

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44333; File No. SR-ODD-00-04]

Self-Regulatory Organizations; Canadian Derivatives Clearing Corporation; Order Approving Proposed Amendments to Options Disclosure Document

May 22, 2001.

On May 17, 2001, the Canadian Derivatives Clearing Corporation ("CDCC")¹ and Bourse de Montréal, Inc. ("Bourse de Montréal") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Rule 9b-1 under the Securities Exchange Act of 1934 ("Act"),² five definitive copies of an amended options disclosure document ("ODD"), which describes the risks and characteristics of Canadian exchange-traded put and call options traded on the Bourse de Montréal.³

The Commission has reviewed the amended ODD and finds that it complies with Rule 9b-1 under the Act.⁴ Among other things, the CDCC and Bourse de Montréal have revised the ODD to describe changes in the Canadian marketplace. Previously, options cleared and settled by the CDCC were purchased and sold in transactions on the Montréal Exchange (now the Bourse de Montréal), the Toronto Stock Exchange ("TSE"), the Toronto Futures Exchange ("TFE"), and the Vancouver Stock Exchange ("VSE"). Under a Memorandum of Agreement dated March 15, 1999, the Alberta Stock Exchange ("ASE"), the Bourse de Montréal, the TSE, and the VSE agreed that the ASE and the VSE would combine to create a single junior equities market, that all senior equities would be transferred to the TSE, and that the Bourse de Montréal would trade all exchange-traded derivative products, including any type of option contracts. Under this agreement, derivative

products traded on the TFE were transformed to the Bourse de Montréal.

Other revisions to the ODD include: a discussion of Enhanced Capital Monitoring,⁵ which was introduced in October 2000; a clarification of certain U.S. federal income tax aspects of options transactions; and the addition of new terms to the ODD glossary. The revised ODD further states that the CDCC is now issuing options on the S&P/TSE 60 Index and deletes reference to the TSE 35 Index options and TSE 100 Index options, which the CDCC no longer issues.

Rule 9b-1 under the Act provides that an options market must file five preliminary copies of an amended ODD with the Commission at least 30 days prior to the date when definitive copies of the ODD are furnished to customers, unless the Commission determines otherwise, having due regard to the adequacy of information disclosed and the protection of investors.⁶ The Commission has reviewed the amended ODD, and finds that it is consistent with the protection of investors and in the public interest to allow the distribution of the disclosure document as of the date of this order.⁷

It is therefore ordered, pursuant to Rule 9b-1 under the Act,⁸ that the proposed amendment to the CDCC and Bourse de Montréal ODD (SR-ODD-00-04) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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¹ The CDCC was formerly known as Trans Canada Options Inc. ("TCO"). The name of the corporation was changed in January 1996.

² 17 CFR 240.19b-1.

³ The Commission initially approved the use and distribution of the TCO ODD in 1984. See Securities Exchange Act Release No. 21365 (October 2, 1984), 49 FR 39400 (October 5, 1984). The Commission subsequently approved several amended versions of the TCO ODD, and after 1996, the CDCC ODD. See Securities Exchange Act Release Nos. 37569 (August 14, 1996), 61 FR 43281 (August 21, 1996); 29033 (April 1, 1991), 56 FR 14407 (April 9, 1991); 24480 (May 19, 1987), 52 FR 20179 (May 29, 1987); and 22349 (August 21, 1985), 50 FR 34956 (August 28, 1985).

⁴ 17 CFT 240.9b-1.

⁵ Enhanced Capital Monitoring is a process designed to assess and mitigate the credit risk of a CDCC Clearing Member to which the CDCC is exposed.

⁶ This provision is intended to permit the Commission either to accelerate or extend the time period in which definitive copies of a disclosure document may be distributed to the public.

⁷ Rule 9b-1 under the Act provides that the use of an ODD shall not be permitted unless the options class to which the documents relates is the subject of an effective registration statement on Form S-20 under the Securities Act of 1933. On April 20, 2001, the Commission, pursuant to delegated authority, declared effective the CDCC's most recent Post-Effective Amendment to its Form S-20 registration statement. See File No. 2-69458.

⁸ 17 CFR 240.9b-1.

⁹ 17 CFR 200.30-3(a)(39)(i).

