

rule change, more than five business days prior to the date of the filing of the proposed rule change.

The Commission finds that it is appropriate to accelerate the operative date of the proposal and designate the proposal to become operative on January 4, 2002.<sup>13</sup> Acceleration of the operative date will allow the Exchange to continue its Pilot Program without interruption. Further the Commission has approved a similar pilot program proposed by another options exchange.<sup>14</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 it is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., 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 provision of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-AMEX-2001-109 and should be submitted by January 31, 2002.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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<sup>13</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> See Securities Exchange Act Release No. 44335 (May 22, 2001), 66 FR 29369 (May 30, 2001) (SR-CBOE-2001-26).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45236; File No. SR-Amex-2001-42]

### Self-Regulatory Organizations; Notice of Proposed Rule Change by American Stock Exchange LLC To Increase Position and Exercise Limits for Nasdaq-100 Index Tracking Stock Options

January 4, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 27, 2001, the American Stock Exchange LLC (the "Amex" or the "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On December 26, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup>

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

The Amex proposed to increase position and exercise limits for Nasdaq-100 Index Tracking Stock ("QQQ") options to 300,000 contracts on the same side of the market. In order to codify the financial requirements imposed by the Exchange and the Commission, the Amex also proposes to add Commentary .11 to Exchange Rule 904.

The text of the proposed rule change is available at the Office of the Secretary, Amex and at the Commission.

#### 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 Amex 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 Amex 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 Exchange is proposing to increase position and exercise limits for QQQ options up to 300,000 contracts on the same side of the market. The Exchange will continue to require that member organizations report all QQQ options positions exceeding 200 contracts pursuant to Exchange Rule 906. Moreover, for accounts holding positions in excess of 10,000 contracts on the same side of the market, the Exchange will also continue to require information concerning the extent to which such positions are hedged. The Amex believes that increasing position and exercise limits from 75,000 to 300,000 contracts for QQQ options will provide greater flexibility for market participants attempting to hedge their market risks.<sup>4</sup> In addition, Exchange staff will be able to re-focus efforts and resources to other notable areas.

#### Manipulation

Position limits restrict the number of options contracts that an investor, or a group of investors acting in concert, may own or control. Similarly, exercise limits prohibit the exercise of more than specified a number of contracts on a particular instrument within five (5) business days. The Commission by imposing these limits on exchange-traded options has sought to: (1) Minimize the potential for mini-manipulations,<sup>5</sup> as well as other forms of market manipulations; (2) impose a ceiling on the position that investor with inside corporate or market information can establish; and (3) reduce the possibility of disruption in the options and underlying cash markets.<sup>6</sup> The Amex believes that the structure of the QQQ option and the tremendous liquidity of both the underlying cash and option market for QQQs should allay regulatory concerns of potential manipulation. The Amex further believes that QQQ options are not readily susceptible to manipulation based largely on the liquidity and

<sup>4</sup> Although the current position limit is 75,000 contracts, due to a 50% reduction in the value of the underlying QQQ on March 20, 2000, the limit was adjusted to 150,000.

<sup>5</sup> Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established options position.

<sup>6</sup> See Becker and Burns, Regulation of Exchange-Traded Options in *The Handbook of Derivatives and Synthetics* (1994), Probus Publishing Company and Regulating the Options Market, *Institutional Investor Forum* (November 1991).

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

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

<sup>3</sup> Amendment No. 1 supersedes and replaces the original 19b-4 filing in its entirety.

activity of the underlying QQQ as well as the securities comprising the QQQ. Therefore, the Exchange submits that increasing position and exercise limits to 300,000 contracts may generate greater order flow for the Amex and provide members with greater flexibility in fulfilling their obligations to customers and the market.

