

(3) clarify that an Exchange Official who is appointed as a Senior Floor Official may not participate in meetings of the Board unless the Board invites such person to attend its meetings.<sup>8</sup>

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<sup>9</sup> and, in particular, the requirements of Section 6(b) of the Act<sup>10</sup> and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,<sup>11</sup> in that the proposed rule change, as amended, is 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; and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers.

The Commission notes that the proposed rule change, as amended, is designed to facilitate the supervision of trading activity on the Exchange's trading floor. The proposal would expand the pool of Exchange Officials who could be appointed to serve as Senior Floor Officials by eliminating the requirement that such Exchange

Officials previously must have served as an Exchange Governor. Further, the proposal specifies that Exchange Officials who are appointed as Senior Floor Officials would have the same authority and responsibilities as a Floor Governor with respect to matters that arise on the floor and require review or action by a Floor Governor or Senior Floor Official. The Commission also notes that the proposed rule change would clarify the status of Exchange Officials who are appointed as Senior Floor Officials by specifying that these officials may not participate in Board meetings except to the extent that they are invited to attend such meetings. The Commission finds that the proposed rule change, as amended, is consistent with Section 6(b) of the Act.<sup>12</sup>

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-Amex-2004-65), as amended, be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated Authority.<sup>14</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51502; File No. SR-Amex-2005-009]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the American Stock Exchange LLC To Require Members To Complete Systems Training and To Include Violations of This Requirement in Its Minor Rule Violation Plan

April 7, 2005.

On February 1, 2005, the American Stock Exchange LLC ("Amex" 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 adopt new Amex Rule 51 to require its members to complete training in such systems as the Exchange may require and to amend its Minor Rule Violation Plan ("Plan") to allow the Exchange to issue minor fines for non-compliance with this rule. The proposed rule

change was published for comment in the **Federal Register** on March 8, 2005.<sup>3</sup> The Commission received no comments regarding the proposal.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>4</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,<sup>5</sup> because a rule that is reasonably designed to require Exchange members to complete necessary systems training should protect investors and the public interest. The Commission also believes that handling violations of Amex Rule 51 pursuant to the Exchange's Plan is consistent with Sections 6(b)(1) and 6(b)(6) of the Act<sup>6</sup> which require that the rules of an exchange enforce compliance with, and provide appropriate discipline for, violations of Commission and Exchange rules. In addition, because existing Amex Rule 590 provides procedural rights to a person fined under the Plan to contest the fine and permits a hearing on the matter, the Commission believes the Plan, as amended by this proposal, provides a fair procedure for the disciplining of members and persons associated with members, consistent with Sections 6(b)(7) and 6(d)(1) of the Act.<sup>7</sup>

Finally, the Commission finds that the proposal is consistent with the public interest, the protection of investors, or otherwise in furtherance of the purposes of the Act, as required by Rule 19d-1(c)(2) under the Act<sup>8</sup> which governs minor rule violation plans. The Commission believes that the change to Amex's Plan will strengthen its ability to carry out its oversight and enforcement responsibilities as a self-regulatory organization in cases where full disciplinary proceedings are unsuitable in view of the minor nature of the particular violation.

In approving this proposed rule change, the Commission in no way minimizes the importance of compliance with Amex rules and all other rules subject to the imposition of fines under the Exchange's Plan. The Commission believes that the violation of any self-regulatory organization's

with future Amex rule changes. Under the amendment to Amex Rule 21, Exchange Officials appointed as Senior Floor Officials would be able to act in place of Floor Governors with respect to these responsibilities. The following is a list of Amex rules that call for action or review by Floor Governors or Senior Floor Officials: Rule 1 (Hours of Business), Rule 22 (Authority of Floor Officials), Rule 25 (Cabinet Trading of Equity and Derivative Securities), Rule 26 (Performance Committee), Rule 27 (Allocations Committee), Rule 118 (Trading in Nasdaq National Market Securities), Rule 119 (Indications, Openings and Reopenings), Rule 128A (Automatic Execution), Rule 170 (Registration and Functions of Specialists), Rule 590 (Minor Rule Violation Fine System), Rule 904 (Position Limits), Rule 918 (Trading Rotations, Halts and Suspensions), Rule 933 (Automatic Execution of Option Orders), Rule 959 (Accommodation Transactions), Rule 918C (Trading Rotations, Halts and Suspensions), Rule 933-ANTE (Automatic Matching and Execution of Options Orders).

<sup>8</sup> Article II, Section 3 of the Amex Constitution (The Board of Governors—Powers, Duties and Procedures) currently allows the Board to invite persons who are not members of the Board to participate in meetings of the Board. In relevant part, Article II, Section 3 provides: "The Board may invite a person, not a member thereof, to attend its meetings and to participate in its deliberations, but such person shall not have the right to vote."

<sup>9</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78f(b).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</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> See Securities Exchange Act Release No. 51294 (March 2, 2005), 70 FR 11282.

<sup>4</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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

<sup>6</sup> 15 U.S.C. 78f(b)(1) and 78f(b)(6).

