procedures; and (e) internal control mechanisms, while the Consob regulates: (a) the rules of conduct to be observed in dealings with customers, especially in terms of conflicts of interest; (b) minimum information requirements; and (c) records of orders and transactions.

The Cassa

The Cassa, an Italian joint-stock company formed on March 31, 1992, is responsible for all clearing functions. The Cassa clears all trades on the Exchange and guarantees the completion of all Option transactions. The Cassa is subject to the supervisory authority of the Consob and the Bank of Italy.¹⁰

⁹ The privatization of the Stock Exchange was achieved through the creation of a new private company, the Borsa Italiana S.p.A., whose fifteen member Board of Directors has taken over all of the duties and responsibilities previously held by the Stock Exchange Council (the organization previously responsible for the management and surveillance of the Exchange prior to its privatization). The shareholders of the Stock Exchange elect the Board of Directors and appoint both the Stock Exchange's chairman and the managing director.

The privatized Stock Exchange has come into full operation on January 2, 1998 after it received authorization to engage in business by the Consob. In granting such authorization, the Consob verified that (i) the Stock Exchange's rules were in compliance with the law of the Commission of the European Community, and (ii) such rules would promote the Stock Exchange's three objectives of supervision: transparency, orderly trading conditions and the protection of investors. Although the Exchange is now privatized, it still remains subject to the regulatory oversight of the Consob.

¹⁰ The Consob, the Bank of Italy and the Ministry of Treasury each reserve the right to attend all meetings of the Cassa's Board of Directors, and each is a member of the Stock Exchange's Board of Auditors.

Prior to trading on the IDEM, intermediary firms must become members of the Cassa ("Clearing Members").¹¹ With shareholders' equity in excess of 55 billion lire, the Cassa serves as the ultimate guarantor of all the trades it registers which are cleared between Clearing Members with respect to Options contracts available on the IDEM, and guarantees each of the Clearing Members, as necessary, full payment of deficits resulting from another Clearing Member's default. The Cassa also benefits from certain institutional procedures designed to ensure the financial security of the Italian securities industry. Although there is no formal arrangement in place, it is understood that the Bank of Italy would intervene to provide support to certain financial institutions, including the Cassa, in the event of a systematic financial crisis.

Each Clearing Member is required to deposit and maintain initial margin with the Cassa with respect to each Option for which it represents the seller (writer).¹² Initial margins consist of two components: premium margins and ordinary margins. Premium margin equals the amount necessary for the Cassa to close the position of a defaulting member by repurchasing the Options sold.¹³ Ordinary margin equals the additional cost sustained by the Cassa to repurchase the Option in a "worst case scenario."¹⁴ The initial margin with respect to each Option equals the sum of the premium margin and the ordinary margin. The Cassa requires initial margins to be posted in Italian lire, Italian government bonds, or any other instrument approved by the Cassa. In addition, the Cassa may require a Clearing Member to deposit "additional" or "intra-day" margins in the event it deems such action necessary and appropriate to protect the interests of other Clearing Members, the Exchange and the public. These "additional" and "intra-day" margin requirements generally occur when there are large variations between the current price of a derivative contract and such contract's price as of the previous day's close.

¹¹ Three different types of Clearing Members clear through the Cassa: general, individual and indirect Clearing Members. Because U.S. Eligible Broker-Dealers and Eligible Institutions are considered only as customers of their respective clearing member, such U.S. Eligible Broker-Dealers and Eligible Institutions are not eligible for clearing membership and, therefore, will not take part in the clearing process. There is no standard agreement which regulates the relationship between Clearing Members and Eligible Broker-Dealers or Eligible Institutions. As a result, all arrangements between such parties are individually negotiated.

¹² Initial margin requirements are calculated using the Theoretical Intermarket Margins System ("TIMS") developed by the Options Clearing Corporation. TIMS allows the Cassa to continually measure and manage Clearing Members' risk exposure levels. TIMS is also used by the Cassa to calculate all "additional" and "intra-day" margin requirements.

¹³ The hypothetical repurchase price is represented by the closing price of the Option.

¹⁴ To determine ordinary margin, the Cassa: (i) defines the "margin interval," which equals the percentage daily maximum change in the underlying stock or Index (this differs according to the volatility of each underlying asset); and (ii) calculates the theoretical value of the sold Option on the basis of the price of the underlying asset plus (for a call) or minus (for a put) the margin interval. The difference between this theoretical value and the closing price of the Option is the ordinary margin.

Margins are calculated, collected and held by the Cassa. Payments to be made to or margin deposit requirements received by Clearing Members are determined on at least a daily basis, and are calculated separately for the house and client accounts of each Clearing Member.

