

of the proposal, the Commission believes that no purpose would be served by delaying approval of Amendment No. 5 until the completion of another notice-and-comment period. Accordingly, the Commission finds good cause for accelerating approval of Amendment No. 5 to the proposed rule change.

## VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-Amex-2003-39) and Amendment Nos. 1, 2, 3, and 4 are approved, and that Amendment No. 5 is approved on an accelerated basis.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04-15330 Filed 7-6-04; 8:45 am]

BILLING CODE 8010-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49932; File No. SR-CBOE-2002-24]

### Self-Regulatory Organizations; Order Granting Approval of the Proposed Rule Change and Amendment Nos. 1 and 2 by the Chicago Board Options Exchange, Inc., and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 3 and 4 Relating to Listing Standards for Options on Micro Narrow-Based Security Indexes

June 28, 2004.

#### I. Introduction

On May 7, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to adopt criteria for a new classification of narrow-based indexes, classified as "Micro Narrow-Based" indexes and adopt initial listing standards and maintenance standards for options on Micro Narrow-Based security indexes. The CBOE filed Amendment Nos. 1 and 2 to the proposed rule change on August

6, 2002<sup>3</sup> and August 29, 2002,<sup>4</sup> respectively. On October 16, 2002, the proposed rule change, as modified by Amendment Nos. 1 and 2, was published in the **Federal Register**.<sup>5</sup> The Commission received no comment letters with respect to the proposal. The CBOE filed Amendment Nos. 3 and 4 on July 15, 2003<sup>6</sup> and May 17, 2004,<sup>7</sup> respectively. This order approves the proposed rule change, as modified by Amendment Nos. 1 and 2, and grants accelerated approval to Amendment Nos. 3 and 4. For the complete text of the proposed rule change, see Exhibit A, attached hereto.

#### II. Description of the Proposal

In the Notice, the Exchange proposes to amend CBOE Rule 24.2 (Designation of the Index) by adopting criteria for a new classification of narrow-based indexes, classified as "Micro Narrow-Based" indexes, that is consistent with the definition of "Narrow-Based" indexes under the Commodity Futures Modernization Act of 2000 ("CFMA").<sup>8</sup> The Exchange proposes to adopt initial listing standards and maintenance standards for options on Micro Narrow-Based security indexes that are consistent with listing standards for futures on a narrow-based security index.<sup>9</sup> CBOE proposes the use of the

<sup>3</sup> See Letter dated August 6, 2002 from Madge Hamilton, Legal Division, CBOE, to Kelly Riley, Senior Special Counsel, Division of Market Regulation ("Division"), Commission ("Amendment No. 1"). Amendment No. 1 makes certain technical corrections to the proposed rule change.

<sup>4</sup> See Letter dated August 29, 2002 from Madge Hamilton, Legal Division, CBOE, to Florence Harmon, Senior Special Counsel, Division, Commission ("Amendment No. 2"). Amendment No. 2 makes certain technical corrections to the proposed rule text and adds a requirement that component securities be registered under Section 12 of the Act. Amendment No. 2 also adds a requirement that the total number of securities in an index may not increase or decrease by more than 33 1/3% from the number of component securities in the index at the time of its initial listing. Finally, Amendment No. 2 adds a requirement that cash settled index options be designated as AM-settled index options.

<sup>5</sup> See Securities Exchange Act Release No. 46629 (October 9, 2002), 67 FR 63949.

<sup>6</sup> See Letter dated July 14, 2003 from James Flynn, Legal Division, CBOE, to Nancy Sanow, Assistant Director, Division, Commission ("Amendment No. 3"). In Amendment No. 3, CBOE submitted a new Form 19b-4, which replaces and supersedes the original filing in its entirety.

<sup>7</sup> See Letter dated May 14, 2003 from James Flynn, Legal Division, CBOE, to Nancy Sanow, Assistant Director, Division, Commission ("Amendment No. 4"). In Amendment No. 4, CBOE submitted a new Form 19b-4, which replaces and supersedes the original filing in its entirety.

<sup>8</sup> Section 201 of the CFMA; 15 U.S.C. 78c(a)(5)(B).

<sup>9</sup> See Securities Exchange Act Release No. 34-48191 (July 17, 2003), 68 FR 43555 (SR-OC-2003-06). The Exchange states that these listing and

term "Micro Narrow-Based" to distinguish this classification of narrow-based indexes from the existing "narrow-based" security indexes, as currently defined under CBOE Rule 24.2(b),<sup>10</sup> which are also referred to as "Industry Indexes" under some provisions of CBOE's rules.<sup>11</sup>

Specifically, under proposed Rule 24.2(d), the Exchange proposes to list and trade options on a Micro Narrow-Based security index, pursuant to Rule 19b-4(e) under the Act, if the index is a Micro Narrow-Based security index:

- (1) That has 9 or fewer component securities; or
- (2) in which a component security comprises more than 30% of the index's weighting; or
- (3) in which the 5 highest weighted component securities in the aggregate comprise more than 60% of the index's weighting; or
- (4) in which the lowest weighted component securities comprising, in the aggregate, 25% of the index's weighting, have an aggregate dollar value of average daily trading volume of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million), except that if there are 2 or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25% of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security.

According to the Exchange, the proposed rule change also makes other modifications that are consistent with the standards for futures on narrow-based indices. For example, the proposed rule change requires that all component securities of a narrow-based security index be registered pursuant to Section 12 of the Act.

The proposed rule change also permits a Micro Narrow-Based index to be a modified capitalization-weighted index.<sup>12</sup> The CBOE also proposes three

maintenance standards are consistent with the Commission's Staff Legal Bulletin No. 15: Listing Standards for Trading Security Futures Products (September 5, 2001) ("Division Bulletin").

<sup>10</sup> CBOE Rule 24.2(b) will remain unchanged.

<sup>11</sup> See e.g. CBOE Rule 24.1(i)(2) and CBOE Rule 24.4A.

