

Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the Amex. 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 submission should refer to File Number SR-Amex-2004-108 and should be submitted on or before January 21, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50935; File No. SR-CHX-2004-44]

Self-Regulatory Organizations; Chicago Stock Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Extension of Pilot Rule Change Relating to Transactions in Certain Exchange-Traded Funds

December 27, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 22, 2004, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a request for extension of a pilot rule change as described in items I, II and III below, which items have been prepared by the Exchange. The Exchange filed the proposed rule change pursuant to section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(6)⁴ thereunder, which renders the rule change 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

In its submission, the Exchange requested extension of a pilot rule change to CHX Article XX, Rule 37(a), which governs manual execution of eligible market and marketable limit orders. The pilot rule change, which will remain in effect for an additional 60-day pilot period, permits a CHX specialist, acting in its principal capacity, to manually execute an incoming market or marketable limit order in one of three exchange-traded funds at a price other than the national best bid or offer. The text of the proposed rule change is available at the Office of the Secretary, CHX 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 CHX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in item IV below. The CHX 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

On August 28, 2002, the Commission issued an order granting a *de minimis* exemption (the "Exemption") for transactions in certain exchange-traded funds ("Exempt ETFs")⁵ from the trade-through provisions of the Intermarket Trading System ("ITS") Plan.⁶

According to the CHX, as stated by both Commission staff and commissioners at an open meeting on August 27, 2002, rapid-fire quotations and executions in Exempt ETFs occur consistent throughout the trading day within a range around the NBBO,

rendering it extremely difficult, if not impossible, to access liquidity at an exact NBBO price point. Compounding the "flickering" noted by the Commission, the Exchange has noted a marked increase in the incidence of locked and crossed markets in Exempt ETFs.

CHX Article XX, Rule 37(a), commonly referred to as the Exchange's "Best Rule," requires that with respect to any market or marketable limit order not executed automatically, a CHX specialist must " * * * either (a) manually execute such order at a price and size equal to the NBBO price and size at the time the order was received; or (b) act as agent for such order in seeking to obtain the best available price for such order on a marketplace other than the Exchange, using order routing systems where appropriate."

According to the CHX, given the unique environment in which the ETFs are traded, and the difficulty that CHX represents that its specialists often encounter in accessing NBBO price points, the Exchange's Department of Market Regulation (the "Department") believes that its enforcement of the Best Rule must take the ETF trading environment into account when the Department evaluates the execution prices of eligible market and marketable limit orders for Exempt ETFs. The Department believes that in certain instances, execution of an order in an Exempt ETF at a price other than the NBBO may nonetheless be consistent with the specialist's best execution obligation, in light of the unique environment that characterizes trading in Exempt ETFs. The Exchange believes that the current version of the BEST Rule contains sufficient latitude with respect to an order executed by a CHX specialist acting as agent for the order,⁷ but does not contemplate any flexibility for specialists acting in their principal capacity.⁸ Accordingly, the Exchange proposed a rule change on a pilot basis, which permits a CHX specialist, acting in its principal capacity, to manually execute an incoming market or marketable limit order in an Exempt ETF at a price other than the NBBO.⁹The

⁷ The Best Rule provision governing manual agency executions obligates the CHX specialist to seek " * * * the best available price." CHX Article XX, Rule 37(a)(2).

⁸ The Best Rule provision governing manual principal executions obligates the CHX specialist to execute the order at the " * * * NBBO price and size at the time the order was received." CHX Article XX, Rule 37(a)(2).

⁹ The CHX represents that this proposed rule change is closely analogous to the Exchange's previously submitted interpretation regarding execution of resting limit orders in Exempt ETFs. Under the limit order interpretation, CHX

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ The three affected Exempt ETFs are the exchange-traded funds tracking the Nasdaq-100 Index ("QQQ"), the Dow Jones Industrial Average ("DIAMONDS") and the Standard & Poor's 500 Index ("SPDRs"). The Commission notes that the QQQ is now traded on Nasdaq.

⁶ See Securities Exchange Act Release No. 46428 (August 28, 2002). At present, the Exemption extends to transactions that are "executed at a price that is no more than three cents lower than the highest bid displayed in CQS and no more than three cents higher than the lowest offer displayed in CQS."

pilot is due to expire on December 24, 2004.¹⁰ Accordingly, the Exchange requests a sixty-day extension of the pilot rule change; the pilot rule text incorporated into this submission does not differ in any respect from the existing pilot rule provisions.