The Options Markets

Prices on Options traded at the IDEM are publicly disseminated, and the Options are quoted, bought and sold in Italian lire. All transactions creating or closing positions in such Options are executed and settled at the Exchange by members of the IDEM. Options are purchased and sold by a member broker by inserting the order into the IDEM's electronic order book, where all orders are sorted by price and time of entry. The Options are not evidenced by certificates, although transactions and positions are recorded in statements from the Cassa to general and individual Clearing Members and statements from such Clearing Members to customers. IDEM Options are not fungible or interchangeable with options traded on any other market.

IDEM Equity Options feature an American-style exercise. "In-the-money" options automatically are exercised by the Cassa at expiration, unless the Clearing Member specifies otherwise. Any IDEM Equity Option position can be closed only on the IDEM or exercised by a Clearing Member giving an exercise notice to the Cassa. The underlying contract size of an Equity Option can be either 1,000, 5,000 or 10,000 shares, depending on the price of the underlying stock. Once an Equity Option is allocated, clearance and settlement of the transaction in the underlying security takes place in five trading days following the date of exercise or expiration.¹⁵ When the seller of an Option is a customer, he is contractually obligated with his broker to whom he pays margins or deposits the underlying stocks. Because the executing broker must be a member of the Cassa, it is contractually obligated with the Cassa (to whom it pays margins).

IDEM Index Options (the options offered on the MIB 30 Index) have a European-style exercise. In-the-money options automatically are exercised at expiration unless the Clearing Member specifies otherwise. Exercised Index Options are settled in cash within one day of exercise.

The Exchange's settlement procedures are designed so that for every outstanding Option there will be a writer (seller)--and a Clearing Member that is or that represents the writer--of an Option of the same series who has undertaken to perform the writer's obligations in the event that an exercise is assigned to such writer. To ensure that there will always be an equal number of writers and buyers, the Exchange requires the authorized dealers to indicate in the "Enter Order" window of the electronic trading system whether the order to be executed is opening a new position or closing a previously opened position. As a result, no matter how many Options of a given series may be outstanding at any time, there always will be a group of writers of Options of the same

¹⁵ Eligible U.S. Broker-Dealers and Eligible Institutions may obtain certificates for underlying securities through an Italian broker-dealer.

series who, in the aggregate, have undertaken to perform the writer's obligations with respect to such Options. Once an exercise of an Option is allocated by a broker to a particular writer, that writer is contractually obligated to its broker to perform in accordance with the terms of the Option. These contractual obligations are secured by the securities or other margin which the customer has deposited with its broker.

Transactions with U.S. Customers

The Exchange wishes to familiarize certain registered broker-dealers and large financial institutions in the United States with the Equity and Index Options traded on the IDEM, and thus proposes to take the limited steps described below with respect only to "Eligible Broker-Dealers" and "Eligible Institutions." To be eligible, each such entity must meet the following standards:

(a) it must be a "qualified institutional buyer" as defined in Rule 144A(a)(1) under the Securities Act of 1933 ("Rule 144A" and the "1933 Act," respectively), or an international organization excluded from the definition of "U.S. person" in Rule 902(k)(2)(vi) of Regulation S under the 1933 Act; and

(b) it must have had prior actual experience with traded options in the U.S. options market (and, therefore, would have received the disclosure document for U.S. standardized options called for by Rule 9b-1 under the 1934 Act).

IDEM members will be required to take reasonable steps to assure themselves, before effecting any IDEM Equity or Index Option transaction for or with a customer located in the United States, that the customer is an Eligible Broker-Dealer or an Eligible Institution, that the customer is acting for its own account or the account of another Eligible Broker-Dealer or Eligible Institution or the managed account of a non-U.S. person (within the meaning of Rule 902(k)(2)(i) of Regulation S under the 1933 Act), and that the customer has received the IDEM disclosure document referred to below. The Exchange will advise IDEM members that, under U.S. law, IDEM members which are not U.S. registered broker-dealers may deal with Eligible Institutions only in accordance with Rule 15a-6 under the 1934 Act, principally through U.S. registered broker-dealers as provided in such Rule.

