

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-60 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-60. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2005-60 and should be submitted on or before November 8, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52578; File No. SR-ISE-2005-27]

#### **Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change and Amendment No. 1 and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 4 to the Proposed Rule Change Relating to Listing Standards for Broad-Based Index Options**

October 7, 2005.

#### **I. Introduction**

On May 19, 2005, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to establish listing and maintenance standards and position limits for options on broad-based indexes. The ISE filed Amendment No. 1 to the proposed rule change on July 13, 2005.<sup>3</sup> The proposed rule change, as amended by Amendment No. 1, was published for comment in the **Federal Register** on July 27, 2005.<sup>4</sup> The Commission received no comments regarding the proposal, as amended. The ISE filed Amendment No. 2 to the proposed rule change on September 26, 2005, and withdrew Amendment No. 2 on September 28, 2005. The ISE filed Amendment No. 3 to the proposed rule change on September 28, 2005, and withdrew Amendment No. 3 on October 6, 2005. The ISE filed Amendment No. 4 to the proposal on October 6, 2005.<sup>5</sup> This

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

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 makes technical corrections to the proposal, including revisions that clarify the applicability of the market capitalization and options eligibility requirements in ISE Rule 2002(d).

<sup>4</sup> See Securities Exchange Act Release No. 52084 (July 20, 2005), 70 FR 43481.

<sup>5</sup> Amendment No. 4 revises the proposal to: (1) Provide that an index's component securities must be "NMS stocks" rather than "reported securities;" (2) identify the entities or services that will disseminate index values; (3) state that the ISE has an adequate surveillance program for broad-based

order approves the proposed rule change, as amended. In addition, the Commission is publishing notice to solicit comments on, and is simultaneously approving, on an accelerated basis, Amendment No. 4 to the proposal.

#### **II. Description of the Proposed Rule Change**

The ISE proposes to adopt ISE Rule 2002(d) to establish initial listing standards for broad-based index options. The proposal will allow the ISE to list, pursuant to Rule 19b-4(e) under the Act,<sup>6</sup> broad-based index options that meet the listing standards in ISE Rule 2002(d). The listing standards require, among other things, that the underlying index be broad-based, as defined in ISE Rule 2001(j); that options on the index be a.m.-settled; that the index be capitalization-weighted, modified capitalization-weighted, price-weighted, or equal dollar-weighted; and that the index be comprised of at least 50 securities, all of which must be "NMS stocks," as defined in Rule 600 of Regulation NMS.<sup>7</sup> In addition, ISE Rule 2002(d) requires that the index's component securities meet certain minimum market capitalization and average daily trading volume requirements; that no single component account for more than 10% of the weight of the index and that the five highest weighed components represent no more than 33% of the weight of the index; that the index value be widely disseminated at least every 15 seconds; and that the ISE have written surveillance procedures in place with respect to the index options.

The ISE also proposes to adopt ISE Rule 2002(e), which establishes maintenance standards for broad-based index options listed pursuant to ISE Rule 2002(d). In addition, the ISE proposes to amend ISE Rule 2004(a) to establish a position limit of 25,000 contracts on the same side of the market for broad-based index options listed pursuant to ISE Rule 2002(d).<sup>8</sup>

index options; and (4) clarify that the position limits for broad-based index options apply to option contracts on the same side of the market.

<sup>6</sup> 17 CFR 240.19b-4(e).

<sup>7</sup> See Amendment No. 4, *supra* note 5. Rule 600 of Regulation NMS defines an "NMS stock" to mean "any NMS security other than an option." An "NMS security" is "any security or class of securities for which transaction reports are collected, processed, and made available pursuant to an effective transaction reporting plan, or an effective national market system plan for reporting transactions in listed options." See 17 CFR 242.600.

<sup>8</sup> See Amendment No. 4, *supra* note 5.

### III. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>9</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system and, in general, to protect investors and the public interest.

To list options on a particular broad-based index, the ISE currently must file a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder. However, Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization ("SRO") will not be deemed a proposed rule change pursuant to Rule 19b-4(c)(1) if the Commission has approved, pursuant to Section 19(b) of the Act, the SRO's trading rules, procedures, and listing standards for the product class that would include the new derivative securities product, and the SRO has a surveillance program for the product class.

