

outstanding, prior to the opening of the Amex. The Exchange will also disseminate the NAV and final dividend amounts to be paid for each Fund on amextrader.com.

As described more fully above, the Advisor will make available through the Distributor on each business day prior to the opening of trading on the Exchange the list of the names and the required number of shares of each Deposit Security included in the current Portfolio Deposit for each Fund to effect purchases of Creation Unit Aggregations of the Fund.

In addition, the Advisor will provide the NSCC on a daily basis with the names and required number of shares of the Deposit Securities in a Creation Unit Aggregation and the Balancing Amount, which the NSCC will make available to NSCC members through an electronic file that NSCC members can download.<sup>57</sup>

#### *I. Scope of the Commission's Order*

The Commission is approving the 7 series of iShares described herein. Other similarly structured products, or additional iShares Funds based on indexes that include securities not listed on a national securities exchange of The Nasdaq Stock Market, would require review by the Commission pursuant to Section 19(b) of the Act prior to being traded on the Amex.

#### *J. Accelerated Approval of the Proposal and Amendment Nos. 1, 2, 3, and 4*

The Commission finds good cause for approving the proposed rule change and Amendment Nos. 1, 2, 3, and 4 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. As discussed more fully above, the Commission has approved the listing and trading of various Index Fund Shares on the Amex. Several of the Amex's previous proposals to list and trade Index Fund Shares were published for comment and the Commission received no comments regarding the proposals. Accordingly, the Commission believes that it is reasonable to make the proposed iShares available to investors as soon as possible. Amendment No. 1 strengthens the Amex's proposal by, among other things, stating that the Exchange will disclose, in an Information Circular that Funds holding shares of Korean, Malaysian, Taiwanese and Brazilian companies will charge creation and redemption fees intended to offset brokerage costs associated with cash creations and redemptions; and

representing that MSCI has implemented procedures to prevent the misuse of material non-public information regarding MSCI indices. Amendment No. 2 clarifies the proposal by, among other things, noting that Fund Participants are limited to DTC Participants and clarifying the level of the Funds' investment in their Underlying Indices. Amendment No. 2 further clarified the proposal explaining that fees assessed in connection with Funds trading in countries where in-kind purchases of securities are precluded, are assessed in part to cover market impact costs. Amendment No. 4 also strengthened the proposal by requiring, among other things, that the Fund prospectus will disclose the possible market impact of a Fund buying or selling securities in those countries prior to calculation of the NAV. Amendment No. 4 clarified the proposal by, among other things, further delineating the level of the Funds investment in their Underlying Indices. Accordingly, the Commission believes that there is good cause, consistent with sections 6(b)(5) and 19(b)(2) of the Act,<sup>58</sup> to approve the proposal and Amendment Nos. 1, 2, 3, and 4 to the proposal on an accelerated basis.

#### **V. Conclusion**

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (SR-Amex-2001-45), as amended, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>59</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-44994; File No. SR-CBOE-2001-22]

### **Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Permanent Approval of the Pilot Program To Eliminate Position and Exercise Limits for OEX, SPX, and DJX Index Options and Flex Options on These Indexes**

October 26, 2001.

#### **I. Introduction**

On May 14, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change seeking permanent approval of the pilot program eliminating position and exercise limits for S&P 500 Index ("SPX"), S&P 100 Index ("OEX"), and Dow Jones Industrial Average ("DJX") as well as for FLEX options overlying these indexes.

The proposed rule change was published for comment in the **Federal Register** on June 25, 2001.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposal.

#### **II. Description of Proposal**

On January 22, 1999, the Commission approved a two-year pilot program ("Pilot Program") that allowed for the elimination of position and exercise limits for options on the OEX, SPX, DJX index options as well as for FLEX options overlying these indexes.<sup>4</sup> On January 22, 2001, the Commission extended the Pilot Program until May 22, 2001.<sup>5</sup> On May 22, 2001, the Commission again extended the Pilot Program until September 22, 2001.<sup>6</sup> On September 24, 2001, the Commission extended the pilot program until March 24, 2002.<sup>7</sup> The Exchange now seeks

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

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

<sup>3</sup> See Securities Exchange Act Release No. 42862 (May 30, 2000), 65 FR 36481.

<sup>4</sup> See Securities Exchange Act Release No. 40969, 64 FR 49111 (Feb. 1, 1999) (approving SR-CBOE-98-23) ("Pilot Approval Order").

<sup>5</sup> See Securities Exchange Act Release No. 43867, 66 FR 8250 (January 30, 2001).

<sup>6</sup> See Securities Exchange Act Release No. 44335, 66 FR 33728 (May 25, 2001).

<sup>7</sup> See Securities Exchange Act Release No. 44837, 66 FR 49988 (October 1, 2001).

<sup>58</sup> 15 U.S.C. 78f(b)(5) and 78s(b)(2).

<sup>59</sup> 17 CFR 200.30-3(a)(12).

<sup>57</sup> See Amendment No. 4, *supra*, footnote 6.

permanent approval of the Pilot Program.