Because the Consob regulates the rules of conduct to be observed in dealings with customers, the Consob will institute rules requiring IDEM members to furnish to Eligible Broker-Dealers and Eligible Institutions an IDEM disclosure document before accepting an order from such entity to purchase or sell IDEM Options. The rules will also require that IDEM members obtain written representations from any Eligible Broker-Dealer or Eligible Institution, signed by an appropriate officer, to the following effect:

(1) it is an Eligible Broker-Dealer or Eligible Institution, and as such it (i) owns and invests on a discretionary basis a specified amount of eligible securities sufficient to be a qualified institutional buyer under Rule 144A under the 1933 Act (and if a bank,

S&L, or other thrift institution, has a net worth meeting the requirements of Rule 144A under the 1933 Act), and (ii) has had prior actual experience in the U.S. standardized options markets and as a result thereof has received the options disclosure document entitled "Understanding the Risks and Uses of Listed Options" ("Options Disclosure Document" or "ODD") that is prepared by the Options Clearing Corporation and U.S. options exchanges;

(2) it has received the IDEM disclosure document;

(3) its transactions in IDEM Equity or Index Options will be for its own account or for the account of another Eligible Broker-Dealer or Eligible Institution or for the managed account of a non-U.S. person within the meaning of Rule 902(k)(2)(i) of Regulation S under the 1933 Act;

(4) it will not transfer any interest or participation in an IDEM Equity or Index Option it has purchased or written to any other U.S. person, or to any person in the United States, that is not an Eligible Broker-Dealer or Eligible Institution;

(5) it will cause any disposition of an IDEM Option that it has purchased or written to be effected only on the IDEM and to be settled on the IDEM in Italy, and it understands that any required payments for premium, settlement, exercise or closing of any IDEM Option in respect of which it has a contract with the IDEM member must be made in Italy and in Italian lire. It also understands that, if in relation to an IDEM Option it has a contract as a writer with the IDEM member, margin must be provided to that IDEM member, and maintained, measured and deposited in Italian lire, Italian government bonds, or any other instrument approved by the Cassa;

(6) if it is an Eligible Broker-Dealer or Eligible Institution acting on behalf of another Eligible Broker-Dealer or Eligible Institution that is not a managed account, it has obtained from the other a written representation to the same effect as the foregoing and will provide it to the IDEM member upon demand; and

(7) it will notify the IDEM member of any change in the foregoing representations prior to placing any future order, and the foregoing representations will be deemed to be made with respect to each order it gives to the IDEM member.

Copies of the IDEM disclosure document, in the form submitted to and reviewed by the Division, will be provided only to Eligible Broker-Dealers and Eligible Institutions. The IDEM disclosure document provides an overview of the IDEM and the IDEM's Equity and Index Options, with attention to significant differences from standardized options in the U.S. domestic options market, and sets forth special factors relevant to U.S. entities transacting in IDEM Equity and Index Options.

The Board of Directors and the Exchange will not engage in any general advertisement concerning IDEM Equity or Index Options in the United States. However,

the Exchange will appoint certain officers of the Stock Exchange and IDEM to act as the IDEM's representatives in the United States (hereinafter referred to as the "IDEM Representative(s)"). The IDEM Representatives will be located in Italy, and will be available to respond to inquiries concerning the IDEM from Eligible Broker-Dealers and Eligible Institutions. Any IDEM Representative may make personal calls on and correspond or otherwise communicate with entities whom such representative reasonably believes to be Eligible Broker-Dealers and Eligible Institutions in order to familiarize them with the availability of the IDEM and the IDEM's operations. Any Eligible Broker-Dealer or Eligible Institution would be provided, upon its first visit, communication or inquiry, with the IDEM disclosure document. The IDEM Representatives located in Italy will maintain a reasonable supply of that document, and of the most recently published annual reports of the Board of Directors and the Cassa, to respond to requests therefor from Eligible Broker-Dealers and Eligible Institutions. An IDEM Representative also may participate in programs and seminars conducted in the United States. IDEM Representatives will not give investment advice or make any recommendations with respect to specific IDEM Equity or Index Options, nor will IDEM Representatives solicit, take, or direct orders, nor recommend or refer particular IDEM members. If requested by an Eligible Broker-Dealer or Eligible Institution, an IDEM Representative may make available to the requesting party a list of all IDEM members and any registered U.S. broker-dealer affiliates of such IDEM members.

You represent that the IDEM will continue to be an organized exchange operating and regulated outside the United States and, while making its IDEM Equity and Index Options known to a particular, sophisticated segment of the U.S. financial community, the Exchange will experience no substantial changes in the foregoing facts and circumstances. You also represent that the Stock Exchange and its Board of Directors will establish careful limitations to assure compliance with applicable U.S. securities laws, and that the Stock Exchange and its Board of Directors will continue as necessary to establish further limitations to assure continued compliance with applicable U.S. securities laws.

You further represent that making information concerning the IDEM available in the United States as described in this letter will serve to increase, in a responsible manner, information concerning an important and growing marketplace in Europe that will be of substantial benefit to appropriate U.S. professionals and institutions.

