

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-BSE-2005-30 and should be submitted on or before September 14, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52295; File No. SR-CFE-2005-01]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by CBOE Futures Exchange, LLC Relating to Its Listing Standards for Security Futures Products

August 18, 2005.

Pursuant to Section 19(b)(7) of the Securities Exchange Act of 1934<sup>1</sup> ("Act") and Rule 19b-7 under the Act,<sup>2</sup> notice is hereby given that on July 26, 2005, CBOE Futures Exchange, LLC ("CFE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change described in Items I, II and III below, which Items have been prepared by CFE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons. CFE also filed the proposed rule change with the Commodity Futures Trading Commission ("CFTC"), together with a written certification under Section 5c(c) of the Commodity Exchange Act ("CEA")<sup>3</sup> on July 25, 2005.

#### I. Self-Regulatory Organization's Description of the Proposed Rule Change<sup>4</sup>

CFE is proposing to adopt rules regarding listing standards for security

futures contracts ("Eligibility and Maintenance Criteria") to comply with the requirements under Section 6(h)(3)<sup>5</sup> of the Act and the criteria under Section 2(a)(1)(D)(i) of the CEA.<sup>6</sup> The text of the proposed rule change is available on CFE's Web site (<http://cfe.cboe.com>), at CFE's principal office, and at the Commission's Public Reference Room. The CFE Listing Standards<sup>7</sup> are, for the most part, identical to the sample listing standards ("Sample Listing Standards") included in the Commission's Staff Legal Bulletin No. 15 ("SLB 15"),<sup>8</sup> except that the CFE Listing Standards:

- Reflect the modifications to the statutory listing standards requirements jointly adopted by the Commission and the CFTC with respect to shares of exchange-traded funds ("ETFs"), trust-issued receipts ("TIRs"), shares of registered closed-end management investment companies ("Closed-End Fund Shares"), and American Depository Receipts ("ADRs");<sup>9</sup>
  - Establish an approximately equal dollar-weighting methodology for physically-settled futures based on narrow-based security indices (all narrow-based security index futures are referred to hereafter as "NBI futures"),<sup>10</sup> which (i) requires the number of shares or receipts of each component security to be rounded up or down to the nearest multiple of 100 in the course of the determination of the initial index composition and any subsequent rebalancing; (ii) contemplates mandatory annual rebalancing of such indices under specified circumstances, complemented by CFE's ability to rebalance indices on an interim basis if it so elects; and (iii) ensures that outstanding contracts will not be affected by any rebalancing; and
    - Contain certain provisions that reflect rule changes that have been filed by other security futures exchanges

<sup>5</sup> 15 U.S.C. 78f(h)(3).

<sup>6</sup> 7 U.S.C. 2(a)(1)(D)(i).

<sup>7</sup> The CFE Listing Standards are set forth in proposed Policy and Procedure VIII, Eligibility and Maintenance Criteria for Security Futures.

<sup>8</sup> SEC, Division of Market Regulation, Staff Legal Bulletin No. 15: Listing Standards for Trading Security Futures Products (September 5, 2001) (available at <http://www.sec.gov/interps/legal/mrs15.htm>).

<sup>9</sup> See Joint Order Granting the Modification of Listing Standards Requirements Securities Exchange Act Release No. 46090 (June 19, 2002), 67 FR 42760 (June 25, 2002) (ETFs, TIRs and Closed-End Fund Shares); Joint Order Granting the Modification of Listing Standards Requirements, Securities Exchange Act Release No. 44725 (August 20, 2001) (ADRs).

<sup>10</sup> CFE Policy and Procedures VIII(C) and VIII(D) contain listing requirements that relate to the initial eligibility criteria and maintenance standards, respectively, for approximately equal dollar-weighted, physically-settled narrow-based security indices.

since the adoption of SLB 15, which vary from the Sample Listing Standards set forth in SLB 15.

CFE is also filing herewith CFE Rules 215, 403, 412-415, 417, 501, 601-605, 610-615, 1801-1806, and 1901-1906, all of which remain unchanged from the CFE Rulebook filed with the Commission as part of CFE's notice registration on Form 1-N. These rules are being filed herewith because they relate to the listing standard requirements set forth in Section 6(h)(3) of the Act<sup>11</sup> as further described below. CFE Rule 517 and CFE Policy and Procedure VII, while also referenced in Item II below, are not filed in this proposed rule change because they were the subjects of a separate filing by CFE on SEC Form 19b-4.<sup>12</sup>

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

CFE has prepared statements concerning the purpose of, and basis for, the proposed rule change, burdens on competition, and comments received from its members, participants, and others. The text of these statements may be examined at the places specified in Item IV below. These statements are set forth in Sections A, B, and C below.