As described more fully above, the ISE proposes to establish listing standards for broad-based index options. The Commission's approval of the ISE's listing standards for broad-based index options will allow options that satisfy the listing standards to begin trading pursuant to Rule 19b-4(e), without constituting a proposed rule change within the meaning of Section 19(b) of the Act and Rule 19b-4, for which notice and comment and Commission approval is necessary.<sup>10</sup> The ISE's ability to rely on Rule 19b-4(e) to list broad-based index options that meet the requirements of ISE Rule 2002(d) potentially reduces the time frame for bringing these securities to the market, thereby promoting competition and making new broad-based index

options available to investors more quickly.

The Commission notes that the ISE has represented that it has adequate trading rules, procedures, listing standards, and surveillance program for broad-based index options. ISE's existing index option trading rules and procedures will apply to broad-based index options listed pursuant to ISE Rule 2002(d). Other existing ISE rules, including provisions addressing sales practices and margin requirements, also will apply to these options. In addition, the ISE proposes to establish position and exercise limits of 25,000 contracts on the same side of the market for broad-based index options listed pursuant to ISE Rule 2002(d).<sup>11</sup> The Commission believes that the proposed position and exercise limits should serve to minimize potential manipulation concerns.

The ISE represents that it has adequate surveillance procedures for broad-based index options and that it intends to apply its existing surveillance procedures for index options to monitor trading in broad-based index options listed pursuant to ISE Rule 2002(d).<sup>12</sup> In addition, because ISE Rule 2002(d) requires that each component of an index be an "NMS stock," as defined in Rule 600 of Regulation NMS under the Act, each index component must trade on a registered national securities exchange or through Nasdaq. Accordingly, the ISE will have access to information concerning trading activity in the component securities of an underlying index through the Intermarket Surveillance Group ("ISG").<sup>13</sup> ISE Rule 2002(d) also provides that non-U.S. index components that are not subject to a comprehensive surveillance sharing agreement between the ISE and the primary market(s) trading the index components may comprise no more than 20% of the weight of the index.<sup>14</sup> The Commission believes that these

requirements will help to ensure that the ISE has the ability to monitor trading in broad-based index options listed pursuant to ISE Rule 2002(d) and in the component securities of the underlying indexes.

The Commission believes that the requirements in ISE Rule 2002(d) regarding, among other things, the minimum market capitalization, trading volume, and relative weightings of an underlying index's component stocks are designed to ensure that the markets for the index's component stocks are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. In addition, ISE Rule 2002(d) requires that the underlying index be "broad-based," as defined in ISE Rule 2001(j).<sup>15</sup> The Commission believes that these requirements minimize the potential for manipulating the underlying index.

The Commission believes that the requirement in ISE Rule 2002(d) that the current index value be widely disseminated at least once every 15 seconds by the Options Price Reporting Authority, the Consolidated Tape Association, the Nasdaq Index Dissemination Service or by one or more major market data vendors during the time an index option trades on the ISE should provide transparency with respect to current index values and contribute to the transparency of the market for broad-based index options.<sup>16</sup> In addition, the Commission believes, as it has noted in other contexts, that the requirement in ISE Rule 2002(d) that an index option be settled based on the opening prices of the index's component securities, rather than on closing prices, could help to reduce the potential impact of expiring index options on the market for the index's component securities.<sup>17</sup>

#### *Accelerated Approval of Amendment No. 4*

The Commission finds good cause for approving Amendment No. 4 to the

<sup>11</sup> See Amendment No. 4, *supra* note 5. Under ISE Rule 2007, the exercise limits for index options are equivalent to the position limits prescribed for option contracts with the nearest expiration in ISE Rule 2004 or ISE Rule 2005.

<sup>12</sup> See Amendment No. 4, *supra* note 5.

<sup>13</sup> The ISG was formed on July 14, 1983, to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. All of the registered national securities exchanges and the National Association of Securities Dealers, Inc., are members of the ISG. In addition, futures exchanges and non-U.S. exchanges and associations are affiliate members of the ISG.