Finally, you also ask, on behalf of the Board of Directors, the Stock Exchange, IDEM, and their respective officers, directors or members, that the Division confirm to you that it will not recommend that the Commission take enforcement action of the nature set forth in the opening paragraph of this letter, and that (a) the furnishing of the IDEM disclosure document by an IDEM Representative, by an IDEM member, or by an Eligible Broker-Dealer, in each case, to an Eligible Broker-Dealer or Eligible Institution will satisfy the obligation of a broker or dealer under Rule 9b-1(d) of the 1934 Act to furnish an options disclosure document before accepting an order from a customer to purchase or sell an IDEM Equity or Index Option, and (b) that neither the IDEM Representative's furnishing of an IDEM disclosure document to an Eligible Broker-Dealer or Eligible

Institution, nor an IDEM member's furnishing of an IDEM disclosure document to an Eligible Broker-Dealer or, in response to an unsolicited inquiry concerning Equity or Index Options, to an Eligible Institution, will constitute "solicitation" or the provision of a "research report" as those terms are used in Rule 15a-6(a) under the 1934 Act.

Response:

Based on the facts and representations set forth above, the Division will not recommend enforcement action to the Commission against the Board of Directors, the Stock Exchange or IDEM members under Section 15(a) of the 1934 Act if the Stock Exchange or IDEM members act as you describe to familiarize Eligible Broker-Dealers and Eligible Institutions in the United States with IDEM Options without the Stock Exchange or IDEM members registering with the Commission as broker-dealers under Section 15(b) of the 1934 Act. Also, the Division will not recommend enforcement action to the Commission against the Board of Directors, the Stock Exchange, the IDEM, and their respective officers, directors or members under Section 15(a) of the 1934 Act if, solely in connection with the satisfaction of the obligation under Rule 9b-1(d) of the 1934 Act and under the limited circumstances set forth above, (1) an IDEM Representative, an IDEM member, or an Eligible Broker-Dealer provides the IDEM disclosure document to an Eligible Broker-Dealer and the IDEM member effects transactions in IDEM Options with or for that Eligible Broker-Dealer pursuant to Rule 15a-6(a)(4) under the 1934 Act, or (2) an IDEM Representative furnishes an IDEM disclosure document to an Eligible Institution, or an IDEM member furnishes an IDEM disclosure document to an Eligible Institution in response to an otherwise unsolicited inquiry concerning IDEM Options, and the IDEM member effects transactions in IDEM Options with or for that Eligible Institution pursuant to Rule 15a-6(a)(1) under the 1934 Act.

Based on the foregoing, the Division also will not recommend that the Commission take enforcement action against the Stock Exchange or the Cassa under Section 17A of the 1934 Act if they operate solely in the manner described above for IDEM Options without registering with the Commission as a clearing agency. In addition, the Division will not recommend that the Commission take enforcement action against the Board of Directors, the Stock Exchange or the IDEM, or any of their respective officers, directors or members under Section 5 of the 1934 Act if the Stock Exchange or IDEM members operate solely in the manner described above with respect to IDEM Options without the Stock Exchange and IDEM registering with the Commission as a national securities exchange under Section 6 of the 1934 Act.

Finally, the Division has reviewed the proposed IDEM disclosure document. Based on our review of that document, the Division wishes to advise you that it will not recommend that the Commission take enforcement action against an IDEM Representative, an IDEM member, the Board of Directors or an Eligible Broker-Dealer pursuant to Rule 9b-1(d) under the 1934 Act, if the IDEM Representative, IDEM member, or Eligible Broker-Dealer furnishes the IDEM disclosure document to an Eligible

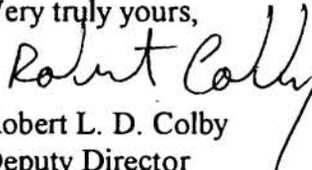
Broker-Dealer or Eligible Institution before the Eligible Broker-Dealer or Eligible Institution effects a transaction in IDEM Options, subject to the following conditions:

- (1) the Eligible Broker-Dealer or Eligible Institution previously has received the ODD;
- (2) Consob requires that IDEM members, before effecting a transaction with or for an Eligible Broker-Dealer or Eligible Institution in IDEM Options, determine as described above that the Eligible Broker-Dealer or Eligible Institution has received the ODD and the IDEM disclosure document and maintain a record of that determination; and
- (3) the Stock Exchange furnishes the Division, at least 30 days prior to the date definitive copies are furnished to Eligible Broker-Dealers or Eligible Institutions, with a copy of any amendment made to the IDEM disclosure document because the information contained in that document becomes or will become materially inaccurate or incomplete, or because there is or will be an omission of material information necessary to ensure that the document is not misleading.