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

Section 6(h)(3) of the Act<sup>13</sup> sets forth a number of requirements for listing standards applicable to security futures products. Among other things, that Section provides that such listing standards must (i) be no less restrictive than comparable listing standards for options traded on a national securities exchange<sup>14</sup> and (ii) require that trading in security futures products not be readily susceptible to manipulation of the price of such products or of the underlying securities or options on such securities.<sup>15</sup>

##### 1. CFE Listing Standards

Commission staff published SLB 15, including the Sample Listing Standards (which were derived from typical listing standards used by exchanges trading options based on securities or security indices), to provide guidance as to how an exchange can comply with the foregoing requirements. SLB 15 also

<sup>11</sup> 15 U.S.C. 78f(h)(3).

<sup>12</sup> See File No. SR-CFE-2005-02 (filed July 27, 2005).

<sup>13</sup> 15 U.S.C. 78f(h)(3).

<sup>14</sup> 15 U.S.C. 78f(h)(3)(C).

<sup>15</sup> 15 U.S.C. 78f(h)(3)(H).

<sup>6</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(7).

<sup>2</sup> 17 CFR 240.19b-7.

<sup>3</sup> 7 U.S.C. 7a-2(c).

<sup>4</sup> With the consent of the CFE, the Commission has made minor clarifications to the text of the descriptions in this Part I and to the statement of purpose in Part II.A below. Telephone call between David Doherty, Attorney, CFE, and Ira Brandriss, Special Counsel, and Nathan Saunders, Special Counsel, Division of Market Regulation, Commission, August 9, 2005.

noted that different listing standards could also be consistent with the Act.

The CFE Listing Standards follow the Sample Listing Standards, subject to the additional modifications relating to ETFs, TIRs, Closed-End Fund Shares, and ADRs; the establishment of an additional weighting methodology for certain physically-settled NBI futures described under Item I above; and certain other rule changes that were filed with the Commission and the CFTC by OneChicago, LLC ("OneChicago")<sup>16</sup> which pertained to OneChicago's listing standards for security futures. Therefore, the CFE Listing Standards as set forth herein do not contain any listing standards that have not already been reviewed by the Commission. The CFE Listing Standards permit CFE to trade both cash-settled and physically-settled NBI futures on the following types of indices: capitalization-weighted, modified capitalization-weighted, price-weighted, and equal dollar-weighted. The modifications to SLB 15, including the modifications that permit CFE to list approximately equal-dollar weighted, physically-settled NBI futures, are explained in further detail below.

## 2. Modifications of SLB 15

### a. *Modification of SLB 15 I(A)(i).*

The modifications set forth in the CFE listing standards that relate to shares of ETFs, TIRs, Closed-End Fund Shares, and ADRs reflect the modifications to the statutory listing standards requirements adopted by the Commission and the CFTC subsequent to the publication of SLB 15.<sup>17</sup> These standards are reflected in Section A(1)(i) of CFE Policy and Procedure VIII.

### b. *Modification of SLB 15 III(A)(ii).*

The modifications that relate to narrow-based security indices are intended to allow CFE to provide for an additional weighting methodology, called an "approximately equal dollar-weighted" methodology, that would be available only for physically-settled NBI

futures, and accordingly, are limited in application to such physically-settled contracts. These modifications are designed to enhance the usefulness and effectiveness of physically-settled NBI futures in connection with hedging, arbitrage and other investment strategies.

The proposed approximately equal dollar-weighted methodology contemplates narrow-based security indices consisting of component securities in increments that are no less than 100 shares or receipts, which corresponds to customary increments for transactions in the markets for those securities. For this reason, rounding will be a necessary step in the determination of the initial index composition and any subsequent rebalancing. The underlying index of a physically-settled NBI future that uses an approximately equal dollar-weighted methodology would be rebalanced annually, but only if the aggregate value of the security position with the highest value is two or more times greater than the aggregate value of the security position with the lowest value in the index for a specified time period. CFE will also have the ability to rebalance any approximately equal dollar-weighted narrow-based security index on an interim basis (but no more frequently than quarterly) should this become necessary as a result of exceptional changes in the relative values of the component securities. As CFE plans to list only physically-settled NBI futures contracts expiring on the next two quarterly expiration dates and the nearest two serial monthly expiration dates that are not quarterly expiration dates, CFE will be able to phase in contracts that are based on a rebalanced narrow-based security index, and thereby replace contracts with open interest that are based on the previous narrow-based security index composition within a short period of time. CFE also believes that investors in approximately equal dollar-weighted NBI futures contracts should be able to rely on the number of shares or receipts evidencing each component security remaining unchanged for the duration of those contracts. Therefore, the CFE Listing Standards state that outstanding contracts overlying approximately equal dollar-weighted narrow-based security indices will not be affected by any rebalancing. The proposed listing standards for approximately equal dollar-weighted narrow-based security indices are identical to the listing standards for approximately equal dollar-weighted narrow-based security indices that were set forth in the OneChicago rules prior to a recent filing