Although the QQQ options is not itself an index option product, it nonetheless is designed to closely track the price and yield performance of the Nasdaq-100 index.<sup>7</sup> Therefore, we believe that in evaluating this proposal to increase position and exercise limits for QQQ options, the Commission should apply an analysis similar to what was used in connection with broad-based index options.<sup>8</sup>

The Amex believes in connection with QQQ options that the restrictive position and exercise limits no longer serve their stated purpose. The Commission has stated that:

Since the inception of standardized options trading, the options exchanges have had rules imposing limits on the aggregate number of options contracts that a member of customer could hold or exercise. These rules are intended to prevent the establishment of options positions that can be used or might create incentives to manipulate or disrupt the underlying market so as to benefit the options position. In particular, position and exercise limits

<sup>7</sup> QQQ represents ownership in the Nasdaq-100 Trust, a long-term unit investment trust established to accumulate and hold a portfolio of the equity securities that comprise the Nasdaq-100 Index. The Nasdaq-100 Index includes 100 of the largest non-financial companies listed on the Nasdaq National Market. The Nasdaq-100 reflects Nasdaq's largest growth companies across major industry groups with all index components having a market capitalization of at least \$500 million and an average daily trading volume of at 100,000 shares. QQQ is intended to provide investment results that generally correspond to the Nasdaq-100 Index with an initial market value approximated at 1/40th the value of the underlying Nasdaq-100 Index. A description and analysis of the Nasdaq-100 Index is set forth by the Commission in Securities Exchange Act Release No. 33428 (January 4, 1994), 59 FR 1576 (January 11, 1994) (order approving trading of Nasdaq-100 options by CBOE). As of November 30, 2001, the market capitalization of the securities underlying the Nasdaq-100 Index was approximately \$1.875 trillion while the QQQ had net assets of \$23.96 billion and 559.1 million shares outstanding. By far the largest economic sector represented is technology amounting to 68.91%. The top QQQ holding is Microsoft accounting for 11.97% while the top ten holdings constitute 43.22%.

<sup>8</sup> See Securities Exchange Act Release Nos. (February 1, 1999), 64 FR 6405 (February 9, 1999) (order approving the elimination of position and exercise limits for XMI and XII options on a two-year pilot basis) and 40969 (January 22, 1999), 64 FR 4911 (February 1, 1999) (order approving the elimination of position and exercise limits for SPX, OEX, DJX and related FLEX options on a two-year pilot basis).

are designed to minimize the potential for mini-manipulations and for concerns or squeezes of the underlying market. In addition such limits such to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.<sup>9</sup>

The Exchange believes that both the size and breadth of the market for QQQs dispels concerns regarding market manipulation and disruption. The average daily trading volumes for the QQQs and QQQ options from January 1, 2001 to November 30, 2001 were 71.21 million shares and 148,181 contracts, respectively. the QQQ option is by far the most actively-traded option product in the U.S., and therefore, the most liquid. The underlying QQQ is the most actively-traded equity security in the U.S. with greater trading volume than both Microsoft and Intel.<sup>10</sup> Accordingly, the Exchange believes that the tremendous liquidity of the QQQ option and the underlying cash market for QQQs severely minimizes the potential for manipulations in both the options and underlying cash market.

To date, there has not been a single disciplinary action involving manipulation or potential manipulation in the QQQ or the QQQ option on the Exchange. We further believe that our extensive experience conducting surveillance of derivative products and program trading activity is sufficient to identify improper activity. Routine oversight inspections of Amex's regulatory programs by the Commission have not uncovered any inconsistencies or shortcomings in the manner in which derivative and options surveillance is conducted. These procedures entail a daily monitoring of market movements via automated surveillance techniques to identify unusual activity in both the options and underlying cash markets.

### Competition

The Commission has stated that "limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market."<sup>11</sup> Based on the large trading volume apparent in both the underlying QQQ

<sup>9</sup> Securities Exchange Act Release No. 39489 (December 24, 1997), (63 FR 276 (January 5, 1998)).

<sup>10</sup> For the period of January 1, 2001 to November 30, 2001, Microsoft and Intel had average daily trading volumes of 39.38 and 53.98 million shares, respectively, compared to the QQQ with an average daily trading volume of 71.21 million shares.

<sup>11</sup> See H.R. Rep. No. IFC-3, 96th Cong., 1st Sess. At 189-91 (Comm. Print 1978).

and QQQ options, the Exchange believes that current position and exercise limits of the QQQ option are too restrictive and may adversely affect the Amex's ability to compete with the OTC market. The Exchange believes that investors who trade listed options on the QQQ at the Amex may be placed at a serious disadvantage in comparison to certain Nasdaq-100 index derivative products traded in the OTC market where some index-based derivatives are not currently subject to position and exercise limits.<sup>12</sup> Member firms also continue to express their concern that position limits on popular, actively-traded products, such as QQQ options, are an impediment to business development on the Exchange. Accordingly, a portion of this business is believed to have moved to the OTC market where some index-based derivative products are not subject to position limit requirements. In addition, current base limits for the QQQ option may not be adequate in many instances for the hedging needs of certain institutions which engage in trading strategies differing from those covered under the current index hedge exemption policy (e.g., delta hedges; OTC vs. listed hedges).<sup>13</sup>