These positions of the Division concern enforcement action only and do not represent conclusions on the applicability of statutory or regulatory provisions of the federal securities laws. The Division has taken these positions based, in part, on the fact that the Commission has entered into a Memorandum of Understanding with the Consob regarding the sharing of investigative information,¹⁶ and that foreign broker-dealers, including IDEM members, electing to deal with U.S. institutional investors pursuant to Rule 15a-6(a)(3) under the 1934 Act are required to provide directly to the Commission, upon request, information, documents, testimony, and assistance in taking the evidence of persons that relate to transactions pursuant to Rule 15a-6(a)(3) under the 1934 Act. Moreover, these positions are based on the understanding that, under Italian law, only members authorized by the competent Italian authorities may have direct access to a market placed under the supervision of the Consob and, therefore, only IDEM members may have direct access to the IDEM.

The positions of the Division in this letter are based on the representations that you have made; any different facts or conditions might require a different response, and these positions are subject to modification or revocation if the facts and representations set forth above are altered.

Very truly yours,



Robert L. D. Colby
Deputy Director

¹⁶ Sec. Understanding Regarding the Establishment of a Framework for Consultations Between the Securities and Exchange Commission and the Commissione Nazionale per le Società e la Borsa (May 7, 1993).

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SECURITIES AND EXCHANGE COMMISSION
RECEIVED

August 31, 1998

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DIVISION OF MARKET REGULATION

Mr. Michael Walinskas
Senior Special Counsel
Division of Market Regulation
Securities and Exchange Commission
450 5th Street, N.W. Mail 10-1
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Washington, D.C. 20549

Dear Mr. Walinskas:

On behalf of the Board of Directors (the "Board of Directors") of the Borsa Italiana S.p.A. (the "Stock Exchange"), the organization responsible for the management and surveillance of the Stock Exchange and its equity derivatives division referred to as the Mercato Italiano dei Derivati (the Italian Derivatives Market, or the "IDEM"),¹ we request your confirmation that, based on the circumstances stated in this letter, and in view of similar relief previously granted by the Division of Market Regulation (the "Division") to other non-U.S. exchanges², the Division will not recommend to the Securities and Exchange Commission (the "Commission") enforcement action (1) against the Board of Directors, the Stock Exchange or the IDEM (the Stock Exchange and IDEM being referred to herein collectively as the "Exchange"), or their respective officers, directors or members under Section 5 of the Securities Exchange Act of 1934 (the "1934 Act"), by reason of the Stock Exchange and IDEM not registering under Section 6 of the 1934 Act as a national securities exchange; (2) against the Board of Directors, the Stock Exchange or IDEM members³ under Section 15 of the 1934 Act,

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"Consob"), which sets the guidelines for corporate disclosure,⁸ and (2) Legislative Decree 415 of July 23, 1996, which established the regulation of: (a) investment services activities; (b) both European Union ("EU") and non-EU investment firms; and (c) markets and clearing and settlement of transactions on such markets.

Pursuant to this Legislative Decree, the Stock Exchange has been privatized and assumed many of the responsibilities previously held by Consob.⁹ As of the date of this letter, the Board of Directors is responsible for: (a) organizing and creating rules governing the markets; (b) creating and maintaining supervisory procedures to ensure proper functioning of the markets; (c) certain surveillance functions with respect to the markets (including the management of price limits for cash markets, the handling of any technical defaults in the electronic trading system which occur, and the management of procedural errors); (d) approving the types of derivative contracts to be traded and the trading methods; (e) the approval and listing of new securities; (f) the dissemination of market and listed company information; and (g) the calculation and management of all stock indices.

In addition to the supervisory activities conducted by the Stock Exchange, the Bank of Italy and Consob also exercise certain supervisory powers over investment firms and banks. Specifically, with respect to investment firms and banks, the Bank of Italy regulates: (a) capital adequacy; (b) risk management procedures; (c) permissible holdings; (d) administrative and accounting procedures; and (e) internal control mechanisms, while the Consob regulates: (a)

⁸ Law 216 also introduced savings shares, requirements for prospectuses, and the certification of financial statements, and provided the guidelines for the organization and operation of stock exchanges and the admission of new listings.

⁹ The privatization of the Stock Exchange was achieved through the creation of a new private company, the Borsa Italiana S.p.A., whose fifteen member Board of Directors has taken over all of the duties and responsibilities previously held by the Stock Exchange Council (the organization previously responsible for the management and surveillance of the Exchange prior to its privatization). The shareholders of the Stock Exchange elect the Board of Directors and appoint both the Stock Exchange's chairman and the managing director.

The privatized Stock Exchange has come into full operation on January 2, 1998 after it received authorization to engage in business by the Consob. In granting such authorization, the Consob verified that (i) the Stock Exchange's rules were in compliance with the law of the Commission of the European Community, and (ii) such rules would promote the Stock Exchange's three objectives of supervision: transparency, orderly trading conditions and the protection of investors. Although the Exchange is now privatized, it still remains subject to the regulatory oversight of the Consob.