Significantly, the pilot rule change does not excuse a CHX specialist from its best execution obligations with respect to manually-executed orders. Moreover, the pilot proposed rule change only relates to orders that are executed manually, when a CHX specialist's ability to obtain liquidity at an exact NBBO price point is extremely limited. Orders that are executed automatically will continue to be executed by the Exchange's MAX automated execution system at the NBBO in effect at the time the order is received.

2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of section 6(b) of the Act.¹¹ The CHX believes the proposal is consistent with section 6(b)(5) of the Act¹² in that it is designed to promote just and equitable principles of trade, to remove impediments to, and to perfect the mechanism of, a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

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

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

No written comments were either solicited or received.

specialists need not provide execution guarantees for Exempt ETFs, based on trade-throughs by other markets, that CHX specialists typically provide to all other listed issues. See Securities Exchange Act Release No. 46557 (September 26, 2002), 67 FR 61941 (October 2, 2002).

¹⁰ See Securities Exchange Act Release No. 50590 (October 26, 2004), 69 FR 63419 (November 1, 2004).

¹¹ 15 U.S.C. 78(f)(b).

¹² 15 U.S.C. 78f(b)(5).

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

The foregoing rule change has been filed by the Exchange as a "non-controversial" rule change pursuant to section 19(b)(3)(A)(i) of the Act¹³ and subparagraph (f)(6) of Rule 19b-4 thereunder.¹⁴ Consequently, because the foregoing rule change: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date on which it was filed or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, it has become effective pursuant to section 19(b)(3)(A) of the Act and Rule 19b-4 thereunder.¹⁵

A proposed rule change filed under Rule 19b-4(f)(6)¹⁶ normally does not become operative prior to thirty days after the date of filing. However, pursuant to Rule 19b-4(f)(6)(iii),¹⁷ the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange seeks to have the proposed rule change become operative immediately so that its specialists may continue trading in accordance with the proposed rule change. The Commission, consistent with the protection of investors and the public interest, has determined to make the proposed rule change effective as of the date of this notice.¹⁸ The Commission notes that the execution guarantees provided by the Exchange are made on a voluntary basis by the Exchange, and that a specialist's duty of best execution will in no way be affected by this proposed rule change.

At any time within 60 days of the filing of such 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 purposes of the Act.

¹³ 15 U.S.C. 78s(b)(3)(A)(i).

¹⁴ 17 CFR 240.19b-4(f)(6).

¹⁵ The Commission has waived the requirement that the Exchange provide the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date.

¹⁶ 17 CFR 240.19b-4(f)(6).

¹⁷ 17 CFR 240.19b-4(f)(6)(iii).

¹⁸ For purposes of only 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. 78(c)(f).

IV. Solicitation of Comments

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

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. Please include File Number SR-CHX-2004-44 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-CHX-2004-44. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing also will be available for inspection and copying at the principal office of the CHX. 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-CHX-2004-44 and should be submitted on or before January 25, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50937; File No. SR-ISE-2004-09]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and No. 2 by the International Securities Exchange, Inc., Relating to the Listing and Trading of Options on the S&P 1000 Index

December 27, 2004.

I. Introduction

On April 5, 2004, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposal to list and trade options based on one-tenth and one one-hundredth of the value of the Standard & Poor's 1000 Index ("S&P 1000" or "Index"). The ISE submitted Amendment Nos. 1 and No. 2 to the proposal on July 16, 2004,³ and August 2, 2004,⁴ respectively. The proposed rule change and Amendment Nos. 1 and No. 2 were published for comment in the **Federal Register** on November 22, 2004.⁵ The Commission received no comment letters regarding this proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

The ISE proposes to list and trade the following A.M. cash-settled, European-style options: (1) Reduced Value S&P

1000 Options ("Reduced Value S&P 1000 Options" or "Reduced Value Index Options") based on one-tenth of the value of the Index; (2) Micro S&P 1000 Index Options ("Micro S&P 1000 Options" or "Micro Index Options") based on one-hundredth of the value of the Index; (3) long-term Reduced Value Index Options; and (4) long-term Micro Index Options (the Reduced Value Index Options, Micro Index Options, long-term Reduced Value Index Options, and long-term Micro Index Options may be referred to, collectively, as the "Index Options").⁶

A brief description of the proposal appears below, the November Release⁷ provides a more detailed description of the proposal.