of an immediately effective proposed rule change by OneChicago.<sup>18</sup> In addition, the contents of the CFE Listing Standards, including the approximately equal dollar-weighting methodology described above, will be publicly available and fully disclosed. These standards are reflected in Sections C(1)(ii) and D(1)(ii) of CFE Policy and Procedure VIII.

### c. *Modification of SLB 15 I(A)(vi).*

CFE is adopting the initial listing standard implemented by OneChicago in SR-OC-2004-02,<sup>19</sup> which would permit CFE to list a single stock future on an underlying security that had trading volume of at least 2,400,000 shares in the preceding 12 months. This standard is reflected in Section A(1)(vi) of CFE Policy and Procedure VIII.

### d. *Modification of SLB 15 I(A)(vii).*

CFE is adopting the initial listing standards implemented by OneChicago in SR-OC-2003-01,<sup>20</sup> which would permit a single stock future to be listed on a security that is a "covered security" as defined under Section 18(b)(1)(A) of the Securities Act of 1933<sup>21</sup> if the market price of the underlying security has been at least \$3.00 for the five consecutive business days prior to the date on which CFE submits a certificate to The Options Clearing Corporation ("OCC") for listing and trading the futures contract. The market price of the underlying security would be measured by the closing price reported in the primary market in which the underlying security is traded. CFE rules would also require that an underlying security that is not a "covered security" meet the price requirement that it have a market price of at least \$7.50 for the majority of the business days for the three calendar months preceding selection. These standards are reflected in Sections A(1)(viii) and A(1)(ix) of CFE Policy and Procedure VIII.

### e. *Modification of SLB 15 II(A)(iv).*

CFE is adopting the maintenance standard implemented by OneChicago in SR-OC-2003-04<sup>22</sup> (as amended by SR-OC-2003-08),<sup>23</sup> pursuant to which CFE would not open for trading a new delivery month for a single stock future trading on CFE if the market price per share of the underlying security closed below \$3.00 on the previous trading day to the expiration day of the nearest expiring contract on the underlying

<sup>16</sup> See SR-OC-2002-04 (Securities Exchange Act Release No. 47114 (December 31, 2002), 68 FR 837 (January 7, 2003)) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change by OneChicago, LLC Relating to Listing Standards for Security Futures Products); see also SR-OC-2003-01 (Securities Exchange Act Release No. 47356 (February 12, 2003), 68 FR 8064 (February 19, 2003)); SR-OC-2003-04 (Securities Exchange Act Release No. 47445 (March 5, 2003), 68 FR 11595 (March 11, 2003)); SR-OC-2003-06 (Securities Exchange Act Release No. 48191 (July 17, 2003), 68 FR 43555 (July 23, 2003)); SR-OC-2003-08 (Securities Exchange Act Release No. 48660 (October 20, 2003), 68 FR 61027 (October 24, 2003)); and SR-OC-2004-02 (Securities Exchange Act Release No. 50373 (September 14, 2004), 69 FR 56470 (September 21, 2004)).

<sup>17</sup> See *supra* note 9.

<sup>18</sup> See SR-OC-2005-02 (Securities Exchange Act Release No. 52180 (July 29, 2005), 70 FR 45464 (August 5, 2005)).

<sup>19</sup> See *supra* note 16.

<sup>20</sup> See *id.*

<sup>21</sup> 15 U.S.C. 77r(b)(1)(A).

<sup>22</sup> See *supra* note 16.

<sup>23</sup> See *id.*

security. The market price per share of the underlying security would be determined by the closing price reported in the primary market in which the underlying security is traded. This standard is reflected in Section B(1)(v) of CFE Policy and Procedure VIII.

### 3. Section 6(h)(3) Requirements

Section 6(h)(3) of the Act<sup>24</sup> contains detailed requirements for listing standards and conditions for trading applicable to security futures products. Set forth below is a summary of each such requirement or condition, followed by a brief explanation of how CFE will comply with it, whether by particular provisions in the CFE Listing Standards or otherwise.

Clause (A) of Section 6(h)(3) of the Act<sup>25</sup> requires that any security underlying a security future be registered pursuant to Section 12 of the Act.<sup>26</sup> This requirement is addressed in Sections A(1)(ii), B(1)(i), C(1)(ii)(b), and D(1)(ii)(a) of CFE Policy and Procedure VIII.