<sup>12</sup> See III.A.(ii)(a) of the Division: Staff Legal Bulletin No. 15, supra note 9. See also Securities Exchange Act Release No. 42787, 65 FR 33598 (May 24, 2000) (amending Amex Rule 1000A to permit the index underlying a series of Index Fund Shares to be calculated based on modified market capitalization weighting methodology, among others); Securities Exchange Act Release No. 43912,

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

<sup>19</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.

additional index weighting methodologies for Micro Narrow-Based indexes—modified equal-dollar weighted, approximate equal-dollar weighted, and share-weighted. According to CBOE, the Commission has previously granted the CBOE approval to list options on a modified equal-dollar weighted index<sup>13</sup> and the Commission has not abrogated the rule filing submitted by OneChicago for products overlying indexes that utilize an approximate equal dollar-weighted methodology.

A modified equal-dollar weighted methodology is designed to be a fair measurement of the particular industry or sector represented by the index, but without assigning an excessive weight to one or more index components that have a large market capitalization relative to other index components. Under this methodology, each component is assigned a weight that takes into account the relative market capitalization of the securities comprising the index. The index is subsequently rebalanced to maintain these pre-established weighting levels. In the case of an index with 9 components or less, the weight assigned to the largest component will not exceed 50% of the entire index weight. Like equal-dollar weighted indexes, the value of a modified equal-dollar weighted index will equal the current combined market value (based on U.S. primary market prices) of the assigned number of shares of each of the underlying components divided by the appropriate index divisor. A modified equal-dollar weighted index will be balanced quarterly.

An approximate equal-dollar weighted index is composed of one or more securities in which each component security will be weighted equally based on its market price on the

index's selection date. The index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision, the Exchange defines "notional value" as the market price of the component times the number of shares of the underlying component in the index. The Exchange also states that the reconstitution and rebalancing are also mandatory if the number of components in the index changes. The Exchange also states that it will reserve the right to rebalance quarterly at its discretion. Exhibit B, attached hereto, contains a table that illustrates the appropriate maintenance procedures that must be taken upon the occurrence of certain types of corporate actions that may affect the components that underlie an approximate equal-dollar weighted index.

A share-weighted index is designed to mimic the value of a portfolio consisting of two or more securities. The weight of each component security is calculated by multiplying the price of the component security by an adjustment factor. Adjustment factors are chosen to reflect the investment objective deemed appropriate by the designer of the index and will be published by the Exchange as part of the contract specifications.<sup>14</sup> The value of the index is calculated by adding the weight of each component security and dividing the total by an index divisor.<sup>15</sup> If a share-weighted Micro Narrow-Based index fails to meet the maintenance listing standards under CBOE Rule 24.2(e), the index would not be rebalanced by the Exchange. Instead, the Exchange would restrict options transactions to "closing-only" transactions and would not issue any additional series for that index.<sup>16</sup> Upon

the expiration of the last series on that index, the Exchange will no longer calculate that index and no additional series would be listed.

Unlike other indexes currently available, share-weighted indexes do not require divisor changes in order to adjust for corporate actions. Rather, a change is made to the adjustment factor for a particular stock undergoing the corporate action. Thus, only the stock undergoing the corporate action is affected, which mimics the impact on a replicating portfolio. For example, the index is adjusted for a stock split by multiplying the adjustment factor of the affected stock by its split ratio. The index is adjusted for spin-offs and other distributions, excluding regular cash dividends, by taking the value of the property being distributed and then changing the adjustment factor to reflect the purchase of additional shares of the index component. Unlike a capitalization-weighted index, share-weighted indexes are not adjusted to reflect changes in the number of outstanding shares of its constituents. So, the issuance of additional shares by a company whose stock underlies the index would not impact a share-weighted index. The Exchange has provided the following examples for the share-weighted index.

Example: Adjusting a share-weighted index to reflect a 2-for-1 stock split in the shares of one of its components.

Consider the following share-weighted index. A company (Stock 2) has declared a 2-for-1 split and the prices listed below represent the closing prices for each index component on the business day immediately prior to the ex-distribution date. The index divisor, which was chosen to yield a benchmark level of 100, is 1.00. Therefore, the closing index level prior to the ex-date is 91.00.

Component	Price (P <sub>i</sub> )	Adjustment factor (A <sup>i</sup> )	P <sub>i</sub> x A <sub>i</sub>	Component weight (percent)
Stock 1 .....	\$23	1.25	28.75	31.59

66 FR 9401 (February 7, 2001) (permitting an index underlying a series of Index Fund Shares to be calculated on modified market capitalization); Philadelphia Stock Exchange, Inc. Rule 1009A(b)(2), which permits a narrow-based index to be modified capitalization-weighted.

<sup>13</sup> Securities Exchange Act Release No. 36623 (December 21, 1995), 60 FR 67379 (December 29, 1995) (approving options on the CBOE Automotive Index, which is modified equal-dollar weighting). In the Commission's release adopting final rules regarding new derivative securities products, it noted that "[t]he index underlying a new derivative securities product should be constructed according to established criteria for initial inclusion of new component securities. SROs seeking to rely on the proposed amendment should employ objective

index construction standards that include a minimum number of component securities and a fixed and objective weighting methodology (e.g., capitalization weighted, price weighted, equal-dollar weighted or modified equal-dollar weighted." (footnote omitted.) Securities Exchange Act Release No. 40761 File No. S7-13-98; 63 FR 70952, 70961 (December 22, 1998). See also Securities Exchange Act Release No. 42787, 65 FR 33598 (May 24, 2000)(amending Rule 1000A to permit the index underlying a series of Index Fund Shares to be calculated based on modified equal-dollar weighting methodology, among others.)

<sup>14</sup> For example, an index designer might want to apply an adjustment factor in order to prevent one or a few components from dominating the weight of the index. This is similar to an adjustment factor

in other types of weighting methods such as modified capitalization weighted indexes.

<sup>15</sup> The index "divisor" is calculated to yield a benchmark index level (50, 100, 200, etc.) as of a particular date.