Index Design and Composition

The Index, which was designed and is maintained by Standard & Poor's ("S&P"), is a market capitalization-weighted index that combines the S&P MidCap 400 Index and the S&P SmallCap 600 Index. The MidCap 400 Index is broad-based index designed to measure the performance of the mid-range sector of the U.S. stock market, and the S&P SmallCap 600 is a broad-based index designed to measure the performance of small capitalization U.S. stocks.⁸ Because the Index is a combination of the S&P MidCap 400 Index and the S&P SmallCap 600 Index, the S&P 1000 does not have its own criteria for selecting Index components. Instead, the selection criteria for the S&P MidCap 400 Index and the S&P SmallCap 600 Index determine the components of the S&P 1000. The S&P 1000 may not contain any component that is a component of the S&P 500 Index.

S&P chooses the components of the S&P MidCap 400 Index and the S&P SmallCap 600 Index on the basis of

market capitalization, liquidity, and industry group representation. As of February 18, 2004, the Index's components were listed on the New York Stock Exchange ("NYSE"), Nasdaq, or the American Stock Exchange ("Amex"), and components representing over 98% of the weight of the Index were options eligible.⁹ All of the Index components listed on Nasdaq are designated as national market system securities by the National Association of Securities Dealers. As described more fully below, the Index's components are classified in ten market sectors and no single security dominates the Index.

Transition to Float-Adjusted Capitalization Weighting

The S&P 1000 Index currently is a "full" market capitalization-weighted index in which the value of the Index is calculated by multiplying, for each component, the total number of shares outstanding by the price per share, adding these values together, and dividing the result by the Index divisor. On March 1, 2004, S&P announced that it would shift its U.S. indexes, including the S&P 1000 to "float-adjusted" market capitalization weighting. As a float-adjusted market capitalization weighted index, the value of the Index will be calculated by multiplying, for each component, the number of shares of the component that are available to investors (rather than all of the component's outstanding shares) by the price per share, adding these values together, and dividing the result by the Index divisor. As described more fully on S&P's Internet Web site, S&P's float adjustment will exclude from the share available to investors shares held by other publicly traded companies and strategic partners, government agencies, and control groups.¹⁰

S&P will implement the transition from full market capitalization weighting to float-adjusted market capitalization weighting over an 18-month period. S&P will calculate provisional indexes alongside of the regular indexes so that passive indexers (institutional investors that model their portfolio construction and weighting according to S&P indexes) can control the timing of adjustments. The ISE will not trade options on any provisional index calculated during the transition period, nor does the ISE expect any securities or futures exchange to trade

⁹ See *infra* note 26 for a description of the options eligibility standards.

¹⁰ See <http://www.freefloat.standardandpoors.com>.

¹⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 15, 2004, and accompanying Form 19b-4 ("Amendment No. 1"). Amendment No. 1 replaced the filing in its entirety.

⁴ See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated July 28, 2004 ("Amendment No. 2"). Amendment No. 2 made technical changes clarifying the description of the Index and the calculation of the Index settlement value.

⁵ See Securities Exchange Act Release No. 50674 (November 16, 2003), 69 FR 67974 ("November Release").

⁶ Under ISE Rule 2009(b)(2), "Long-Term Index Options Series," the ISE may list long-term index options that expire from 12 to 60 months from the date of issuance. The Exchange will not list reduced value long-term index options on either of the Reduced Value S&P 1000 Indexes or the Reduced Value Micro S&P 1000 Indexes pursuant to ISE Rule 2009(B)(2)(i). Telephone conversation between Joseph W. Ferraro III, Associate General Counsel, ISE, and Florence Harmon, Senior Special Counsel, Division, Commission, and A. Michael Pierson, Attorney, Division, Commission, on November 16, 2004 ("November 16 Conversation").

⁷ See *supra* note 5.

⁸ See Exchange Act Release Nos. 48587 (October 2, 2003), 68 FR 58154 (October 8, 2003) (order approving File No. SR-ISE-2003-18) (approving the listing and trading of options on the S&P SmallCap 600 Index) "S&P SmallCap 600 Order"; and 49696 (May 13, 2004), 69 FR 28962 (May 19, 2004) (order approving File No. SR-ISE-2004-08) (approving the listing and trading of options on the S&P MidCap 400 Index) ("S&P MidCap 400 Order").