Clause (B) of Section 6(h)(3) of the Act<sup>27</sup> requires that a market on which a physically-settled security futures product is traded have arrangements in place with a registered clearing agency for the payment and delivery of the securities underlying the security futures product. CFE has entered into an arrangement with OCC, which is a registered clearing agency, relating to the clearing of security futures products. By virtue of OCC having in place arrangements with the National Securities Clearing Corporation for the delivery of securities underlying physically-settled security futures products, CFE believes that the payment and delivery of the securities underlying CFE's security futures products in accordance with the statutory requirements should be ensured.

Clause (C) of Section 6(h)(3) of the Act<sup>28</sup> provides that listing standards for security futures products must be no less restrictive than comparable listing standards for options traded on a national securities exchange or national securities association registered pursuant to Section 15A(a) of the Act.<sup>29</sup> For the reasons discussed under Item II.A.1 above, notwithstanding specified differences between the Sample Listing Standards and the CFE Listing Standards, CFE believes that the latter are no less restrictive than comparable

listing standards for exchange-traded options.

Clause (D) of Section 6(h)(3) of the Act<sup>30</sup> requires that each security future be based on common stock or such other equity securities as the Commission and the CFTC jointly determine appropriate. This requirement is addressed in Sections A(1)(i), C(1)(ii)(c), and D(1)(ii)(b) of CFE Policy and Procedure VIII.

Clause (E) of Section 6(h)(3) of the Act<sup>31</sup> requires that each security futures product be cleared by a clearing agency that has in place provisions for linked and coordinated clearing with other clearing agencies that clear security futures products, which permits the security futures product to be purchased on one market and offset on another market that trades such product. CFE notes that pursuant to Section 6(h)(7) of the Act,<sup>32</sup> the foregoing requirement is deferred until the "compliance date" (as defined therein). CFE expects OCC will have in place procedures complying with the requirements of clause (E) upon and after such compliance date.

Clause (F) of Section 6(h)(3) of the Act<sup>33</sup> requires that only a broker or dealer subject to suitability rules comparable to those of a national securities association registered pursuant to Section 15A(a) of the Act<sup>34</sup> may effect transactions in a security futures product. This requirement is addressed by CFE Rule 605, Sales Practice Rules. CFE Rule 605 requires each Trading Privilege Holder (including its Related Parties) to comply with the sales practice rules applicable to such Trading Privilege Holder from time to time promulgated by the National Futures Association or the National Association of Securities Dealers, both of which are national securities associations.

Clause (G) of Section 6(h)(3) of the Act<sup>35</sup> requires that each security futures product be subject to the prohibition against dual trading in Section 4j of the CEA<sup>36</sup> and the rules and regulations thereunder or the provisions of Section 11(a) of the Act<sup>37</sup> and the rules and regulations thereunder. Trading Privilege Holders and their Related Parties trading on CFE will be subject to the aforementioned statutory and regulatory prohibitions against dual trading by virtue of CFE Rule 604,

Adherence to Law, which requires them to comply with all applicable law. CFE Rules 610 through 613 contain customary provisions relating to the priority of customers' orders, trading against customers' orders, withholding orders and disclosing orders, consistent with CFTC Regulations §§ 155.2 through 155.4<sup>38</sup> under the CEA. CFE notes, however, that the prohibition of dual trading in security futures products as set forth in CFTC Regulation § 41.27<sup>39</sup> adopted pursuant to Section 4j(a) of the CEA<sup>40</sup> by its terms only applies to a contract market operating an electronic trading system if such market provides participants with a time or place advantage or the ability to override a predetermined algorithm.<sup>41</sup> Since those conditions do not exist on CFE, CFE has no specific rule prohibiting dual trading.

Clause (H) of Section 6(h)(3) of the Act<sup>42</sup> requires that trading in a security futures product not be readily susceptible to manipulation of the price of such security futures product, nor to causing or being used in the manipulation of the price of any underlying security, option on such security, or option on a group or index including such securities. As discussed above, the eligibility and maintenance criteria for security futures products contained in the CFE Listing Standards have been designed to ensure that the products that will be listed on CFE and the underlying securities will not be readily susceptible to price manipulation. In addition, CFE Rules 415, Block Trading, 603, Market Manipulation, 614, Pre-Arranged Trades, and 615, Simultaneous Buying and Selling Orders, either prohibit market manipulation outright (for example, CFE Rule 603 forbids generating unnecessary volatility or creating a condition where prices do not or will not reflect fair market values) or contain standards and limitations that are designed to prevent market manipulation.