### III. Discussion

After careful review, 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>8</sup> Specifically, the Commission believes that the proposed rule change is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities and to remove impediments to and perfect the mechanism of a free and open market and a national market system.<sup>9</sup>

The Commission believes for the same reasons discussed in the Pilot Approval Order, in addition to the lack of any problems identified during the pilot period as discussed below, that the pilot should be approved on a permanent basis.<sup>10</sup> The Commission notes that the Pilot Approval Order required the Exchange to submit a report to the Commission on the status of the Pilot Program so that the Commission could use this information to evaluate any consequences of the program and to determine whether to approve the elimination of position and exercise limits for these products on a permanent basis.<sup>11</sup> The CBOE submitted the required report to the Commission on December 21, 2000.<sup>12</sup>

The report represents that during the review period, CBOE did not discover any instances where an account maintained an unusually large unhedged position. The data from the report found that only 12 accounts

established positions in excess of 10% of the standard limit applicable to each index at the time the Pilot Program was approved. These positions were all in SPX and most were established by firms and market makers. All of the accounts were hedged, although to different degrees. CBOE represented that it did not discover any aberrations caused by large unhedged positions during the life of the Pilot Program.<sup>13</sup>

In addition to no identifiable problems during the pilot program, the Commission also believes that the factors for approval of the pilot program continue to be met. For example, in approving the pilot, the Commission stated, among other things, that the enormous capitalization of and deep, liquid markets for the underlying securities contained in the OEX, SPX and DJX significantly reduces concerns regarding market manipulation or disruption in the underlying market. In this regard, we note that the indexes continue to have enormous capitalizations. Indeed, the current capitalizations' of the indexes are currently higher than the capitalizations we relied on in originally approving the pilot.<sup>14</sup>

The Commission also continues to believe that the financial requirements imposed by CBOE and the Commission help to address concerns that a CBOE member or is customer may try to maintain an inordinately large unhedged position in the indexes. As noted in the Pilot Approval Order, the CBOE has the authority to impose additional margin and/or assess capital charges and should be able to monitor accounts to determine when such action is warranted.<sup>15</sup>

Finally, in addition to the other basis for approval of the pilot as discussed in the Pilot Approval Order, the

Commission relied heavily on the enhanced surveillance<sup>16</sup> and reporting safeguards that would allow CBOE to detect and deter trading abuses arising from the elimination of position and exercise limits in options and Flex options on the subject indexes.<sup>17</sup> The Commission continues to believe that these enhanced procedures are critical in our determination to permanently approve the pilot. While the pilot did not note any aberrations or concerns about large unhedged positions, the Commission continues to believe that these procedures will enable the CBOE to adequately assess and respond to market concerns at an early stage. In this regard the Commission continues to expect CBOE to take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop.

### IV. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-CBOE-2001-22) is approved.

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

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>8</sup> In approving this rule proposal, 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).

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

<sup>10</sup> The bases for approving the pilot as discussed in the Pilot Approval Order are incorporated herein to this permanent approval order.

<sup>11</sup> In the prior Approval Order, the Commission stated, "CBOE will provide the Commission with a report detailing the size and different types of strategies employed with respect to positions established in those classes not subject to position limits. In addition, the report will note whether any problems resulted due to the no limit approach and any other information that may be useful in evaluating the effectiveness of the pilot program. The Commission expects that CBOE will take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop."

<sup>12</sup> Letter from Patricia L. Cerny, Director, Office of Trading Practices, CBOE, to Elizabeth King, Division of Market Regulation, Commission, dated December 21, 2000.

<sup>13</sup> In its latest filing extending the pilot program, CBOE again represented that it had not discovered any aberrations caused by large unhedged positions during the pilot program. See *supra* note 7.

<sup>14</sup> The Pilot Approval Order stated that, as of August 1998, the market capitalizations for the SPX, OEX, and DJX were \$8.5 trillion, \$3.8 trillion and \$2.2 trillion, respectively. As of October 2001, these figures had increased to \$9.81 trillion, \$5.7 trillion and \$3.23 trillion, respectively.

<sup>15</sup> As originally noted in the Pilot Approval Order, the Commission's net capital rule, Rule 15c3-1 under the Exchange Act, imposes a capital charge on members to the extent of any margin deficiency. More specifically, Exchange Act Rule 15c3-1 requires a capital charge equal to the maximum potential loss on a broker-dealer's aggregate index position over a +(-) 10% market move. Exchange margin rules require margin on naked index options which are in or at-the-money equal to a 15% move in the underlying index; and a minimum 10% charge for naked out-of-the money contracts. At an index value of 9,000 this approximates to a \$135,000 to \$90,000 requirement per each unhedged contract.

<sup>16</sup> It is inappropriate to discuss the details of CBOE's enhanced surveillance program because the disclosure of specific surveillance procedures could provide market participants with information that could aid potential attempts at avoiding regulatory detection of inappropriate trading activity.

<sup>17</sup> CBOE's reporting requirements subject SPX, OEX and FLEX options on those indexes to a 100,000 contract hedge reporting requirement, and DJX, which is one-tenth the size of a full value index contract, and FLEX options on the DJX, are subject to a 1 million contract hedge reporting threshold. Each member or member organization that maintains a position on the same side of the market in excess of these contract thresholds for its own account or for the account of a customer must file a report that includes, but is not limited to, data related to the option position, whether such position is hedged and if so, a description of the hedge. If applicable, the report must contain information concerning collateral used to carry the position.

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

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