SECURITIES AND EXCHANGE COMMISSION

[Docket No. 34-4331; File No. SR-ISE-2001-11]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the International Securities Exchange LLC To Trade Standardized Equity Options on Trust Issued Receipts

May 21, 2001.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 20, 2001, the International Securities Exchange LLC ("ISE" and "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On May 17, 2001, the ISE submitted Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and to approve the proposed rule change on an accelerated basis.

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

The Exchange proposes to adopt new listing and maintenance standards to allow for trading of standardized equity options on trust issued receipts. The text of the proposed rule change follows. Proposed new language is in italics.

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Rule 502. Criteria for Underlying Securities

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(j) Securities deemed appropriate for options trading shall include shares or other securities ("Trust Issued Receipts") that are principally traded on a national securities exchange or through the facilities of a national

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter to Susie Cho, Division of Market Regulation ("Division"), SEC, from Michael Simon, Senior Vice President and General Counsel, ISE, dated May 16, 2001 ("Amendment No. 1"). In Amendment No. 1, the ISE noted that the trust issued receipts will be issued upon the deposit of the shares of underlying securities represented by a round-lot of 100 receipts and that the trust will cancel, and an investor may obtain, hold, trade or surrender trust issued receipts in a round-lot and round-lot multiples of 100 receipts. The ISE also added proposed margin requirements for options on trust issued receipts and corrected a typographical error in the proposed rule language.

securities association and reported as a national market security, and that represent ownership of the specific deposited securities held by a trust, provided:

(1) the Trust Issued Receipts (i) meet the criteria and guidelines for underlying securities set forth in paragraph (b) to this Rule; or (ii) must be available for issuance or cancellation each business day from the Trust in exchange for the underlying deposited securities, and

(2) not more than 20% of the weight of the Trust Issued Receipt is represented by ADRs on securities for which the primary market is not subject to a comprehensive surveillance agreement.

Rule 503. Withdrawal of Approval of Underlying Securities

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(j) Absent exceptional circumstances, securities initially approved for options trading pursuant to paragraph (j) of Rule 502 (such securities are defined and referred to in that paragraph as "Trust Issued Receipts") shall not be deemed to meet the Exchange's requirements for continued approval, and the Exchange shall not open for trading any additional series of option contracts of the class covering such Trust Issued Receipts, whenever the Trust Issued Receipts are delisted and trading in the Receipts is suspended on a national securities exchange, or the Trust Issued Receipts are no longer traded as national market securities through the facilities of a national securities association. In addition, the Exchange shall consider the suspension of opening transactions in any series of options of the class covering Trust Issued Receipts in any of the following circumstances:

(1) in accordance with the terms of paragraph (b) this Rule 503 in the case of options covering Trust Issued Receipts when such options were approved pursuant to subparagraph (j)(1)(i) under Rule 502;

(2) the Trust has more than 60 days remaining until termination and there are fewer than 50 record and/or beneficial holders of Trust Issued Receipts for 30 or more consecutive trading days;

(3) the Trust has fewer than 50,000 receipts issued and outstanding;

(4) the market value of all receipts issued and outstanding is less than \$1,000,000; or

(5) such other event shall occur or condition exist that in the option of the Exchange makes further dealing in such options on the Exchange inadvisable.

(k) For Holding Company Depository Receipts (HOLDRs), the Exchange will not open additional series of options overlying HOLDRs (without prior Commission approval) if:

(1) the proportion of securities underlying standardized equity options to all securities held in a HOLDRs trust is less than 80% (as measured by their relative weightings in the HOLDRs trust); or

(2) less than 80% of the total number of securities held in a HOLDRs trust underlie standardized equity options.

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

In its filing with the Commission, the Exchange 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. The Exchange 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

The purpose of the proposed rule change is to provide for the trading of options on trust issued receipts.⁴ The Exchange believes that the listing and maintenance criteria proposed in its new rule are consistent with the options listing and maintenance criteria for trust issued receipts currently used by the American Stock Exchange LLC ("Amex"), the Chicago Board Options Exchange, Inc. ("CBOE") and the Pacific Exchange, Inc. ("PCX"),⁵ Trust issued receipts are exchange-listed securities representing beneficial ownership of the specific deposited securities represented by the receipts. They are negotiable receipts issued by a trust representing securities of issuers that have been deposited and are held on behalf of the holders of the trust issued receipts. Trust issued receipts, which trade in

⁴ The Exchange is not proposing at this time to list FLEX options on trust issued receipts.