CFE's position limit standards set forth in CFE Rule 412, Position Limits, are designed to prevent market manipulation with respect to physically-settled NBI futures through the adoption of the position limits established under CFTC Regulation § 41.25.<sup>43</sup> With respect to cash-settled NBI futures, CFE Rule 1902(e), Speculative Position Limits, adopts the

<sup>24</sup> 15 U.S.C. 78f(h)(3).

<sup>25</sup> 15 U.S.C. 78f(h)(3)(A).

<sup>26</sup> 15 U.S.C. 78l.

<sup>27</sup> 15 U.S.C. 78f(h)(3)(B).

<sup>28</sup> 15 U.S.C. 78f(h)(3)(C).

<sup>29</sup> 15 U.S.C. 78o-3(a).

<sup>30</sup> 15 U.S.C. 78f(h)(3)(D).

<sup>31</sup> 15 U.S.C. 78f(h)(3)(E).

<sup>32</sup> 15 U.S.C. 78f(h)(7).

<sup>33</sup> 15 U.S.C. 78f(h)(3)(F).

<sup>34</sup> 15 U.S.C. 78o-3(a).

<sup>35</sup> 15 U.S.C. 78f(h)(3)(G).

<sup>36</sup> 7 U.S.C. 6j.

<sup>37</sup> 15 U.S.C. 78k(a).

<sup>38</sup> 17 CFR 155.2-155.4.

<sup>39</sup> 17 CFR 41.27.

<sup>40</sup> 7 U.S.C. 6j(a).

<sup>41</sup> 17 CFR 41.27(b)(2).

<sup>42</sup> 15 U.S.C. 78f(h)(3)(H).

<sup>43</sup> 17 CFR 41.25.

position limit standards set forth in OneChicago Rule 1002(e)(2) and applies those standards to all cash-settled NBI futures traded on CFE.<sup>44</sup> Under CFE Rule 1902(e), CFE calculates two numbers: the Market Cap Position Limit and the SSF Position Limit. The Market Cap Position Limit is based on the market capitalization of each NBI future and the notional value compared to the market capitalization of the Chicago Mercantile Exchange Inc. ("CME") position limit for its futures contract on Standard & Poor's ("S&P" 500 Index. The SSF Position Limit is based on the current position limit permitted for single stock futures under CFTC Regulation § 41.25.<sup>45</sup> CFE imposes a position limit on each cash-settled NBI future equal to the lower of the Market Cap Position Limit and the SSF Position Limit, rounded to the nearest multiple of 1,000 contracts; provided, however, that if the lower of the two limits is less than 500 but not less than 400, the position limit for such future is rounded up to 1,000 contracts.

To calculate the Market Cap Position Limit, CFE determines the market capitalization of the S&P 500 Index (as of the selection date for the component securities in the index underlying the NBI future), then calculates the notional value of a position at the limit of CME's S&P 500 Index futures contract ("S&P 500 Notional Value Limit")<sup>46</sup> and divides the first amount by the second to determine the market capitalization ratio ("Market Cap Ratio").<sup>47</sup> CFE then determines the market capitalization of the index underlying the NBI future ("Stock Index Market Cap")<sup>48</sup> and the notional value of the index underlying the NBI future ("Notional Value").<sup>49</sup> To calculate the Market Cap Position Limit, CFE divides the Stock Index Market Cap by the Notional Value multiplied by the Market Cap Ratio.<sup>50</sup>

To calculate the SSF Position Limit for an NBI future, CFE first calculates its Notional Value in the same manner as

described above.<sup>51</sup> Then, for each component security in the index underlying the NBI future, CFE multiplies the index weight of the component security<sup>52</sup> by the Notional Value to determine the security's proportion of the NBI future ("Share Weighting"). CFE then divides each security's Share Weighting by its price to calculate the number of shares of that security represented in the NBI futures contract ("Implied Shares"). CFE then, for each component security in the index underlying the NBI future, divides its Implied Shares by 100 to obtain the implied number of 100-share contracts of such component security in each NBI futures contract. CFE then divides the applicable single stock futures contract speculative position limit permitted under CFTC Regulation § 41.25(a)(3)<sup>53</sup> (either 13,500 or 22,500 contracts) for each component security by the number of implied 100-share contracts. This equals the number of NBI futures contracts that could be held without exceeding the speculative position limit on a futures contract on that component security ("Implied SSF Speculative Limit"). If a component security qualified for position accountability under CFTC Regulation 41.25(a)(3),<sup>54</sup> that security would be ignored for purposes of this calculation. After calculating the Implied SSF Speculative Limit for each security in the index underlying the NBI future, CFE identifies the lowest Implied SSF Speculative Limit as the SSF Position Limit for that NBI future.