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the rules of conduct to be observed in dealings with customers, especially in terms of conflicts of interest; (b) minimum information requirements; and (c) records of orders and transactions.

The Cassa

The Cassa, an Italian joint-stock company formed on March 31, 1992, is responsible for all clearing functions. The Cassa clears all trades on the Exchange and guarantees the completion of all Option transactions. The Cassa is subject to the supervisory authority of the Consob and the Bank of Italy.¹⁰

Prior to trading on the IDEM, intermediary firms must become members of the Cassa ("Clearing Members").¹¹ With shareholders' equity in excess of 55 billion lire, the Cassa serves as the ultimate guarantor of all the trades it registers which are cleared between Clearing Members with respect to Options contracts available on the IDEM, and guarantees each of the Clearing Members, as necessary, full payment of deficits resulting from another Clearing Member's default. The Cassa also benefits from certain institutional procedures designed to ensure the financial security of the Italian securities industry. Although there is no formal arrangement in place, it is understood that the Bank of Italy would intervene to provide support to certain financial institutions, including the Cassa, in the event of a systematic financial crisis.

Each Clearing Member is required to deposit and maintain initial margin with the Cassa with respect to each Option for which it represents the seller (writer).¹² Initial margins consist of two components: premium margins and ordinary margins. Premium margin equals the

¹⁰ The Consob, the Bank of Italy and the Ministry of Treasury each reserve the right to attend all meetings of the Cassa's Board of Directors, and each is a member of the Stock Exchange's Board of Auditors.

¹¹ Three different types of Clearing Members clear through the Cassa: general, individual and indirect Clearing Members. Because U.S. Eligible Broker-Dealers and Eligible Institutions are considered only as customers of their respective clearing member, such U.S. Eligible Broker-Dealers and Eligible Institutions are not eligible for clearing membership and, therefore, will not take part in the clearing process. There is no standard agreement which regulates the relationship between Clearing Members and Eligible Broker-Dealers or Eligible Institutions. As a result, all arrangements between such parties are individually negotiated.

¹² Initial margin requirements are calculated using the Theoretical Intermarket Margins System ("TIMS") developed by the Options Clearing Corporation. TIMS allows the Cassa to continually measure and manage Clearing Members' risk exposure levels. TIMS is also used by the Cassa to calculate all "additional" and "intra-day" margin requirements.

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amount necessary for the Cassa to close the position of a defaulting member by repurchasing the Options sold.¹³ Ordinary margin equals the additional cost sustained by the Cassa to repurchase the Option in a "worst case scenario."¹⁴ The initial margin with respect to each Option equals the sum of the premium margin and the ordinary margin. The Cassa requires initial margins to be posted in Italian lire, Italian government bonds, or any other instrument approved by the Cassa. In addition, the Cassa may require a Clearing Member to deposit "additional" or "intra-day" margins in the event it deems such action necessary and appropriate to protect the interests of other Clearing Members, the Exchange and the public. These "additional" and "intra-day" margin requirements generally occur when there are large variations between the current price of a derivative contract and such contract's price as of the previous day's close.

Margins are calculated, collected and held by the Cassa. Payments to be made to or margin deposit requirements received by Clearing Members are determined on at least a daily basis, and are calculated separately for the house and client accounts of each Clearing Member.

The Options Markets

Prices on Options traded at the IDEM are publicly disseminated, and the Options are quoted, bought and sold in Italian lire. All transactions creating or closing positions in such Options are executed and settled at the Exchange by members of the IDEM. Options are purchased and sold by a member broker by inserting the order into the IDEM's electronic order book, where all orders are sorted by price and time of entry. The Options are not evidenced by certificates, although transactions and positions are recorded in statements from the Cassa to general and individual Clearing Members and statements from such Clearing Members to customers. IDEM Options are not fungible or interchangeable with options traded on any other market.

IDEM Equity Options feature an American-style exercise. "In-the-money" options automatically are exercised by the Cassa at expiration, unless the Clearing Member specifies otherwise. Any IDEM Equity Option position can be closed only on the IDEM or exercised by

¹³ The hypothetical repurchase price is represented by the closing price of the Option.

¹⁴ To determine ordinary margin, the Cassa: (i) defines the "margin interval," which equals the percentage daily maximum change in the underlying stock or Index (this differs according to the volatility of each underlying asset); and (ii) calculates the theoretical value of the sold Option on the basis of the price of the underlying asset plus (for a call) or minus (for a put) the margin interval. The difference between this theoretical value and the closing price of the Option is the ordinary margin.