⁵ See Securities Exchange Act Release No. 44138 (March 30, 2001), 66 FR 19593 (April 16, 2001) (approving SR-PCX-2001-15); Securities Exchange Act Release No. 43043 (July 17, 2000), 65 FR 46520 (July 28, 2000) (approving SR-CBOE-00-25); and Securities Exchange Act Release No. 42947 (June 15, 2000), 65 FR 39211 (June 23, 2000) (approving SR-Amex-99-37).

round-lots of 100, and multiples thereof, may be issued after their initial offering through a deposit with the trustee of the required number of shares of common stock of the underlying issuers. This characteristic of trust issued receipts is similar to that of exchange-traded fund shares, which also may be created on any business day upon deposit of the requisite securities comprising a creation unit.⁶ The trust will only issue receipts upon the deposit of the shares of underlying securities that are represented by a round-lot of 100 receipts. Likewise, the trust will cancel, and an investor may obtain, hold, trade or surrender trust issued receipts in a round-lot and round-lot multiples of 100 receipts.

Generally, options on trust issued receipts are proposed to be traded to the Exchange pursuant to the same rules and procedures that apply to trading in options on equity securities. The Exchange will list option contracts covering 100 trust issued receipts, the minimum required round-lot trading size for the underlying receipts. Strike prices for trust issued receipts will be set to bracket the trust issued receipts at the same intervals that apply to other equity options under ISE Rule 504 (i.e., 2½ point intervals for underlying equity values up to \$25; 5 point intervals for underlying equity values greater than \$25 up to \$200; and 10 point intervals for underlying equity values greater than \$200). The proposed position and exercise limits for trust issued receipts would be the same as those established for other equity options, as set forth in ISE Rules 412 and 414, respectively. The Exchange anticipates that most options on trust issued receipts will initially qualify for the lowest position limit. However, as with other equity options, applicable position limits will be increased for options if the volume of trading in the trust issued receipts increases to the extent needed to permit a higher limit.

The listing and maintenance standards proposed for options on trust issued receipts are set forth respectively in proposed paragraph (j) under ISE Rule 502, and in proposed paragraphs (j) and (k) under ISE Rule 503. Pursuant to the proposed initial listing standards, the Exchange will list options only on trust issued receipts that are principally traded on a national securities exchange or through the facilities of a national securities association and reported as national market securities. In addition,

⁶ The Exchange received approval to trade options on exchange-traded fund shares on February 28, 2001. See Securities Exchange Act Release No. 44037 (March 2, 2001), 66 FR 14613 (March 13, 2001).

the initial listing standards require that either: (i) The trust issued receipts meet the uniform options listing standards in paragraph (b) of ISE Rule 502, which include criteria covering the minimum public float, trading volume, and share price of the underlying security in order to list the option;⁷ or (ii) the trust issued receipts must be available for issuance or cancellation each business day from the trust in exchange for the underlying deposited securities.

In addition, listing standards for options on trust issued receipts will require that any American Depository Receipts ("ADRs") in the portfolio on which the Trust is based for which the securities underlying the ADRs' primary markets are in countries that are not subject to comprehensive surveillance agreements will not in the aggregate represent more than 20 percent of the weight of the portfolio.

The Exchange's proposed maintenance standards provide that if a particular series of trust issued receipts should cease to trade on an exchange or as national market securities in the over-the-counter market, there will be no opening transactions in the options on the trust issued receipts, and all such options will trade on a liquidation-only basis (*i.e.*, only closing transactions to permit the closing of outstanding open options positions will be permitted). In addition, the Exchange will consider the suspension of opening transactions in any series of options of the class covering trust issued receipts if: (i) For options on trust issued receipts that were listed pursuant to the equity option listing standards in paragraph (j)(1)(i) of ISE Rule 502, the options fail to meet the option maintenance standards in paragraph (b) of ISE Rule 503;⁸ (ii) the trust has more than 60 days remaining until termination and there are fewer than 50 record and/or beneficial holders of trust issued receipts for 30 or more consecutive trading days; (iii) the trust has fewer than 50,000 receipts issued and