<sup>14</sup> However, such non-U.S. index components, as "NMS stocks," would be registered under Section 12 of the Act and listed and traded on a national securities exchange or Nasdaq, where there is last sale reporting.

<sup>15</sup> ISE Rule 2001(j) defines "broad-based index" to mean "an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries."

<sup>16</sup> See Amendment No. 4, *supra* note 5. The Commission notes, however, that if the ISE designated a data vendor, on an exclusive basis, to disseminate index values on behalf of the ISE, such vendor would be an "exclusive processor" under Section 3(a)(22)(B) of the Act and, absent an exemption, would be required to register as a securities information processor under Section 11A(b)(1) of the Act.

<sup>17</sup> See, e.g., Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992) (order approving a Chicago Board Options Exchange, Incorporated proposal to establish opening price settlement for S&P 500 Index options).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> When relying on Rule 19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the SRO begins trading the new derivative securities product. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 4 strengthens and clarifies the proposal by revising the proposal to: (1) Provide that an index's component securities must be "NMS stocks" rather than "reported securities;" (2) identify the entities or services that will disseminate index values; (3) state that the ISE has an adequate surveillance program for broad-based index options; and (4) clarify that the position limits for broad-based index options apply to option contracts on the same side of the market. Accordingly, the Commission finds that it is consistent with Sections 6(b)(5) and 19(b) of the Act to approve Amendment No. 4 on an accelerated basis.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 4, including whether Amendment No. 4 is consistent with the Act. Comments may be submitted by any of the following methods:

##### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-ISE-2005-27 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC 20549-9303.

All submissions should refer to File Number SR-ISE-2005-27. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference

Section, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the ISE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-ISE-2005-27 and should be submitted on or before November 8, 2005.

#### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-ISE-2005-27), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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**BILLING CODE 8010-01-P**

#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52581; File No. SR-NASD-2005-101]

#### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Notice of Filing of Proposed Rule Change Relating to Expansion of OATS Reporting Requirements to OTC Equity Securities

October 11, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on August 25, 2005, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by NASD. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

NASD is proposing to amend NASD Rules 6951 and 6952 to require members to record and report to the Order Audit Trail System ("OATS")

order information relating to OTC equity securities. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in *brackets*.

\* \* \* \* \*

#### 6950. Order Audit Trail System

#### 6951. Definitions

For purposes of Rules 6950 through 6957:

(a) through (i) No change.

(j) "Order" shall mean any oral, written, or electronic instruction to effect a transaction in a Nasdaq Stock Market equity security or *OTC equity security* that is received by a member from another person for handling or execution, or that is originated by a department of a member for execution by the same or another member, other than any such instruction to effect a proprietary transaction originated by a trading desk in the ordinary course of a member's market making activities.

(k) "Order Audit Trail System" shall mean the automated system owned and operated by the Association that is designed to capture order information reported by members for integration with trade [information reported to the Nasdaq Market Center] and quotation information [disseminated by members in order] to provide the Association with an accurate time sequenced record of orders and transactions.

(l) "OTC equity security" shall mean:

(1) any equity security that is not listed on The Nasdaq Stock Market or a national securities exchange;

(2) any equity security that is listed on one or more regional stock exchanges and does not qualify for dissemination of transaction reports via the facilities of the Consolidated Tape; or

(3) any Direct Participation Program as defined in Rule 6910 that is not listed on The Nasdaq Stock Market or a national securities exchange.

[(l)] (m) "Program Trade" shall mean a trading strategy involving the related purchase or sale of a group of 15 or more securities having a total market value of \$1 million or more, as further defined in New York Stock Exchange Rule 80A.

[(m)] (n) "Reporting Agent" shall mean a third party that enters into any agreement with a member pursuant to which the Reporting Agent agrees to fulfill such member's obligations under Rule 6955.

[(n)] (o) "Reporting Member" shall mean a member that receives or originates an order and has an obligation to record and report information under Rules 6954 and 6955.

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.