### Financial Requirements

The Exchange believes that financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an inordinately large unhedged position in QQQ options. Current margin, and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. It should also be noted that the Exchange has the

<sup>12</sup> The Commission notes, however, that as an equity product, options on the QQQ are subject to position limits in the OTC market. See NASD Rule 2860.

<sup>13</sup> The current limit for QQQ options is 150,000 contracts due to the 50% reduction in the underlying value of the QQQ that occurred on March 20, 2000. At this limit, the QQQ options equate to 15,000,000 QQQ shares or an aggregate value of \$59.47 billion as of November 30, 2001. At the time of approval of QQQ options, position and exercise limits were set at 25,000 (250,000 QQQ shares) equating to an aggregate value of \$2,500,000 as of March 9, 1999 (commencement of trading). When QQQs commenced trading, the volume was 10.4 million shares with an opening price of \$100.00 per share. The average daily trading volumes for the QQQ during 1999, 2000 and year-to-date 2001 were 13.9 million, 30.9 million and 71.21 million shares respectively, while for the same periods the average daily trading contract volume for the QQQ option were 9,206, 91,656, and 148,181. As of November 30, 2001, the price of a single QQQ was \$39.65.

authority under paragraph (d)(2)(k) of Rule 462 to impose a higher margin requirement upon the member or member organization when the Exchange determines a higher requirement is warranted. Proposed Commentary .11 to Exchange Rule 904 codifies these financial requirements imposed by the Exchange and the Commission.

### Reporting Requirements

Consistent with Amex Rule 906(b), the Amex will continue to require that each member or member organization that maintains a position on the same side of the market in excess of 10,000 contracts in the QQQ option, for its own account or for the account of a customer report certain information. This data includes, but is not limited to, the option position, whether such position is hedged and if so, a description of the hedge and if applicable, the collateral used to carry the position. Exchange market-makers are exempt from this reporting requirement as market-maker information can be accessed through the Exchange's market surveillance systems. Once the 10,000 contract reporting threshold is attained, the Amex requires members and member organizations to similarly report each increase of 2,500 contracts on the same side of the market for customer accounts and each increase of 5,000 contracts on the same side of the market for proprietary accounts. The Exchange believes that the reporting level of 10,000 contracts on the same side of the market for members other than Exchange market-makers is consistent with the designation of the QQQ as an equity option, and therefore, the existing regulatory regime. Pursuant to Rule 906(a), the general reporting requirement for customer accounts that maintain a position in excess of 200 contracts will remain at this level for QQQ options. Lastly, the Amex believes that the 10,000 contract reporting requirement is above and beyond what is currently required in the OTC market. According to the Amex, NASD member firms are only required to report options positions in excess of 200 contracts and are not required to report any related hedging information.

### 2. Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act<sup>14</sup> in general and furthers the objectives of section 6(b)(5)<sup>15</sup> in particular in that it 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.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Amex consents, the Commission will:

- (A) By order approve such proposed rule change, or
- (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 is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., 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 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer File No. SR-

AMEX-2001-42 and should be submitted by January 31, 2002.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 02-635 Filed 1-9-02; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45230; File No. SR-CBOE-2001-68]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated To Extend for a Six-Month Period the Pilot Program for the Exchange's 100 Spoke RAES Wheel

January 3, 2002.

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 December 26, 2001, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. CBOE filed the proposal 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 the proposal 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

CBOE hereby proposes to extend, for an additional six-month period, the pilot program that permits the appropriate Floor Procedure Committee ("FPC") to allocate orders on the Exchange's Retail Automatic Execution System ("RAES") under the allocation system known as the 100 Spoke RAES Wheel. CBOE has designated this proposal as non-controversial and requests that the Commission waive the 30-day pre-operative waiting period set forth in Rule 19b-4(f)(6)(iii) under the

<sup>16</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> 15 U.S.C. 78s(b)(3)(A).

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

<sup>14</sup> 15 U.S.C. 78f(b).

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