outstanding; (iv) the market value of all receipts issued and outstanding is less than \$1,000,000; or (v) such other event shall occur or condition exists that, in the opinion of the Exchange, makes further dealing in such options on the Exchange inadvisable. Furthermore, the Exchange will not open additional series of options on any Holding Company Depository Receipts ("HOLDRs"), a type of trust issued receipt, without prior Commission approval, if: (i) The proportion of securities underlying standardized equity options to all securities held in a HOLDRs trust is less than 80 percent (as measured by the relative weightings in the HOLDRs trust);⁹ or (ii) less than 80 percent of the number of securities held by a HOLDR trust underlie standardized options.

Options on trust issued receipts will be physically settled and will have the American-style exercise feature used on all equity options, and not the European-style feature.¹⁰ The proposed margin requirements for options on trust issued receipts are at the same levels that apply to options generally under ISE Rule 1202,¹¹ except, with respect to trust issued receipts based on a broad-based portfolio, minimum margin must be deposited and maintained equal to 100% of the current market value of the option plus 15% of the market value of equivalent units of the underlying security value. Trust issued receipts that hold securities based upon a narrow-based portfolio must have options margin that equals at least 100% of the current market value of the contract plus 20% of the market value of equivalent unit of the underlying security value. In this respect, the margin requirements proposed for options on trust issued receipts are comparable to margin requirements that currently apply to broad-based and narrow-based index options on the NYSE and CBOE.¹² Also, holders of options on trust issued receipts that

exercise and receive the underlying trust issued receipts must receive a product description or prospectus, as appropriate.

Lastly, the Exchange believes it has the necessary system capacity to support the additional series of options that would result from the trading of options on trust issued receipts, and it has been advised that the Options Price Reporting Authority ("OPRA") also will have the capacity to support these additional series.

2. Statutory Basis

The ISE believes that the proposed rule change is consistent with Section 6(b)(5) of the Act.¹³ Section 6(b)(5) requires that exchange rules be designed 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 public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The ISE does not believe that the proposed rule change will impose 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

The Exchange did not solicit or receive comments on the proposed rule change.

III. 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, DC 20549-0609. 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 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be

⁷ Specifically, paragraph (b) of ISE Rule 502 requires the underlying security to have a public float of 7,000,000 shares, 2,000 holders, trading volume of 2,400,000 shares in the preceding 12 months, a share price of \$7.50 for the majority of the business days during the three calendar months preceding the date of the selection, and that the issuer of the underlying security is in compliance with the Act.

⁸ Specifically, paragraph (b) of ISE Rule 503 provides that an underlying security will not meet the Exchange's requirements for continued listing when, among other things: (i) There are fewer than 6,300,000 publicly-held shares; (ii) there are fewer than 1,600 holders; (iii) trading volume was less than 1,800,000 shares in the preceding twelve months; or (iv) the share price of the underlying security closed below \$5 on a majority of the business days during the preceding six months.

⁹ The Exchange represents that the weight of each security in a HOLDR trust will be determined by calculating the sum of the number of shares of each security (represented in a single HOLDR) and underlying options multiplied by its respective share price divided by the sum of the number of shares of all securities (represented in a single HOLDR) multiplied by their respective share prices.

¹⁰ An American-style option may be exercised at any time prior to its expiration, while a European-style option may be exercised only at its expiration date.

¹¹ The Exchange's margin rules cross-reference the rules of the CBOE and the New York Stock Exchange, Inc ("NYSE")

¹² The Exchange agrees to modify its margin rules to reflect the proposed margin requirements for options on trust issued receipts based on broad-based and narrow-based indexes. See Amendment No. 1, *supra* note 3.

¹³ 15 U.S.C. 78f(b)(5).

available for inspection and copying at the principal office of the Exchange. All submissions should refer to the File No. SR-ISE-2001-11 and should be submitted by June 19, 2001.