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a Clearing Member giving an exercise notice to the Cassa. The underlying contract size of an Equity Option can be either 1,000, 5,000 or 10,000 shares, depending on the price of the underlying stock. Once an Equity Option is allocated, clearance and settlement of the transaction in the underlying security takes place in five trading days following the date of exercise or expiration.¹⁵ When the seller of an Option is a customer, he is contractually obligated with his broker to whom he pays margins or deposits the underlying stocks. Because the executing broker must be a member of the Cassa, it is contractually obligated with the Cassa (to whom it pays margins).

IDEM Index Options (the options offered on the MIB 30 Index) have a European-style exercise. In-the-money options automatically are exercised at expiration unless the Clearing Member specifies otherwise. Exercised Index Options are settled in cash within one day of exercise.

The Exchange's settlement procedures are designed so that for every outstanding Option there will be a writer (seller)--and a Clearing Member that is or that represents the writer--of an Option of the same series who has undertaken to perform the writer's obligations in the event that an exercise is assigned to such writer. To ensure that there will always be an equal number of writers and buyers, the Exchange requires the authorized dealers to indicate in the "Enter Order" window of the electronic trading system whether the order to be executed is opening a new position or closing a previously opened position. As a result, no matter how many Options of a given series may be outstanding at any time, there always will be a group of writers of Options of the same series who, in the aggregate, have undertaken to perform the writer's obligations with respect to such Options. Once an exercise of an Option is allocated by a broker to a particular writer, that writer is contractually obligated to its broker to perform in accordance with the terms of the Option. These contractual obligations are secured by the securities or other margin which the customer has deposited with its broker.

Transactions with U.S. Customers

The Exchange wishes to familiarize certain registered broker-dealers and large financial institutions in the U.S. with the Equity and Index Options traded on the IDEM, and thus proposes to take the limited steps described below with respect only to "Eligible Broker-Dealers" and "Eligible Institutions." To be eligible, each such entity must meet the following standards:

¹⁵ Eligible U.S. Broker-Dealers and Eligible Institutions may obtain certificates for underlying securities through an Italian broker-dealer.

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(a) it must be a "qualified institutional buyer" as defined in Rule 144A(a)(1) under the Securities Act of 1933 ("Rule 144A" and the "1933 Act," respectively), or an international organization excluded from the definition of "U.S. Person" in Rule 902(k)(2)(vi) of Regulation S under the 1933 Act; and

(b) it must have had prior actual experience with traded options in the United States options market (and, therefore, would have received the disclosure document for U.S. standardized options called for by Rule 9b-1 under the 1934 Act).

IDEM members will be required to take reasonable steps to assure themselves, before effecting any IDEM Equity or Index Option transaction for or with a customer located in the United States, that the customer is an Eligible Broker-Dealer or an Eligible Institution, that the customer is acting for its own account or the account of another Eligible Broker-Dealer or Eligible Institution or the managed account of a non-U.S. person (within the meaning of Rule 902(k)(2)(i) of Regulation S under the 1933 Act), and that the customer has received the IDEM disclosure document referred to below. The Exchange will advise IDEM members that, under U.S. law, IDEM members which are not U.S. registered broker-dealers may deal with Eligible Institutions only in accordance with Rule 15a-6 under the 1934 Act, principally through U.S. registered broker-dealers as provided in such Rule.

Because the Consob regulates the rules of conduct to be observed in dealings with customers, the Consob will institute rules requiring IDEM members to furnish to Eligible Broker-Dealers and Eligible Institutions an IDEM disclosure document before accepting an order from such entity to purchase or sell IDEM Options. The rules will also require that IDEM members obtain written representations from any Eligible Broker-Dealer or Eligible Institution, signed by an appropriate officer, to the following effect:

(1) it is an Eligible Broker-Dealer or Eligible Institution, and as such it (i) owns and invests on a discretionary basis a specified amount of eligible securities sufficient to be a qualified institutional buyer under Rule 144A under the 1933 Act (and if a bank, S&L, or other thrift institution, has a net worth meeting the requirements of Rule 144A under the 1933 Act), and (ii) has had prior actual experience in the U.S. standardized options markets and as a result thereof has received the options disclosure document entitled "Understanding the Risks and Uses of Listed Options" that is prepared by the Options Clearing Corporation and U.S. options exchanges;

(2) it has received the IDEM disclosure document;

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(3) its transactions in IDEM Equity or Index Options will be for its own account or for the account of another Eligible Broker-Dealer or Eligible Institution or for the managed account of a non-U.S. person within the meaning of Rule 902(k)(2)(i) of Regulation S under the 1933 Act;

(4) it will not transfer any interest or participation in an IDEM Equity or Index Option it has purchased or written to any other U.S. person, or to any person in the United States, that is not an Eligible Broker-Dealer or Eligible Institution;