<sup>16</sup> When option series are restricted to "closing-only" status, the only opening transactions allowed in such a series are (i) opening transactions by market-makers executed to accommodate closing transactions of other market participants and (ii) opening transactions by CBOE member organizations to facilitate the closing transactions of public customers executed as crosses pursuant to and in accordance with CBOE Rule 6.74(b) or (d). CBOE will issue a regulatory circular to notify members and member organizations of such a situation.

Component	Price (P <sub>i</sub> )	Adjustment factor (A <sub>i</sub> )	P <sub>i</sub> x A <sub>i</sub>	Component weight (percent)
Stock 2 .....	92	0.5	46	50.55
Stock 3 .....	5	1.25	6.25	6.87
Stock 4 .....	8	1.25	10	10.99
Total .....			91	100.00

As shown in the table below, the adjustment to reflect the 2-for-1 split would require that the Adjustment Factor for Stock 2 be multiplied by the split ratio (2), thereby changing it from 0.5 to 1.0. The post-split price of Stock

2 (\$46) is adjusted by dividing the pre-split price (\$92) by the split ratio. The product of the new Adjustment Factor and the post-split price of Stock 2 is exactly the same as product of the old Adjustment Factor and pre-split price of

Stock 2. Furthermore, the sum of the products (P<sub>i</sub> x A<sub>i</sub>) and individual component weights are exactly the same as before the split, and the index divisor remains unchanged at 1.00.

Component	Price (P <sub>i</sub> )	Adjustment factor (A <sub>i</sub> )	P <sub>i</sub> x A <sub>i</sub>	Component weight (percent)
Stock 1 .....	\$23	1.25	28.75	31.59
Stock 2 .....	46	1.0	46	50.55
Stock 3 .....	5	1.25	6.25	6.87
Stock 4 .....	8	1.25	10	10.99
Total .....			91	100.00

Exhibit C, attached hereto, contains a table that illustrates the appropriate maintenance procedures that must be taken upon the occurrence of certain types of corporate actions that may affect the components that underlie a share-weighted index.

Regardless of the weighting methodology, the Exchange represents that it will also reserves the right to rebalance any Micro Narrow-Based index on an interim basis if warranted as a result of extraordinary changes in the relative values of the component securities. Proposed CBOE Rule 24.2(d)(2)(iv) shall provide that, to the extent investors with open positions must rely upon the continuity of the options contract on the index, CBOE listing standards will clarify that outstanding contracts are unaffected by rebalancings. The Exchange believes that these provisions are consistent with previous rule changes approved by the Commission.<sup>17</sup>

Proposed CBOE Rule 24.2(e) contains the maintenance standards that will apply to Micro Narrow-Based security indexes. The Exchange believes that the maintenance standards generally adhere to the Division's Bulletin and those standards applicable to futures in a narrow-based security index. The Exchange represents that CBOE's surveillance procedures are adequate to monitor the trading in options on Micro

Narrow-Based Indexes as defined under CBOE Rule 24.2(d).<sup>18</sup>

*Position Limits and Exercise Limits*

CBOE also proposes to establish a new method for determining the applicable position limits for options on any Micro Narrow-Based Index that meets the generic listing standards under proposed CBOE Rule 24.2(d). CBOE represents that it will utilize a formulaic approach as provided in proposed CBOE Rule, 24.4B, "Position Limits for Options on Micro Narrow-Based Indexes as Defined Under Rule 24.2(d)."

This new methodology is a departure from the manner in which position limits are assigned for index options under existing CBOE rules. Under CBOE Rule 24.4 ("Position Limits for Broad-Based Index Options") and CBOE Rule 24.4A ("Position Limits for Industry Index Options"), position limits are assigned from pre-determined tiers based on an analysis of the respective index's underlying components. Under the proposed methodology, position limits would be determined in accordance with a formula that considers a Micro Narrow-Based Index's market capitalization and contract size in relation to the market capitalization of the S&P 500 index and the contract

size and position limit of a futures contract on the S&P 500 index.

In determining compliance with CBOE Rule 4.12 (Exercise Limits), the applicable exercise limit for option contracts on any Micro Narrow-Based Index, as defined under proposed CBOE Rule 24.2(b), shall be a limit equivalent to the applicable position limits for options on that Micro Narrow-Based Index, as calculated under CBOE Rule 24.4B(a)(1)-(7).

*Margin*

CBOE Rule 12.3 governs the determination of the applicable margin treatment for options traded on the exchange, including options that overlie Narrow-Based indexes. The existing applicable margin for options on narrow-based indexes, as provided under CBOE Rule 12.3, also shall apply to Micro Narrow-Based indexes.

*Strikes Prices*

The interval between strike prices for options on indexes that meet the criteria under CBOE Rule 24.4(d) will be no less than \$2.50.

**III. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 4, including whether Amendment No. 4 is consistent with the Act. Comments may be submitted by any of the following methods:

<sup>17</sup> Securities Exchange Act Release No. 42787, *supra* note 4 (citing to Commentary .03 to AMEX Rule 1000, Commentary .02 to AMEX Rule 1000A, Commentary .01 to AMEX Rule 1202).

<sup>18</sup> The Exchange removed from this proposed rule change any reference to the trading of LEAPs in Micro Narrow-Based Indexes. Telephone conversation between James Flynn, Attorney, CBOE, and Florence Harmon, Senior Special Counsel, Commission, Division on June 25, 2004.

*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 Number SR-CBOE-2002-24 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2002-24. 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 Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. 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 Number SR-CBOE-2002-24 and should be submitted on or before July 28, 2004.

**IV. Discussion and Commission Findings**

The Commission has reviewed carefully the proposed rule change and 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. In particular, the Commission finds that the proposed rule change is consistent with Rule 6(b)(5)<sup>19</sup> of the Act, which requires that the rules of an exchange be 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>20</sup> Specifically, the Commission notes that the proposed rule change would permit the Exchange to list and trade, pursuant to Section 19b-4(e) of the Act, options on Micro Narrow-Based security indexes that meet the listing criteria of CBOE Rule 24.2.