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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, and in particular, with the requirements of Section 6(b)(5).¹⁴ The Commission notes that it has previously approved similar listing standards proposed by the Amex, CBOE, and PCX for options on trust issued receipts, and it believes that the ISE's proposal contains adequate safeguards, matching those previously approved.¹⁵ As the Commission found in its previous approvals of the listing standards proposed by the other exchanges, the listing and trading of options should give investors a better means to hedge their positions in the underlying trust issued receipts. The Commission also believes that pricing of the underlying trust issued receipts may become more efficient, and market makers in these shares, by virtue of enhanced hedging opportunities, may be able to provide deeper and more liquid markets. In sum, the Commission believes that options on trust issued receipts likely will engender the same benefits to investors and the marketplace that exist with respect to options on common stock, thereby serving to promote the public interest, to remove impediments to a free and open securities market, and to promote efficiency, competition, and capital formation.¹⁶

The Commission finds that the Exchange's listing and delisting criteria for options on trust issued receipts are adequate. The proposed listing and maintenance requirements should ensure that there exist adequate supplies of the underlying trust issued receipts in case of the exercise of an option, and a minimum level of liquidity to control against manipulation and to allow for the maintenance of fair and orderly markets. The ISE's additional requirements for opening additional series of options on HOLDRs will also ensure that the underlying securities are options eligible, and for the most part will

satisfy minimum thresholds previously approved by the Commission.

The Commission also believes that the surveillance standards developed by the ISE for options on trust issued receipts are adequate to address the concerns associated with the listing and trading of such securities. The ISE's proposal to limit the weight of the portfolio that may be composed of ADRs whose primary markets are in countries that are not subject to comprehensive surveillance agreements is similar to that previously approved by the Commission.¹⁷ As to domestically traded trust issued receipts themselves and the domestic stocks in the underlying portfolio, the Intermarket Surveillance Group ("ISG") Agreement will be applicable to the trading of options on trust issued receipts.¹⁸

Finally, the Commission believes that the ISE's proposed margin requirements, which mirror those of the CBOE, are appropriate.¹⁹ The Commission notes that they are comparable to margin requirements that currently apply to broad-based and narrow-based index options, and to those previously approved for use at the Amex, CBOE, and PCX.²⁰

The Commission finds good cause for approving the proposed rule change (SR-ISE-2001-11) prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register** under Section 19(b)(2) of the Act.²¹ As noted above, the trading requirement for options on trust issued receipts at the ISE will be substantially similar to those at the Amex, CBOE, and PCX, which the Commission has approved.²² The Commission does not believe that the proposed rule change raises novel regulatory issues that were not already addressed and should benefit holders of trust issued receipts by permitting them to use options to manage the risks of their positions in the receipts. Accordingly, the Commission finds that there is good cause, consistent with Section 6(b)(5) of the Act,²³ to approve the proposal on an accelerated basis.

¹⁷ See *supra* note 5.

¹⁸ 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.

¹⁹ See *supra* note 5.

²⁰ The Commission also notes that the ISE will file a proposed rule change to amend its margin rules, if necessary. See Amendment No. 1, *supra* note 3.

²¹ 15 U.S.C. 78s(b)(2).

²² See *supra* note 5.

²³ 15 U.S.C. 78f(b)(5).

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-ISE-2001-11) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44332; File No. SR-NASD-00-77]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Registration Requirements for Limited Principals-Financial and Operations and Limited Principals-Introducing Broker/Dealer Financial and Operations

May 21, 2001.

I. Introduction

On December 20, 2000, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, NASD Regulation, Inc. ("NASD Regulation") filed with the Securities and Exchange Commission ("Commission" or "SEC") a proposed rule change pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")¹ and Rule 19b-4 thereunder.² The proposal amends NASD Rule 1022(b), "Limited Principal—Financial and Operations" ("FINOP"), NASD Rule 1022(c), "Limited Principal—Introduction Broker/Dealer Financial and Operations" ("Introducing FINOP"), and NASD Rule 9610, "Procedures for Exemptions." Notice of the proposed rule change was published for comment in the **Federal Register** on February 9, 2001.³ The Commission received one comment letter regarding the proposal.⁴ This order approves the proposed rule change.

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 43928 (February 5, 2001), 66 FR 9737.

⁴ See letter to the Secretary, SEC, from the Ad Hoc Committee for Small Firm Financial and Operational Responsibility ("Ad Hoc Committee"), dated March 2, 2001 ("Ad Hoc Committee Letter").

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ See *supra* note 5.

¹⁶ In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).