(5) it will cause any disposition of an IDEM Option that it has purchased or written to be effected only on the IDEM and to be settled on the IDEM in Italy, and it understands that any required payments for premium, settlement, exercise or closing of any IDEM Option in respect of which it has a contract with the IDEM member must be made in Italy and in Italian lire. It also understands that, if in relation to an IDEM Option it has a contract as a writer with the IDEM member, margin must be provided to that IDEM member, and maintained, measured and deposited in Italian lire, Italian government bonds, or any other instrument approved by the Cassa;

(6) if it is an Eligible Broker-Dealer or Eligible Institution acting on behalf of another Eligible Broker-Dealer or Eligible Institution that is not a managed account, it has obtained from the other a written representation to the same effect as the foregoing and will provide it to the IDEM member upon demand; and

(7) it will notify the IDEM member of any change in the foregoing representations prior to placing any future order, and the foregoing representations will be deemed to be made with respect to each order it gives to the IDEM member.

Copies of the IDEM disclosure document, in the form submitted to and reviewed by the Division, will be provided only to Eligible Broker-Dealers and Eligible Institutions. The IDEM disclosure document provides an overview of the IDEM and the IDEM's Equity and Index Options, with attention to significant differences from standardized options in the U.S. domestic options market, and sets forth special factors relevant to U.S. entities transacting in IDEM Equity and Index Options.

The Board of Directors and the Exchange will not engage in any general advertisement concerning IDEM Equity or Index Options in the United States. However, the Exchange will appoint certain officers of the Stock Exchange and IDEM to act as the IDEM's representatives in the United States (hereinafter referred to as the "IDEM Representative(s)"). The IDEM Representatives will be located in Italy, and will be available to respond to inquiries concerning the IDEM from Eligible Broker-Dealers and Eligible Institutions. Any IDEM Representative

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may make personal calls on and correspond or otherwise communicate with entities whom such representative reasonably believes to be Eligible Broker-Dealers and Eligible Institutions in order to familiarize them with the availability of the IDEM and the IDEM's operations. Any Eligible Broker-Dealer or Eligible Institution would be provided, upon its first visit, communication or inquiry, with the IDEM disclosure document. The IDEM Representatives located in Italy will maintain a reasonable supply of that document, and of the most recently published annual reports of the Board of Directors and the Cassa, to respond to requests therefor from Eligible Broker-Dealers and Eligible Institutions. An IDEM Representative also may participate in programs and seminars conducted in the United States. IDEM Representatives will not give investment advice or make any recommendations with respect to specific IDEM Equity or Index Options, nor will IDEM Representatives solicit, take, or direct orders, nor recommend or refer particular IDEM members. If requested by an Eligible Broker-Dealer or Eligible Institution, an IDEM Representative may make available to the requesting party a list of all IDEM members and any registered U.S. broker-dealer affiliates of such IDEM members.

The IDEM will continue to be an organized exchange operating and regulated outside the U.S. and, while making its IDEM Equity and Index Options known to a particular, sophisticated segment of the U.S. financial community, the Exchange will experience no substantial changes in the foregoing facts and circumstances. Careful limitations also will be taken to assure compliance with applicable U.S. securities laws, and the Stock Exchange and its Board of Directors will continue as necessary to establish further limitations to assure continued compliance with applicable U.S. securities laws.

Making information concerning the IDEM available in the United States as described in this letter will serve to increase, in a responsible manner, information concerning an important and growing marketplace in Europe that will be of substantial benefit to appropriate U.S. professionals and institutions.

We therefore respectfully request on behalf of the Board of Directors, the Stock Exchange, IDEM, and their respective officers, directors or members that you confirm to us that the Division will not recommend that the Commission take enforcement action of the nature set forth in the opening paragraph of this letter, and that you advise us that (a) the furnishing of the IDEM disclosure document by an IDEM Representative, by an IDEM member, or by an Eligible Broker-Dealer, in each case, to an Eligible Broker-Dealer or Eligible Institution will satisfy the obligation of a broker or dealer under Rule 9b-1(d) of the 1934 Act to furnish an options disclosure document before accepting an order from a customer to purchase or sell an IDEM Equity or Index Option, and (b) neither the IDEM Representatives' furnishing of an IDEM disclosure document to an Eligible Broker-Dealer or Eligible Institution, nor an IDEM member's furnishing of an IDEM disclosure document to an Eligible Broker-Dealer or, in response to an unsolicited inquiry concerning Equity or Index Options, to an Eligible Institution, will constitute

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"solicitation" or the provision of a "research report" as those terms are used in Rule 15a-6(a) under the 1934 Act.

If you need any further information concerning this request, please call me collect at (312) 902-5365.

Very truly yours,



Wesley G. Nissen

Enclosures

WGN:cl303205.12