The Commission believes that the proposed initial listing and maintenance standards are consistent with the listing standards for futures on a narrow-based security index.<sup>21</sup> The Commission also believes that the proposed generic standards covering, among other things, minimum capitalization, monthly trading volume, and relative weightings of component stocks are reasonably designed to ensure that the trading market for component stocks are adequately capitalized and sufficiently liquid. In addition, the Commission notes position limits for options on any Micro-Narrow-Based index that meets the generic listing standards of proposed CBOE Rule 24.2(d) would be determined in accordance with a proposed new formula that considers the index's market capitalization and contract size in relation to the market capitalization of the S&P 500 index and the contract size and position limit of a futures contract on the S&P 500 index. The Commission believes that the proposed formula for determining position limits is appropriate to deter manipulation of the index. In addition, the Commission finds that the weighting methodologies, employed by CBOE, including the modified equal-dollar weighted, approximate equal-dollar weighted, and share-weighted methodologies, are appropriate index construction standards. The Commission believes that the applicable margin standards for options on narrow-based indexes, as provided under CBOE Rule 12.3, are adequate standards for Micro Narrow-Based indexes. The Commission notes that the Exchange represents that the Options Price Reporting Authority ("OPRA") has

provided CBOE with assurances that it has sufficient operational capacity to accommodate CBOE's listing and trading of Micro Narrow-Based security indexes.

The Exchange is also charged with surveillance for the product class, options on Micro Narrow-Based security indexes. The Exchange represents that its surveillance procedures are adequate to monitor the trading in options in Micro Narrow-Based Indices. The Exchange will have complete access to information regarding trading activity in the underlying securities. The Exchange has developed new surveillance procedures specific to this new derivative product that the Commission finds adequate to monitor for manipulation in the Micro Narrow Based Indexes.

The Commission's approval of the proposed generic listing standards for options on Micro Narrow-Based security indexes will allow those options that satisfy these standards to start trading under Rule 19b-4(e), without constituting a proposed rule change within the meaning of section 19(b) of the Act<sup>22</sup> and Rule 19b-4,<sup>23</sup> for which notice and comment and Commission approval is necessary. Rule 19b-4(e)<sup>24</sup> states that the listing and trading of a new derivative securities product by [an SRO] shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of [Rule 19b-4], if the Commission has approved, pursuant to Section 19(b) of the Act, such [SRO's] trading rules, procedures and listing standards for the product class that would include the new derivative securities product, and the SRO has a surveillance program for the product class. The Exchange's ability to rely on Rule 19b-4(e) for these products potentially reduces the time frame for bringing these securities to the market, promoting competition and providing investors with derivative securities products to meet their needs more quickly. As stated above, the Commission believes that the Exchange has adequate trading rules, procedures, listing standards, and a surveillance program for the Micro Narrow-Based indexes, and thus the Commission is approving generic listing standards pursuant to Rule 19b-4(e) for this product class.

The Commission finds good cause for approving Amendment Nos. 3 and 4 to the proposed rule change prior to the thirtieth day after the amendment is published for comment in the **Federal Register** pursuant to section 19(b)(2) of

<sup>20</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>21</sup> See Release No. 34-48191, supra note 9. This definition in CBOE Rule 24.2(d)(1) is consistent with the definition of narrow-based security index established by the CFMA for purposes of determining whether futures on security indexes are security futures subject to the jurisdiction of the Commission and the Commodity Futures Trading Commission ("CFTC").

<sup>22</sup> 15 U.S.C. 78s(b).

<sup>23</sup> 17 CFR 240.19b-4.

<sup>24</sup> 17 CFR 240.19b-4(e).

<sup>19</sup> 15 U.S.C. 78f(b)(5).

the Act.<sup>25</sup> The Commission believes that the adoption of the proposed rule change will enable CBOE to act expeditiously in listing options on new Micro Narrow-Based security indexes in the same manner currently afforded to narrow-based indexes as defined under CBOE Rule 24.2(b). In addition, the Commission believes that the proposed rule change would remove impediments to a free and open market place by providing competition for new products. Accordingly, the Commission finds good cause for accelerating approval of Amendment Nos. 3 and 4 to the proposed rule change.

**V. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, section 6(b)(5) of the Act.<sup>26</sup>

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change (SR-CBOE-2002-24), as amended by Amendment Nos. 1

and 2, be, and hereby is, approved and that Amendment Nos. 3 and 4 to the proposed rule change be, and hereby are, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

**EXHIBIT A**

(Additions are *italicized*; deletions are [bracketed])

**Chicago Board Options Exchange, Incorporated**

**Rules**

**CHAPTER XII**

**Margins**

Rule 12.1–Rule 12.2 No Change.

**Rule 12.3—Margin Requirements**

Rule 12.3(a)–(b) No Change.

Rule 12.3(c) Customer Margin Account—Exception. The foregoing requirements are subject to the following exceptions. Nothing in this paragraph (c) shall prevent a broker-dealer from requiring margin from any

account in excess of the amounts specified in these provisions.

(1)–(4) No Change.

(5) Initial and Maintenance Requirements on Short Options, Stock Index Warrants, Currency Index Warrants and Currency Warrants.

(A) Listed. General Rule. The initial and maintenance margin required on any listed put, call, stock index warrant, currency index warrant or currency warrant carried “short” in a customer’s account shall be 100% of the current market value of the option or warrant plus the percentage of the current “underlying component value” (as described in Column IV of the table below) specified in column II of the table below reduced by any “out-of-the-money” amount as defined in this subparagraph (c)(5)(A) below.

Notwithstanding the margin required above, the minimum margin for each such call option or call warrant shall not be less than 100% of the current market value of the option or warrant plus the percentage of the current market value of the underlying component specified in column III of the table below, and for each such put option or put warrant, shall not be less than 100% of the current market value of the option or warrant plus the percentage of the option or warrant’s aggregate exercise price amount specified in column III of the table below.

