

for NDX options and FLEX options is consistent with Amex rules relating to similar broad-based indexes and would also allow Amex members and their customers greater hedging and investment opportunities.

### III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>9</sup> The Commission believes the proposed rule change is consistent with Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general to protect investors and the public interest.<sup>10</sup>

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

The Commission notes that it continues to believe that the fundamental purposes of position and exercise limits remain valid. Nevertheless, the Commission believes that experience with the trading of index options as well as enhanced reporting requirements and the Exchange's surveillance capabilities have made it possible to approve the elimination of position and exercise limits on certain broad-based index options. Thus, in 2002, the Commission approved an Amex proposal to eliminate permanently position and exercise limits for options on the XMI and XII.<sup>11</sup>

The Commission believes that the considerations upon which it relied in approving the elimination of position and exercise limits for XMI and XII

options equally apply with respect to options on the NDX.

As noted by the Amex, the market capitalization of the NDX as of the date of filing of the proposal was \$1.86 trillion. The ADTV for the period from January 1, 2005 through May 31, 2005 for all underlying components of the index was 425.8 million shares. The Commission believes that the enormous market capitalization of the NDX and the deep, liquid market for the underlying component securities significantly reduce concerns regarding market manipulation or disruption in the underlying market. Removing position and exercise limits for NDX options may also bring additional depth and liquidity, in terms of both volume and open interest, to NDX options without significantly increasing concerns regarding intermarket manipulation or disruption of the options or the underlying securities.

In addition, the Commission believes that financial requirements imposed by both the Exchange and the Commission adequately address concerns that an Amex member or its customer may try to maintain an inordinately large unhedged position in NDX options. Current risk-based haircut and margin methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer.<sup>12</sup> Under the proposal, the Amex also would have the authority under its rules to impose a higher margin requirement upon an account maintaining an under-hedged position when it determines a higher requirement is warranted. As noted in the Amex rules, the clearing firm carrying the account would be subject to capital charges under Rule 15c3-1 under the Act to the extent of any margin deficiency resulting from the higher margin requirement.

Finally, in approving the elimination of position and exercise limits for options on the XMI and XII, the Commission took note of the enhanced surveillance and reporting safeguards that the Amex had adopted to allow it to detect and deter trading abuses that might arise as a result.<sup>13</sup> The Amex represents that it monitors trading in NDX options in the same manner as

trading in XMI options. These safeguards, including the 100,000-contract reporting requirement described above, would allow the Amex to monitor large positions in order to identify instances of potential risk and to assess and respond to any market concerns at an early stage. In this regard, the Commission expects the Amex to take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop. Moreover, as previously noted, the Exchange has the flexibility to specify other reporting requirements, as well as to vary the limit at which the reporting requirements may be triggered.

The Commission further notes that in eliminating position and exercise limits for FLEX NDX options, the Amex is adopting the same additional rules for these options as for FLEX XMI options.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Amex-2005-063) be, and it hereby is, approved.

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

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52650; File No. SR-CBOE-2005-41]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Relating to the Elimination of Position and Exercise Limits on NDX Options

October 21, 2005.

#### I. Introduction

On May 23, 2005, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4

<sup>9</sup> In approving this rule proposal, 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>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> See XMI/XII Permanent Approval Order, *supra* note 5.

<sup>12</sup> See Securities Exchange Act Release No. 41011 (February 1, 1999), 64 FR 6405 (February 9, 1999) (notice of filing and order granting accelerated approval to proposed rule change implementing pilot program to eliminate position and exercise limits for XMI and XII options) ("XMI/XII Pilot Approval Order").

<sup>13</sup> See, in particular, XMI/XII Pilot Approval Order, *supra* note 12.

<sup>14</sup> 15 U.S.C. 78s(b)(2).

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

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

thereunder,<sup>2</sup> a proposed rule change to amend its rules to eliminate position and exercise limits for options on the Nasdaq 100 Index ("NDX"). The Commission published the proposed rule change for comment in the **Federal Register** on August 26, 2005.<sup>3</sup> On October 5, 2005, the CBOE filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

## II. Description of the Proposal

The CBOE proposes to amend its rules to eliminate position and exercise limits for options on the NDX, a broad-based security index. In connection with this change, options on the NDX would be subject to specific reporting requirements and additional margin provisions imposed by the CBOE with respect to options on the S&P 500 Index ("SPX"), the S&P 100 Index ("OEX"), and the Dow Jones Industrial Average ("DJX"), the three broad-based index options that, under the Exchange's current rules, are not subject to position and exercise limits.