CFE Rules 413(b), Price Limits; Final Settlement Prices, and 417, Regulatory Halts, implement the requirements contained in Rule 6h-1 under the Act<sup>55</sup> relating to settlement and regulatory halts with respect to security futures products.

With respect to final settlement prices, CFE Rule 1902(i), Settlement Price, establishes how the final settlement price is determined for cash-settled NBI futures. Under CFE Rule 1902(i), a special opening quotation of the relevant index underlying the NBI future will be derived from the sum of the opening prices<sup>56</sup> of each component

stock. When all of the component stocks have opened, the final special opening quotation will be calculated and disseminated.

If the price of one or more of the component securities is not readily available<sup>57</sup> on the day scheduled for determination of the final settlement price, the price of the component security or securities shall be based on the next available opening price of that security, unless the President of the Exchange or his designee for such purposes ("Designated Officer") determines that one or more component securities are not likely to open within a reasonable time. If the Designated Officer makes such a determination, the price of the relevant component security or securities for purposes of calculating the final settlement price will be the last trading price of the security or securities during the most recent regular trading session for such security or securities.

CFE Rule 1902(i) also provides that the Rule shall not be used to calculate the final settlement price of an NBI future if OCC fixes the final settlement price of the NBI future in accordance with OCC's rules and by-laws and as permitted under the Commission's Rule 6h-1(b)(3)<sup>58</sup> and CFTC Regulation 41.25(b)(3).<sup>59</sup>

Clause (I) of Section 6(h)(3) of the Act<sup>60</sup> requires that procedures be in place for coordinated surveillance among the market on which a security futures product is traded, any market on which any security underlying the security futures product is traded, and other markets on which any related security is traded to detect manipulation and insider trading. The relevant provisions are CFE Rules 601, 602 and 603, which prohibit fraudulent acts, fictitious transactions and market manipulation, respectively. CFE notes that it is an affiliate member of the Intermarket Surveillance Group ("ISG") and has executed (1) an Agreement to

security. If the security is not listed on a national securities exchange or a national securities association, then "opening price" shall mean the price at which a security opened for trading on the primary market for the security. Under this provision, if a component security is an [ADR] traded on a national securities exchange or national securities association, the opening price for the ADR would be derived from the national securities exchange or national securities association that lists it.

<sup>57</sup> Under CFE Rule 1902(i)(II)(C)(4), the price of a security is "not readily available" if the underlying market does not open on the date set for determination of the final settlement price, or if the security does not trade on the securities exchange or national securities association that lists the security during regular trading hours.

<sup>58</sup> 17 CFR 240.6h-1(b)(3).

<sup>59</sup> 17 CFR 41.25(b)(3).

<sup>60</sup> 15 U.S.C. 78f(h)(3)(I).

<sup>44</sup> Consistent with CFTC Regulation 41.25, position limits apply to positions in any cash-settled NBI future held during the last five trading days of an expiring contract.

<sup>45</sup> 17 CFR 41.25.

<sup>46</sup> The speculative position limit for the CME's S&P 500 Index futures contract is 20,000 contracts (in all months combined) and the contract multiplier is \$250. Thus, S&P 500 Notional Value Limit = Level of the S&P 500 Index \* 20,000 \* 250.

<sup>47</sup> Market Cap Ratio = Market Capitalization of the S&P 500 Index / S&P 500 Notional Value Limit.

<sup>48</sup> The Stock Index Market Cap is calculated by adding the market capitalizations of each stock comprising the underlying narrow-based security index.

<sup>49</sup> Notional Value = Level of the index underlying the NBI future \* contract multiplier.

<sup>50</sup> Market Cap Position Limit = Stock Index Market Cap / (Notional Value \* Market Cap Ratio).

<sup>51</sup> See *supra* note 49.

<sup>52</sup> Index weight of the component security = (assigned shares \* price) of the component security / the sum of (assigned shares \* price) for each component security.

<sup>53</sup> 17 CFR 41.25(a)(3).

<sup>54</sup> *Id.*

<sup>55</sup> 17 CFR 240.6h-1.