I. Type of option	II. Initial and/or maintenance margin required (percent)	III. Minimum margin required (percent)	IV. Underlying component value
1. Stock .....	20	10	The equivalent number of shares at current market prices.
2. Narrow based index as defined in Rule 24.1 and <i>Micro Narrow-Based Index as defined in Rule 24.2(d)</i> .	20	10	The product of the current index group value and the applicable index multiplier.
3. Broad-based index (including Capped-style options (CAPS & QCAPS) Packaged Vertical Spreads and Packaged Butterfly Spreads) as defined in Rule 24.1 15%.	<sup>1</sup> 15	<sup>2</sup> 10	The product of the current index group value and the applicable index multiplier.
4. Interest Rate Contracts .....	10	5	The product of the index value and the applicable index multiplier.
5. U.S. Treasury bills—95 days or less to maturity ...	10	5	The underlying principal amount.
6. U.S. Treasury notes .....	3	1/2	The underlying principal amount.
7. U.S. Treasury bonds .....	3.5	1/2	The underlying principal amount.
8. Foreign Currency Options Warrants .....	.....	.....	The product of units per foreign currency contract and the closing spot price. <sup>3</sup>
Australian Dollar .....	4	3/4	
British Pound .....	4	3/4	
Canadian Dollar .....	4	3/4	
German Mark .....	4	3/4	
European Currency Unit .....	4	3/4	
French Franc .....	4	3/4	
Japanese Yen .....	4	3/4	
Swiss Franc .....	4	3/4	
9. Currency Index Warrants .....	3	( <sup>4</sup> )	The product of the index value and the applicable index multiplier.
10. Stock Index Warrants (broad-based) .....	15	10	The product of the index value and the applicable index multiplier.
11. Stock Index Warrants (narrow-based) .....	20	10	The product of the index value and the applicable index multiplier.
12. Registered investment companies based on a broad-based index or portfolio of securities.	15	10	The equivalent number of shares at current market prices.

<sup>25</sup> 15 U.S.C. 78s(b)(2).

<sup>26</sup> 15 U.S.C. 78f(b)(5).

<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

I. Type of option	II. Initial and/or maintenance margin required (percent)	III. Minimum margin required (percent)	IV. Underlying component value
13. Registered investment companies based on a narrow-based index or portfolio of securities.	20	10	The equivalent number of shares at current market prices.

<sup>1</sup> In any event, the maximum margin required on a capped style index option (CAPS and Q-CAPS), Packaged Vertical Spread and Packaged Butterfly Spread as defined in Rule 24.1 need not exceed the aggregate cap interval, vertical spread interval and butterfly spread interval, respectively. Cap interval, vertical spread interval and butterfly spread interval shall have the meanings defined in Rule 24.1.

<sup>2</sup> In respect of a capped-style index option, Packaged Vertical Spread and Packaged Butterfly Spread as defined in Rule 24.1 which is out-of-the-money, the minimum margin required is as follows: CALLS—the lesser of (a) 100% of the current market value of the option plus 10% of the underlying index value or (b) the aggregate cap, vertical spread or butterfly spread interval, respectively, PUTS—the lesser of (a) 100% of the current market value of the option plus 10% of the aggregate put exercise price or (b) the aggregate cap, vertical spread or butterfly spread interval, respectively. Cap interval, vertical spread interval and butterfly spread interval shall have the meanings defined in Rule 24.1.

<sup>3</sup> The term “spot price” in respect of a currency warrant on a particular business day means the noon buying rate in U.S. dollars on such day in New York City for cable transfers of the particular underlying currency as certified for customs purposes by the Federal Reserve Bank of New York.

<sup>4</sup> A percentage of the aggregate exercise price as specified by the exchange and approved by the SEC.

For purposes of this subparagraph (c)(5)(A), “out-of-the-money” amounts are determined as follows:

Option or warrant issue	Call	Put
Stock Options, Registered Investment Company Options.	Any excess of the aggregate exercise price of the option over the current market value of the equivalent number of shares of the underlying security.	Any excess of the current market value of the equivalent number of shares of the underlying security over the aggregate exercise price of the option.
U.S. Treasury Options .....	Any excess of the aggregate exercise price of the option over the current market value of the underlying principal amount.	Any excess of the current market value of the underlying principal amount over the aggregate exercise price of the option.
Index stock options, currency index warrants and stock index warrants.	Any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable multiplier.	Any excess of the product of the current index value and the applicable multiplier over the aggregate exercise price of the option or warrant.
Foreign currency options and warrants .....	Any excess of the aggregate exercise price of the option or warrant over the product of units per foreign currency contract and the closing spot prices.	Any excess of the product of units per foreign currency contract and the closing spot prices over the aggregate price of the option or warrant.
Interest rate options .....	Any excess of the aggregate exercise price of the option over the product of the current interest rate measure value and the applicable multiplier.	Any excess of the product of the current interest rate measure value and the applicable multiplier over the aggregate exercise price of the option.

(B) OTC Option. General Rule. (No Change).

I. Type of option	II. Initial and/or maintenance margin required (percent)	III. Minimum margin required (percent)	IV. Underlying aggregate value
1. Stock and Convertible Corporate Debt .....	30	10	The equivalent number of shares times current market price per share for stocks or the underlying principal amount for convertible securities.
2. Narrow based index and Micro Narrow-Based index as defined in Rule 24.2(d). 3. (No changes). 4. (No changes). 5. (No changes). 6. (No changes).	30	10	The product of the current index value and the applicable index multiplier.

<sup>1</sup> Options contracts under category (4) must be for a principal amount of not less than \$500,000. If the principal amount is less than \$500,000, category (6) will apply.

<sup>2</sup> Option transactions on all other OTC margin bonds as defined in paragraph 12.3(a) are not eligible for the margin requirements contained in this provision. Margin requirements for such securities are to be computed pursuant to category (6).

(c) No Change.

(d)–(k) No Change.

Interpretations and Policies . . . .01–13  
No Change.

## CHAPTER XXIV

### Index Options

#### Rule 24.1 Definitions—

##### Rule 24.1

(a)–(h) No Change.

(i)(1) The terms “market index” and “broad-based index” mean an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries.

(2) The terms “industry index” and “narrow-based” index mean an index designed to be representative of a particular industry or a group of related industries.

(3) The term “Micro Narrow-Based Index” means an industry or narrow-based index that meets the specific criteria provided under Rule 24.2(d).

