

appear reasonably designed to deter a member or its customer from assuming an imprudent position in credit default options.

In support of this proposal, the Exchange made the following representations:

- The Exchange will have in place adequate surveillance procedures to monitor trading in credit default basket options prior to listing and trading such options, thereby helping to ensure the maintenance of a fair and orderly market for trading in credit default options.

- The Exchange and the OPRA will have the necessary systems capacity to accommodate the additional volume associated with credit default basket options as proposed.

This approval order is based on CBOE's representations.

For the foregoing reasons, the Commission finds that the proposed rule is consistent with the Act.

#### IV. Designation of Credit Default Basket Options Pursuant to Rule 9b-1

Rule 9b-1 establishes a disclosure framework for standardized options that are traded on a national securities exchange and cleared through a registered clearing agency. Under this framework, the exchange on which a standardized option is listed and traded must prepare an ODD that, among other things, identifies the issuer and describes the uses, mechanics, and risks of options trading, in language that can be easily understood by the general investing public. The ODD is treated as a substitute for the traditional prospectus. A broker-dealer must provide a copy of the ODD to each customer at or before approving of the customer's account for trading any standardized option.<sup>43</sup> Any amendment to the ODD must be distributed to each customer whose account is approved for trading the options class for which the ODD relates.<sup>44</sup>

Under Rule 9b-1, use of the ODD is limited to "standardized options" for which there is an effective registration statement on Form S-20 under the Securities Act or that are exempt from registration.<sup>45</sup> The Commission

specifically reserved in Rule 9b-1 the ability to designate as standardized options other securities "that the Commission believes should be included within the options disclosure framework."<sup>46</sup>

The Commission hereby designates credit default basket options, as defined in the OCC Proposal,<sup>47</sup> as standardized options for purposes of Rule 9b-1 under the Act. Like credit default options, credit default basket options do not meet the definition of "standardized options," because they do not have an exercise price.<sup>48</sup> However, they resemble standardized options in other significant respects. Credit default basket options have underlying securities and an expiration date. Like other standardized options, credit default basket options have standardized terms relating to exercise procedures, contract adjustments, time of issuance, effect of closing transactions, restrictions, and other matters pertaining to the rights and obligations of holders and writers. Further, credit default basket options

offer or sale of the underlying security or securities as defined in Section 2(a)(3) of the Securities Act, 15 U.S.C. 77b(a)(3). *See also* Securities Act Release No. 8171 (December 23, 2002), 68 FR 188 (January 2, 2003) (Exemption for Standardized Options From Provisions of the Securities Act of 1933 and From Registration Requirements of the Exchange Act of 1934).

<sup>46</sup> *See* Securities Exchange Act Release No. 19055 and Securities Act Release No. 6426 (September 16, 1982), 47 FR 41950, 41954 (September 23, 1982).

<sup>47</sup> For purposes of its proposal, OCC would define the term "credit default basket option" as an option that is based on a basket comprised of at least two reference entities and that is either a "multiple payout credit default basket option" or a "single payout credit default basket option." A "multiple payout credit default basket option" would mean a credit default basket option that automatically pays an exercise settlement amount each time a credit event is confirmed with respect to any one of the reference entities prior to expiration of the option. A "single payout credit default basket option" would be automatically exercised and pay a single exercise settlement amount only when the first credit event is confirmed with respect to a reference entity prior to expiration of the option. *See* proposed Section 1.C.(2) of Article XIV of the OCC By-Laws.

"Credit event" would be as defined in the rules of the exchange on which the credit default basket options are listed, with respect to a reference obligation for such option. *See* proposed Section 1.C.(3) of Article XIV of the OCC By-Laws.

"Reference entity" would mean any one of the issuers or guarantors of the reference obligation(s) that underlie a credit default basket option. *See* proposed Section 1.R.(1) of Article XIV of the OCC By-Laws.

"Reference obligation" would mean any debt security the terms of which are used to define the occurrence of a credit event with respect to the reference entity that is its issuer or guarantor for a class of credit default basket options, as provided in the rules of the listing exchange. *See id.*

<sup>48</sup> *See* Credit Default Options Approval Order at Section VI (designating credit default options as standardized options for purposes of Rule 9b-1 under the Act).

are designed to provide market participants with the ability to hedge their exposure to underlying securities. The fact that credit default basket options lack a specified exercise price does not detract from this option-like benefit. The Commission believes that the fact that the OCC, the clearing agency for all standardized options, is willing to serve as issuer of credit default basket options supports the view that adding credit default basket options to the standardized option disclosure framework is reasonable.