<sup>56</sup> Consistent with 17 CFR 41.1(j), CFE Rule 1902(i)(II)(C)(1) defines "opening price" as follows: "Opening price" means the official price at which a security opened for trading during the regular trading session of the national securities exchange or national securities association that lists the

Share Market Surveillance and Regulatory Information between CFE and the full members of ISG; (2) the Agreement to Share Market Surveillance and Regulatory Information between CFE and the affiliate members of ISG; and (3) the Addendum for Security Futures Products to agreements between the full members of ISG and the affiliate members of ISG trading security futures products (including CFE). CFE Rule 215, Regulatory Cooperation, permits CFE to enter into these and other agreements for the exchange of information and other forms of mutual assistance with domestic or foreign self-regulatory organizations, associations, boards of trade and their respective regulators. Under CFE Rule 215, CFE is authorized to provide information to any such organization, association, board of trade or regulator that is a party to an information sharing agreement with CFE, in accordance with the terms and subject to the conditions set forth in such agreement. Additional provisions related to coordinated surveillance are contained in Sections A(1)(x)(a), C(1)(ii)(g), and D(1)(ii)(f) of CFE Policy and Procedure VIII.

Clause (J) of Section 6(h)(3) of the Act<sup>61</sup> requires that a market on which a security futures product is traded have in place audit trails necessary or appropriate to facilitate the coordinated surveillance referred to in the preceding paragraph. The audit trail capability provided by CBOE*Direct*, CFE's trade matching engine, will create and maintain an electronic transaction history database that contains information with respect to all orders, whether executed or not, and resulting transactions on CFE. The information recorded with respect to each order includes: time received, terms of the order, order type, instrument and contract month, price, quantity, account type, account designation, user code and clearing firm. This information will enable CFE to trace each order back to the clearing firm by or through which it was submitted. If any question or issue arises as to the source of an order prior to submission by or through a clearing firm, CFE will request that the clearing firm provide an electronic or other record of the order.

For orders that cannot be immediately entered into CFE systems, and therefore will not be recorded electronically by CBOE*Direct* at the time they are placed, CFE Rule 403(b), Order Entry, requires that the Clearing Member or, if applicable, the Trading Privilege Holder or the Authorized Trader receiving such order must prepare an order form in a

non-alterable written medium, which must be time-stamped and include the account designation, date and other required information (including order terms, order type, instrument and contract month, price, and quantity). Each such form must be retained for at least five years from the time it is prepared. In addition, CFE Rule 501, Books and Records, establishes a general recordkeeping requirement pursuant to which each Clearing Member and Trading Privilege Holder must keep all books and records required to be kept by it pursuant to the CEA, CFTC regulations, the Act, regulations under the Act, and CFE Rules. CFE Rule 501 also requires that such books and records be made available to CFE upon request. Current CFTC regulations require books and records to be maintained for a period of five years.<sup>62</sup>

Pursuant to CFE Rule 415, Block Trading, block trades will be entered in CBOE*Direct* by CFE's operations management after they are verbally reported by designated individuals at the Clearing Member for the selling party. At the time of each such verbal report, a trade identification number will be assigned and provided to the caller. Both the buyer and the seller in each trade will then follow up the verbal report by submitting a block trade reporting form via facsimile or email to CFE. The same procedures generally apply to exchange of future for related position ("EFP") transactions as provided in CFE Rule 414. Since block trades and EFP transactions involve orders that cannot be immediately entered into CFE's systems, the Clearing Members or, if applicable, CFE Trading Privilege Holders or CFE Authorized Traders, must comply with the recordkeeping procedures specified in the preceding paragraph.

Clause (K) of Section 6(h)(3) of the Act<sup>63</sup> requires that a market on which a security futures product is traded have in place procedures to coordinate trading halts between such market and any market on which any security underlying the security futures product is traded and other markets on which any related security is traded. CFE Rule 417, Regulatory Halts, provides for trading in a security future to be halted at all times that a regulatory halt has been instituted for the relevant underlying security or securities.

Clause (L) of Section 6(h)(3) of the Act<sup>64</sup> requires that the margin requirements for a security futures product comply with the regulations

prescribed pursuant to Section 7(c)(2)(B) of the Act.<sup>65</sup> CFE believes that its proposed CFE Rule 517, Customer Margin Requirements for Contracts That Are Security Futures, and CFE Policy and Procedure VII, Security Futures Market Maker Registration Policy and Procedures, which have been filed with the Commission<sup>66</sup> pursuant to Section 19(b)(2) of the Act,<sup>67</sup> together with a written certification under Section 5c(c) of the CEA<sup>68</sup> regarding customer margin, are consistent with the requirements of the Act.

CFE Rules 1801–1806 and 1901–1906 set forth the contract rule specifications that relate to single stock futures and NBI futures, respectively. The contract rule specifications contain information that is specific to the trading of those products on CFE and some of the specification provisions provide additional detail with respect to issues addressed by rule provisions noted above.