(j)–(x) No Change.

##### Rule 24.2. Designation of the Index

(a) The component securities of an index underlying an index option contract need not meet the requirements of Rule 5.3. Except as set forth in subparagraph (b) and (d) below, the listing of a class of index options on a new underlying index will be treated by the Exchange as a proposed rule change subject to filing with and approval by the Securities and Exchange Commission (“Commission”) under Section 19(b) of the Exchange Act.

(b)–(c) No Change.

(d) Notwithstanding paragraph (a) above, the Exchange may trade options on a Micro Narrow-Based security index pursuant to Rule 19b–4(e) of the Securities Exchange Act of 1934, if each of the following conditions is satisfied:

(1) The Index is a security index:

(i) That has 9 or fewer component securities; or

(ii) In which a component security comprises more than 30 percent of the index’s weighting; or

(iii) In which the 5 highest weighted component securities in the aggregate comprise more than 60 percent of the index’s weighting; or

(iv) In which the lowest weighted component securities comprising, in the aggregate, 25 percent of the index’s weighting have an aggregate dollar value of average daily trading volume of less than \$50,000,000 (or in the case of an index with 15 or more component securities, \$30,000,000) except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index’s weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security;

(2) The index is capitalization-weighted, modified capitalization-weighted, price-weighted, share weighted, equal dollar-weighted, approximate equal-dollar weighted, or modified equal-dollar weighted;

(i) For the purposes of this Rule 24.2(d), an approximate equal-dollar weighted index is composed of one or more securities in which each component security will be weighted equally based on its market price on the index’s selection date and the index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision the “notional value” is the market price of the component times the number of shares of the underlying component in the index. Reconstitution and rebalancing are also mandatory if the number of components in the index is greater than five at the time of rebalancing. The Exchange reserves the right to rebalance quarterly at its discretion.

(ii) For the purposes of this Rule 24.2(d), a modified equal-dollar weighted index is an index in which each underlying component represents a pre-determined weighting percentage of the entire index. Each component is assigned a weight that takes into account the relative market capitalization of the securities comprising the index. A modified equal-dollar weighted index will be balanced quarterly.

(iii) For the purposes of this Rule 24.4(d), a share-weighted index is calculated by multiplying the price of the component security by an adjustment factor. Adjustment factors are chosen to reflect the investment objective deemed appropriate by the designer of the index and will be published by the Exchange as part of the contract specifications. The value of the index is calculated by adding the weight of each component security and dividing the total by an index divisor, calculated to yield a benchmark index level as of a particular date. A share-weighted index is not adjusted to reflect changes in the number of outstanding shares of its components. A share-weighted Micro Narrow-Based index will not be re-balanced. If a share-weighted Micro Narrow-Based Index fails to meet the maintenance listing standards under Rule 24.2(e), the Exchange will restrict trading in existing option series to closing transactions and will not issue additional series for that index.

(iv) The Exchange may rebalance any Micro Narrow-Based index on an interim basis if warranted as a result of extraordinary changes in the relative values of the component securities. To the extent investors with open positions must rely upon the continuity of the options contract on the index, outstanding contracts are unaffected by rebalancings.

(3) Each component security in the index has a minimum market capitalization of at least \$75 million, except that each of the lowest weighted securities in the index that in the aggregate account for no more than 10% of the weight of the index may have a minimum market capitalization of only \$50 million;

(4) The average daily trading volume in each of the preceding six months for each component security in the index is at least 45,500 shares, except that each of the lowest

weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index may have an average daily trading volume of only 22,750 shares for each of the last six months;

(5) In a capitalization-weighted index, the lesser of: (1) The five highest weighted component securities in the index each have had an average daily trading volume of at least 90,000 shares over the past six months; or (2) the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average daily trading volume of at least 90,000 shares over the past six months;

(6) Subject to subparagraphs (4) and (5) above, the component securities that account for at least 90% of the total index weight and at least 80% of the total number of component securities in the index must meet the requirements of Rule 5.3 applicable to individual underlying securities;

(7)(i) Each component security in the index is a “reported security” as defined in Rule 11Aa3–1 under the Exchange Act; and

(ii) Foreign securities or ADRs that are not subject to comprehensive surveillance sharing agreements do not represent more than 20% of the weight of the index;

(8) The current underlying index value will be reported at least once every fifteen seconds during the time the index options are traded on the Exchange;

(9) An equal dollar-weighted index will be rebalanced at least once every quarter;

(10) If the underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has in place an information barrier around its personnel who have access to information concerning changes in and adjustments to the index;

(11) Each component security in the index is registered pursuant to Section 12 of the Exchange Act; and

(12) Cash settled index options are designated as A.M.-settled options.

(e) The following maintenance listing standards shall apply to each class of index options originally listed pursuant to paragraph (d) above:

(1) The index meets the criteria of paragraph (d)(1) of this Rule;

(2) Subject to subparagraphs (4) and (9) below, the component securities that account for at least 90% of the total index weight and at least 80% of the total number of component securities in the index must meet the requirements of Rule 5.3;

(3) Each component security in the index has a market capitalization of at least \$75 million, except that each of the lowest weighted component securities that in the aggregate account for no more than 10% of the weight of the index may have a market capitalization of only \$50 million;

(4) The average daily trading volume in each of the preceding six months for each component security in the index is at least 22,750 shares, except that each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index may have an average daily trading volume of at least 18,200 shares for each of the last six months;

(5) Each component security in the index is a "reported security" as defined in Rule 11Aa3-1 under the Exchange Act; and

(6) Foreign securities or ADRs thereon that are not subject to comprehensive surveillance sharing agreements do not represent more than 20% of the weight of the index;

(7) The current underlying index value will be reported at least once every fifteen seconds during the time the index options are traded on the Exchange;

(8) If the underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has in place an information barrier around its personnel who have access to information concerning changes in and adjustments to the index;

(9) In a capitalization-weighted index the lesser of: (1) the five highest weighted component securities in the index each have had an average daily trading volume of at least 45,500 shares over the past six months; or (2) the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index each have had an average daily trading volume of at least 45,500 shares over the past six months;