The Exchange noted that in approving the elimination of position limits for SPX, OEX, and DJX options, the Commission considered the enormous capitalization of each of these indexes and the deep and liquid markets for the securities underlying each index significantly reduced concerns of market manipulation or disruption in the underlying markets.<sup>5</sup> The CBOE noted that the market capitalization of NDX, as of the date of filing of the proposed rule change, was \$1.84 trillion and the average daily trading volume ("ADTV"), in the aggregate, for the component securities of the NDX, for the period three months prior to the date of filing of the proposed rule change, was 420 million shares. For the same period, the ADTV for options on the NDX was 44,008 contracts.

The Exchange also stated that in the SPX/OEX/DJX Permanent Approval

Order, the Commission noted that the financial requirements imposed by both the Exchange and the Commission serve to address any concerns that an Exchange member or its customer(s) may try to maintain an inordinately large unhedged position in SPX/OEX/DJX options. The CBOE noted that these same financial requirements would apply equally to NDX options. The Exchange further noted that it has the authority to impose additional margin upon accounts maintaining underhedged positions, and is further able to monitor accounts to determine when such action is warranted. As noted in the Exchange's rules, the clearing firm carrying such an account would be subject to capital charges under Rule 15c3-1 under the Act<sup>6</sup> to the extent of any resulting margin deficiency.<sup>7</sup>

The CBOE indicated that the Commission, in the SPX/OEX/DJX Permanent Approval Order, relied substantially on the Exchange's ability to provide surveillance and reporting safeguards to detect and deter trading abuses arising from the elimination of position and exercise limits on SPX, OEX, and DJX options. The Exchange represents that it monitors the trading in NDX options in the same manner as trading in SPX, OEX, and DJX options and that the current CBOE surveillance procedures are adequate to continue monitoring NDX options. In addition, the Exchange intends to impose a reporting requirement on CBOE members (other than CBOE market-makers) or member organizations who trade NDX options. This reporting requirement, which is currently imposed on members who trade SPX and OEX options, would require members or member organizations who maintain in excess of 100,000 NDX option contracts on the same side of the market, for their own accounts or for the account of customers, to report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in a manner and form required by the Exchange's Department of Market Regulation. The Exchange also would be permitted to specify other reporting requirements, as well as the limit at

which the reporting requirement may be triggered.<sup>8</sup>

Finally, the CBOE proposes to amend Exchange rules relating to the trading of FLEX broad-based index options to eliminate position and exercise limits on FLEX NDX options, and to adopt for NDX FLEX options the same 100,000 contract reporting requirement and additional margin provisions that apply for SPX and OEX FLEX options.

The Exchange believes that eliminating position and exercise limits for NDX options and FLEX options is consistent with CBOE rules relating to similar broad-based indexes and would also allow CBOE members and their customers greater hedging and investment opportunities.

## III. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>9</sup> In particular, the Commission believes the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act, which requires that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general to protect investors and the public interest.<sup>10</sup>

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

The Commission notes that it continues to believe that the fundamental purposes of position and exercise limits remain valid. Nevertheless, the Commission believes that experience with the trading of index options as well as enhanced reporting requirements and the

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

<sup>3</sup> Securities Exchange Act Release No. 52313 (August 22, 2005), 70 FR 50433 ("Notice").

<sup>4</sup> In Amendment No. 1, the CBOE made a technical revision to a table in the rule text of the proposed rule change to reflect that the NDX is the Nasdaq 100 Index (Full Value). This technical amendment did not require notice and comment, as it did not affect the substance of the rule filing.

<sup>5</sup> See Securities Exchange Act Release No. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (order granting permanent approval to the elimination of position and exercise limits on the SPX, OEX, and DJX) ("SPX/OEX/DJX Permanent Approval Order"). See also Securities Exchange Act Release No. 40969 (January 22, 1999), 64 FR 4911 (February 1, 1999) (order approving the original pilot program) ("SPX/OEX/DJX Pilot Approval Order").

<sup>6</sup> 17 CFR 240.15c3-1.