Therefore, the Commission hereby designates credit default basket options, such as those proposed by CBOE, as standardized options for purposes of Rule 9b-1 under the Act.

#### V. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>49</sup> that the proposed rule change (SR-CBOE-2007-26), as modified by Amendment No. 3, be and hereby is approved.

*It is further ordered*, pursuant to Rule 9b-1(a)(4) under the Act, that credit default basket options, as defined in proposed rule change SR-OCC-2007-06, are designated as standardized options.

By the Commission.

**Florence E. Harmon,**  
*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56265; File No. SR-FINRA-2007-002]

#### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Extend a Pilot Program That Increases Position and Exercise Limits for Certain Equity Options

August 15, 2007.

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> notice is hereby given that on July 31, 2007, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a the National Association of Securities Dealers, Inc. ("NASD")) filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and

<sup>49</sup> 15 U.S.C. 78s(b)(2).

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

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

<sup>43</sup> *See* 17 CFR 240.9b-1(d)(1).

<sup>44</sup> *See* 17 CFR 240.9b-1(d)(2).

<sup>45</sup> *See* 17 CFR 240.9b-1(b)(1) and (c)(8). *See also* 17 CFR 230.238, Rule 238 under the Securities Act provides an exemption from the Securities Act for any standardized option, as defined by Rule 9b-1(a)(4) under the Act, with limited exceptions. Rule 238 does not exempt standardized options from the antifraud provisions of Section 17 of the Securities Act, 15 U.S.C. 77q. Also, offers and sales of standardized options by or on behalf of the issuer of the underlying security or securities, an affiliate of the issuer, or an underwriter, will constitute an

III below, which Items have been substantially prepared by FINRA. FINRA has filed the proposal as a “non-controversial” rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders it effective upon filing with the Commission. 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**

FINRA proposes to amend Rule 2860 to extend a pilot program increasing certain options position and exercise limits. The text of the proposed rule change is available at FINRA, the Commission’s Public Reference Room, and <http://www.finra.org>.

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

In its filing with the Commission, FINRA included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. FINRA has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

##### **1. Purpose**

FINRA proposes to amend Rule 2860 to extend a pilot program until March 1, 2008 (unless extended) increasing position and exercise limits for both standardized and conventional options (“Pilot Program”).<sup>5</sup> Unless extended, the Pilot Program will expire on September 1, 2007.<sup>6</sup> FINRA believes that the Pilot Program should be extended so that it may continue without interruption for the same reasons that are discussed in the Pilot Program Notice.

##### **2. Statutory Basis**

FINRA believes that the proposed rule change is consistent with the provisions

of Section 15A(b)(6) of the Act,<sup>7</sup> which requires, among other things, that FINRA’s rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change is being made so that the Pilot Program, which achieves these goals as discussed in the Pilot Program Notice, may continue without interruption.

#### **B. Self-Regulatory Organization’s Statement on Burden on Competition**

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

#### **C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others**

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Because the foregoing rule change does not: (1) Significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>8</sup> and Rule 19b-4(f)(6) thereunder.<sup>9</sup>

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the Act.

### **IV. Solicitation of Comments**

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

<sup>7</sup> 15 U.S.C. 78o-3(b)(6).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(6). Rule 19b-4(f)(6) also requires the self-regulatory organization to give the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. FINRA has satisfied the five-day pre-filing requirement.

#### **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 No. SR-FINRA-2007-002 on the subject line.

#### **Paper Comments**

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File No. SR-FINRA-2007-002. 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, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing will also be available for inspection and copying at the principal office of FINRA. 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 No. SR-FINRA-2007-002 and should be submitted on or before September 12, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Florence E. Harmon,**  
Deputy Secretary.

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<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

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

<sup>5</sup> See Securities Exchange Act Release No. 51520 (April 11, 2005), 70 FR 19977 (April 15, 2005) (SR-NASD-2005-040) (“Pilot Program Notice”).

<sup>6</sup> See Securities Exchange Act Release No. 55225 (February 1, 2007), 72 FR 6634 (February 12, 2007) (SR-NASD-2007-007).