(10) The total number of component securities in the index may not increase or decrease by more than 33 1/3% from the number of component securities in the index at the time of its initial listing;

(11) Trading volume of each component security in the index must be at least 500,000 shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume must be at least 400,000 shares for each of the last six months;

(12) In a capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index each have had an average monthly trading volume of at least 1,000,000 shares over the past six months;

(13) Each component security in the index is registered pursuant to Section 12 of the Exchange Act;

(14) In an approximate equal-dollar weighted index, the index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision the "notional value" is the market price of the component times the number of shares of the underlying component in the index. Reconstitution and rebalancing are also mandatory if the number of components in the index is greater than five at the time of rebalancing. The Exchange reserves the right to rebalance quarterly at its discretion;

(15) In a modified equal-dollar weighted index the Exchange will re-balance the index quarterly;

(16) In a share-weighted index, if a share-weighted Micro Narrow-Based Index fails to meet the maintenance listing standards under Rule 24.2(e), the Exchange will not rebalance the index, will restrict trading in existing option series to closing transactions, and will not issue additional series for that index; and

(17) In the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the Commission concurs in that determination, or unless the continued listing of that class of index options has been approved by the Commission under Section 19(b)(2) of the Exchange Act.

Rule 24.4B—Position Limits for Options on Micro Narrow-Based Indexes As Defined Under Rule 24.2(d)

Rule 24.4B. In determining compliance with Rule 4.11, cash-settled option contracts on any Micro Narrow-Based Index, as defined and determined under Rule 24.2(d), shall be subject to the following methodologies for determining the applicable position limits:

(a) Methodology for Establishing Position Limits on Cash-Settled Options on Micro Narrow-Based Indexes as defined under Rule 24.2(d). The position limit for a cash-settled option on a Micro Narrow-Based Index that

meets the criteria under Rule 24.2(d) shall be calculated in accordance with the following methodology:

(1) Determine the Market Capitalization of the S&P 500 Index.

(2) Calculate the Notional Value of a position at the limit in the Chicago Mercantile Exchange's ("CME") S&P 500 futures contract. The position limit for that contract is 20,000 (in all months combined) and the Index Multiplier is \$250.

Notional Value for the purposes of this Rule 24.4B(a)(1) = Index Level \* Index Multiplier. Therefore,

Notional Value of 20,000 S&P 500 futures contracts = 20,000 \* S&P 500 Index Level \* 250.

(3) Calculate the Market Capitalization Ratio of the S&P 500 Index Market Capitalization to the Notional Value of a position limit at the limit.

Market Capitalization Ratio = Market Capitalization of the S&P 500 ÷ Notional Value of 20,000 S&P 500 futures contract positions.

(4) Determine the Market Capitalization of the Micro Narrow-Based Index by adding together the market capitalization of each underlying security component.

(5) Determine the Notional Value of the Micro Narrow-Based Index Option (Index Level \* Contract Multiplier).

(6) Calculate the Position Limit of the Micro Narrow-Based Index using the following formula: Contract Position Limit on the Micro Narrow-Based Index = Market Capitalization of Micro Narrow-Based Index ÷ (Notional Value of Micro Narrow-Based Index Option \* Market Capitalization Ratio).

(7) Establishing the Position Limit. After the applicable position limit has been determined pursuant to section 24.4B(a)(1)–(6), round the calculated position limit to the nearest 1,000 contracts using standard rounding procedures. For position limits that are 400 or greater, but less than 1000 contracts, round up to 1,000 contracts.

Rule 24.2(d) shall not apply to any Micro Narrow-Based Index in which the applicable position limit, as calculated using Rule 24.4B(a)(1)–(6), for that Micro Narrow-Based Index is less than 400 contracts.

**Exhibit B**

**MAINTENANCE OF APPROXIMATE EQUAL-DOLLAR WEIGHTED INDEXES**

Type		Adjustments		Notes
Action	Company	Close price/action	Share lot	
Special Cash Dividend	Component of Index ..	Adj. Close = Prev. Close – Dividend.	Adj. Share Lot = (Share Lot * Prev Close)/Adj. Close.	Adjustment Factor = number of new shares for one old share.  Ratio = number of shares of spun-off company received for every share of parent company owned. Spun-off company be added at a weight such that the market capitalization of the two companies after the event is equal to the market capitalization of the parent prior to the event.
Stock Split or Dividend.	Component of Index ..	Adj. Close = Prev. Close/Adjustment Factor.	Adj. Share Lot = Prev. Share Lot * Adjustment Factor.	
Spin Off .....	Component of Index (A).	Adj. Close = Close – (Ratio * Spun off company's Price).	.....	

MAINTENANCE OF APPROXIMATE EQUAL-DOLLAR WEIGHTED INDEXES—Continued

Type		Adjustments		Notes
Action	Company	Close price/action	Share lot	
Two Components Merge in an All Stock, Cash or Combination Deal.	Spun Off Company (B).	ADDED .....	Share Lot = ((Share Lot A * Prev. Close A) = (Adj. Share Lot A*Adj. Close A))/Close B.	All remaining companies will be adjusted using the formula to the left. Their shares will increase based on their price so as to distribute the weight of the acquired company evenly.
	Remaining Companies (A).	.....	Adj. Share Lot = Share Lot + B's Share Lot)/number of remaining components)/A's Close.	
A Non-Component Takes Over a Component.	Acquired Company (B).	DELETED.		The acquiring company will replace the acquired company in the index and the share lot will be adjusted.
	Acquirer (A) .....	ADDED .....	Adj. Share Lot = (B's Share Lot * B's Close)/A's Close.	
Rights Issue .....	Acquired Component of Index (B).	DELETED.		Ratio = number of rights received for 1 share of A.
	Component of Index (A).	Adj Close = (Close + (Ratio * Subscription Price))/(1 + Ratio).	Adj. Share Lot = (Close * Share Lot)/Adj. Close.	
Extraordinary Removal.	Replacement Company (A).	ADDED .....	Adj. Share Lot = (B's Share Lot * B's Close)/A's Close.	Component B may be removed for: bankruptcy proceedings, financial distress (as determined by Dow Jones), delisting from a primary exchange (NYSE, Nasdaq, Amex), or illiquidity (10 consecutive no-trade days). Replacement A would be the highest ranked (as of the most recent Selection Date) of the remaining securities in the industry group which qualify for inclusion.
	Component of Index (B).	DELETED.		