<sup>7</sup> See Interpretation and Policy .04 to CBOE Rule 24.4. Clarified as per telephone conversation between Ira Brandriss, Special Counsel, and Theodore Venuti, Attorney, Division of Market Regulation, Commission, and James M. Flynn, Attorney II, Legal Division, CBOE, on August 12, 2005.

<sup>8</sup> See Interpretation and Policy .03 to CBOE Rule 24.4.

<sup>9</sup> In approving this rule proposal, 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>10</sup> 15 U.S.C. 78f(b)(5).

Exchange's surveillance capabilities have made it possible to approve the elimination of position and exercise limits on certain broad-based index options. Thus, in 2001, the Commission approved a CBOE proposal to eliminate permanently position and exercise limits for options on the SPX, OEX, and DJX.<sup>11</sup>

The Commission believes that the considerations upon which it relied in approving the elimination of position and exercise limits for SPX, OEX, and DJX options equally apply with respect to options on the NDX.

As noted by the CBOE, the market capitalization of the NDX as of the date of filing of the proposal was \$1.84 trillion. The ADTV for the period three months prior to the date of filing of the proposed rule change for all underlying components of the index was 420 million shares. The Commission believes that the enormous market capitalization of the NDX and the deep, liquid market for the underlying component securities significantly reduce concerns regarding market manipulation or disruption in the underlying market. Removing position and exercise limits for NDX options may also bring additional depth and liquidity, in terms of both volume and open interest, to NDX options without significantly increasing concerns regarding intermarket manipulation or disruption of the options or the underlying securities.

In addition, the Commission believes that financial requirements imposed by both the Exchange and the Commission adequately address concerns that a CBOE member or its customer may try to maintain an inordinately large unhedged position in NDX options. Current risk-based haircut and margin methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer.<sup>12</sup> Under the proposal, the CBOE also would have the authority under its rules to impose a higher margin requirement upon an account maintaining an under-hedged position when it determines a higher requirement is warranted. As noted in the CBOE rules, the clearing firm carrying the account would be subject to capital charges under Rule 15c3-1 under the Act to the extent of any

margin deficiency resulting from the higher margin requirement.

Finally, in approving the elimination of position and exercise limits for options on the SPX, OEX, and DJX, the Commission took note of the enhanced surveillance and reporting safeguards that the CBOE had adopted to allow it to detect and deter trading abuses that might arise as a result.<sup>13</sup> The CBOE represents that it monitors trading in NDX options in much the same manner as trading in SPX, OEX, and DJX options. These safeguards, including the 100,000-contract reporting requirement described above, would allow the CBOE to monitor large positions in order to identify instances of potential risk and to assess and respond to any market concerns at an early stage. In this regard, the Commission expects the CBOE to take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop. Moreover, as previously noted, the Exchange has the flexibility to specify other reporting requirements, as well as to vary the limit at which the reporting requirements may be triggered.

The Commission further notes that in eliminating position and exercise limits for FLEX NDX options, the CBOE is adopting the same additional rules for these options as for FLEX SPX and OEX options.

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-CBOE-2005-41) be, and it hereby is, approved.

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

**Jonathan G. Katz,**  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52659; File No. SR-CBOE-2005-85]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Rule Change To Adopt a Market Turner Priority for Index Options and Options on ETFs on the Exchange's Hybrid System

October 24, 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 October 14, 2005, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the CBOE. The Exchange has filed the proposal pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange proposes to modify its Hybrid System rule regarding priority and allocation of trades in index options and options on ETFs to adopt a market turner priority. The Exchange has designated this proposal as non-controversial and has requested that the Commission waive the 30-day pre-operative waiting period contained in Rule 19b-4(f)(6)(iii) under the Act.<sup>5</sup> The text of the proposed rule change is available on CBOE's Web site (<http://www.cboe.com>), at the CBOE's Office of the Secretary, 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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed

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

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

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

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

<sup>5</sup> 17 CFR 240.19b-4(f)(6)(iii).

<sup>11</sup> See SPX/OEX/DJX Permanent Approval Order, *supra* note 5.

<sup>12</sup> See SPX/OEX/DJX Pilot Approval Order, *supra* note 5.

<sup>13</sup> See, in particular, SPX/OEX/DJX Pilot Approval Order, *supra* note 5.

<sup>14</sup> 15 U.S.C. 78s(b)(2).

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