For the reasons discussed above, CFE submits that the CFE Listing Standards satisfy the requirements set forth in Section 6(h)(3) of the Act.<sup>69</sup>

#### *Statutory Basis*

CFE has filed these proposed rules pursuant to Section 19(b)(7) of the Act.<sup>70</sup> CFE believes the CFE Listing Standards are authorized by, and consistent with, Section 6(b)(5) of the Act<sup>71</sup> because they are designed to promote just and equitable principles of trade.

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

CFE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. Since this rule change in conjunction with other related regulatory filings being made by CFE will permit CFE to become authorized to provide a trading venue for security futures, this rule change serves to enhance and promote competition by allowing an additional exchange to list and trade security futures.

<sup>65</sup> 15 U.S.C. 78g(c)(2)(B).

<sup>66</sup> See File No. SR-CFE-2005-02 (filed July 27, 2005).

<sup>67</sup> 15 U.S.C. 78s(b)(2).

<sup>68</sup> 7 U.S.C. 7a-2(c).

<sup>69</sup> 15 U.S.C. 78f(h)(3).

<sup>70</sup> 15 U.S.C. 78s(b)(7).

<sup>71</sup> 15 U.S.C. 78f(b)(5).

<sup>62</sup> 17 CFR 1.31(a)(1).

<sup>63</sup> 15 U.S.C. 78f(h)(3)(K).

<sup>64</sup> 15 U.S.C. 78f(h)(3)(L).

<sup>61</sup> 15 U.S.C. 78f(h)(3)(I).

*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**

Pursuant to Section 19(b)(7)(B) of the Act,<sup>72</sup> the proposed rule change became effective on July 26, 2005.<sup>73</sup> Within 60 days of the date of effectiveness of the proposed rule change, the Commission, after consultation with the CFTC, may summarily abrogate the proposed rule change and require that the proposed rule change be re-filed in accordance with the provisions of Section 19(b)(1) of the Act.<sup>74</sup>

**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](mailto:rule-comments@sec.gov). Please include File Number SR-CFE-2005-01 on the subject line.

*Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549.

All submissions should refer to File Number SR-CFE-2005-01. 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, 100 F Street, NE., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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-CFE-2005-01 and should be submitted on or before September 14, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>75</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. E5-4624 Filed 8-23-05; 8:45 am]

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-52290; File No. SR-MSRB-2005-02]

**Self-Regulatory Organizations; Municipal Securities Rulemaking Board; Notice of Filing of Proposed Rule Change Relating to Amendments to MSRB Rule G-20, on Gifts and Gratuities, and MSRB Rule G-8, on Recordkeeping**

August 18, 2005.

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 January 13, 2005, the Municipal Securities Rulemaking Board ("MSRB" or "Board") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the MSRB. 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 MSRB is filing with the Commission a proposed rule change consisting of amendments to Rule G-20, on gifts and gratuities, and the related recordkeeping requirements of Rule G-8.<sup>3</sup> The text of the proposed rule change is available on the MSRB's Web site (<http://www.msrb.org>), at the MSRB's principal office, and at the Commission's Public Reference Room.

**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 MSRB 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 MSRB 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

MSRB Rule G-20 prohibits dealers from directly or indirectly giving or permitting to be given any thing or service of value in excess of \$100 per year to any person other than an employee or partner of the dealer in relation to the municipal securities activities of the recipient's employer. The rule provides certain exemptions from the \$100 annual limit for "normal business dealings," including (i) occasional gifts of meals or tickets to theatrical, sporting and other entertainment; (ii) sponsoring legitimate business functions that are recognized by the IRS as deductible business expenses; and (iii) gifts of reminder advertising. However, such gifts must not be so frequent or excessive as to raise a suggestion of unethical conduct.

MSRB Rule G-20 currently does not mandate specific requirements with respect to non-cash sales incentives, although the general fair practice

<sup>3</sup>The New York Stock Exchange, Inc. ("NYSE") has a pending rule filing with the Commission on gifts and gratuities that is currently being reviewed. The MSRB has agreed to consider filing further amendments to Rule G-20 or other rules, as necessary, to make its rules on gifts and gratuities consistent with future rule changes made by other self-regulatory organizations (SROs) overseen by the Commission.

<sup>72</sup> 15 U.S.C. 78s(b)(7)(B).

<sup>73</sup> CFE filed the proposed rule change with the CFTC, together with a written certification under Section 5c(c) of the Commodity Exchange Act CEA, on July 25, 2005. CFE's written certification requested that the proposed rule change become effective on July 26, 2005, the date that the proposed rule change was filed with the Commission.

<sup>74</sup> 15 U.S.C. 78s(b)(1).

<sup>75</sup> 17 CFR 200.30-3(a)(75).

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

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