EXHIBIT C

MAINTENANCE OF SHARE-WEIGHTED INDEXES

Type		Adjustments		Notes
Corporate action	Company	Component price change	Adjustment factor change	
Special Cash Dividend	Component of Index ..	New Close = Prev Close – Dividend.	New Adj. Factor = (Prev. Adj. Factor * Prev. Close)/New Close.	For example, in the case of a 2-for-1 split, the Split Ratio would be 2. In the case of a 5% stock dividend, the split ratio would be 1.05.
Stock Split or Dividend.	Component of Index ..	New Close = Prev. Close/Split Ratio.	New Adj. Factor = Prev. Adj. Factor * Split Ratio.	
Spin Off .....	Component of Index ..	New Close = Prev. Close – (Price Adjustment due value of spun-off company).	New Adj. Factor = (Prev. Adj. Factor * Prev. Close)/New Close.	Price Adjustment due to value of spun-off company = (market capitalization of parent company – market capitalization of spun-off company)/number of outstanding shares of the parent company. Spun-off Company is not added.
Two Index Components Merge in an All Stock, Cash or Combination Deal.	Acquiring Company ...	.....	New Adj. Factor = Prev. Adj. Factor + ((Acquired Company's Close * Acquired Company's Adj. Factor)/Acquiring Company's Close).	The weight of the Acquired Company is added to the weight of the Acquiring Company.
	Acquired Company ....	COMPONENT DELETED.		

MAINTENANCE OF SHARE-WEIGHTED INDEXES—Continued

Type		Adjustments		Notes
Corporate action	Company	Component price change	Adjustment factor change	
A Non-Component Takes Over a Component.	Non-Component Acquiring Company.	ADDED .....	New Adj. Factor = ((Acquired Company's Close * Acquired Company's Adj. Factor)/Acquiring Company's Close).	Non-Component Acquiring Company added to index at Acquired Company's weight.
Rights Offering .....	Acquired Component of Index. Component of Index ..	DELETED. New Close = Prev. Close - Price Adjustment due to value of offering.	New Adj. Factor = (Prev. Adj. Factor * Prev. Close)/New Close.	Price Adjustment due to value of rights offering = (market capitalization of parent company - market capitalization of rights)/number of outstanding shares of the parent company.
Extraordinary Removal.	Index Component .....	DELETED .....	The Adjustment Factors for each remaining component will be increased to reflect an equal distribution of the weight of a deleted component..	An Index Component will be removed for: bankruptcy proceedings, financial distress, or delisting from a national market (NYSE, Nasdaq, Amex).

[FR Doc. 04-15329 Filed 7-6-04; 8:45 am]  
BILLING CODE 8010-01-P

**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49930; File No. SR-DTC-2003-09]

**Self-Regulatory Organizations; The Depository Trust Company; Order Granting Approval of a Proposed Rule Change Relating to Establishing a New Service To Destroy Certain Certificates**

June 28, 2004.

**I. Introduction**

On June 12, 2003, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") a proposed rule change SR-DTC-2003-03 pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act").<sup>1</sup> Notice of the proposal was published in the **Federal Register** on January 23, 2004.<sup>2</sup> The Commission received ten comment letters, which are discussed in Section III. For the reasons discussed below, the Commission is approving the proposed rule change.

**II. Description**

DTC filed this proposed rule change to establish a new service, which DTC calls the Destruction of Non-Transferable Securities Certificate

Program. The new service will allow DTC to destroy certain certificates that represent positions in securities for which transfer agent services are not available and have not been available for six years or longer. DTC notes that the issuers of the securities in question are often inactive or insolvent and that the lack of transfer agent services generally renders the certificates non-transferable. The new service will reduce DTC's custodial expenses for such non-transferable securities and will allow participants to avoid certain fees to which they would otherwise be subject for the ongoing custody of the non-transferable issues. The filing also was to implement a DTC fee increase relating to DTC's custody of such non-transferable securities that are not designated for destruction by DTC participants, but as noted below the fee increase was implemented in a separate filing on December 23, 2003.

(1) Background. Over the years, DTC has moved aggressively to reduce the number of securities certificates held in its vaults, principally through expansion of the Book-Entry-Only ("BEO") program, bearer-to-registered conversions, and Fast Automated Securities Transfer ("FAST") program. These efforts have been spurred by the desire of the industry and regulators to move towards a book-entry or dematerialized environment. Because significant costs and risks are associated with ongoing maintenance of custody, control, and audit of certificates, certificate reduction reduces DTC's

costs and risks. As a result of these efforts, DTC has significantly reduced the number of corporate, municipal, and bearer certificates it holds.

At the same time, however, the number and percentage of certificates held in DTC's vaults that represent securities for which transfer agent services are not available has grown considerably. DTC refers to these certificates as "non-transferable securities certificates." Typically, they are equity securities of a company that has become inactive or insolvent. Currently, DTC holds approximately 1.2 million such certificates, representing nearly 22% of its entire certificate inventory.

To address the costs and risks presented by the rising inventory of non-transferable certificates, DTC, having considered helpful input provided by many participants and industry groups, has developed its Destruction of Non-Transferable Securities Certificates Program.

(2) Previous Commission Orders Approving Certificate Destruction. DTC has twice in the past adopted programs pursuant to which it destroys certificates. The Commission approved DTC programs to destroy certificates representing (1) worthless warrants, rights, and put options whose expiration dates have passed<sup>3</sup> and (2) matured

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

<sup>2</sup> Securities Exchange Act Release No. 49080 (January 14, 2004), 69 FR 3405.

<sup>3</sup> Securities Exchange Act Release No. 28642 (November 21, 1990), 55 FR 49725 [File No. SR-DTC-90-11].