<sup>7</sup> 15 U.S.C. 78f(b)(7) and 78f(d)(1).

<sup>8</sup> 17 CFR 240.19d-1(c)(2).

rules, as well as Commission rules, is a serious matter. However, the Exchange's Plan provides a reasonable means of addressing rule violations that do not rise to the level of requiring formal disciplinary proceedings, while providing greater flexibility in handling certain violations. The Commission expects that Amex will continue to conduct surveillance with due diligence and make a determination based on its findings, on a case-by-case basis, whether a fine of more or less than the recommended amount is appropriate for a violation under the Plan or whether a violation requires formal disciplinary action.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act<sup>9</sup> and Rule 19d-1(c)(2) under the Act,<sup>10</sup> that the proposed rule change (SR-Amex-2005-009) be, and hereby is, approved and declared effective.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 51497; File No. SR-CBOE-2004-54]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Partial Amendment No. 1 Thereto By the Chicago Board Options Exchange, Incorporated To Amend Rules Relating Margin Treatment on Stock Transactions Effected By an Options Market Maker To Hedge Options Positions

April 6, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("the Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on July 30, 2004, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On February 22, 2005, the CBOE filed a partial amendment to its proposed rule

change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Chicago Board Options Exchange, Incorporated (the "CBOE" or "Exchange") is proposing to eliminate a rule that essentially disallows favorable margin treatment on stock transactions initiated by options market makers to hedge an option position if the exercise price of the option is more than two standard exercise price intervals above the price of the stock in the case of a call option, or below in the case of a put option. The text of the proposed rule change is available on CBOE's Web site (<http://www.cboe.com>), at the CBOE's Office of the Secretary, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

##### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

###### 1. Purpose

When options market makers hedge their option positions by taking a long or short position in the underlying security, the underlying security is allowed "good faith" margin treatment,<sup>4</sup> provided the underlying security meets the definition of a "permitted offset."<sup>5</sup> To qualify as a permitted offset, CBOE Rule 12.3(f)(3) requires, among other things, that the transaction price of the underlying security be not more than two standard exercise price intervals below the exercise price of the option being hedged in the case of a call option, or above in the case of a put option. The term "in-or-at-the-money" is used in CBOE Rule 12.3(f)(3) to refer to the two standard strike price interval requirement. Stated another way, "in-or-at-the-money" means the option being hedged cannot be "out-of-the-money"

by more than two standard exercise price intervals.<sup>6</sup>

The intent of this requirement was to confine good faith margining of transactions in the underlying security to those that constituted meaningful hedges of an option position. The need to hedge with 100 shares or units of the underlying security diminishes the more the exercise price of a call option is above the price of the underlying security, and the more the exercise price of a put option is below. If these inexpensive, "out-of-the-money" options are offset with a position in the underlying security equivalent in size (that is, units or shares) to that represented by the option, the risk of the combined positions is nearly the same as the underlying security position without the option. The option has very little effect. To prevent inexpensive, "out-of-the-money" options from being used as a means to gain good faith margin for trading in the underlying security, the two standard strike price interval limitation was imposed.

The Exchange is proposing to remove the "in-or-at-the-money" requirement.<sup>7</sup> The Exchange believes that a hedging transaction in the underlying security by an options market-maker can constitute a reasonable hedge, and is deserving of good faith margin, even if the exercise price of the option is out-of-the-money by more than two standard exercise price intervals. The listing of option series is not limited to options that meet the "in-or-at-the-money" requirement and options market-makers are obligated to provide liquidity in such "out-of-the-money" options. In today's listed options market, there can be numerous options series that are out-of-the-money, more so than when the idea of an "in-or-at-the-money" requirement was first conceived. Moreover, in today's listed options market, smaller standard exercise price intervals have been introduced in some options (for example, 1 point and 2½ points), in contrast to the earlier days of the listed

<sup>6</sup> An option is "out-of-the-money" when, based on comparison of the exercise price to the current market price of the underlying security, it makes no economic sense to exercise the option. For example, a call option with the right to purchase the underlying security at \$50 per share would not be exercised if the underlying security were trading in the market for \$46 per share.

<sup>7</sup> The New York Stock Exchange ("NYSE") also has filed a proposed rule change to remove the "in-or-at-the-money" language from its rules on permitted offsets. Although the language of the NYSE's proposed rule change differs from the language of the CBOE's proposed rule change, the proposed changes from the two exchanges are substantively identical. The Commission is publishing a notice to solicit comments on the NYSE's proposed rule change.

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 240.19d-1(c)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12); 17 CFR 200.30-3(a)(44).

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

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

<sup>3</sup> SR-CBOE-2004-54: Amendment No. 1. Under the partial amendment, the options market maker must be able to demonstrate that it effected its permitted offset transactions for market-making purposes.

<sup>4</sup> Good faith margin is defined in Regulation T of the Board of Governors of the Federal Reserve System ("Regulation T"), the margin setting authority for the securities industry, as the amount of margin a creditor would require in exercising sound credit judgment.

<sup>5</sup> A "permitted offset" is defined in CBOE Rule 12.3(f)(3).