

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56251; File No. SR-Amex-2004-27]

### Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing of Amendment No. 4 to a Proposed Rule Change and Order Granting Accelerated Approval to a Proposed Rule Change, as Modified by Amendment Nos. 2, 3, and 4 Thereto, Relating to the Listing and Trading of Fixed Return Options

August 14, 2007.

#### I. Introduction

On April 29, 2004, the American Stock Exchange LLC ("Amex" 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 thereunder,<sup>2</sup> a proposed rule change to list and trade Fixed Return Options ("FROs"). Amex filed Amendment Nos. 1, 2, 3, and 4 to the proposal on September 26, 2006, April 19, 2007, May 23, 2007, and August 14, 2007, respectively.<sup>3</sup> The proposed rule change, as modified by Amendment Nos. 2 and 3, was published for comment in the **Federal Register** on June 7, 2007.<sup>4</sup> The Commission received no comment letters regarding the proposed rule change, as modified by Amendment Nos. 2 and 3. This order provides notice and solicits comments from interested persons regarding Amendment No. 4 and approves the proposed rule change, as amended, on an accelerated basis.

#### II. Description of the Proposal

##### A. FROs Generally

Amex proposes to list and trade cash-settled, European-style FROs on individual stocks and exchange-traded funds ("ETFs") that satisfy specified listing criteria. FROs are binary options and, as such, differ from the options currently traded on U.S. options exchanges by providing a discontinuous or non-linear payout. An in-the-money

FRO will pay a fixed sum at expiration regardless of the magnitude of the difference between the option's exercise price and the settlement price. Amex proposes to list Finish High<sup>SM</sup> ("Finish High") FROs, which will return \$100 per contract if the settlement price of the underlying security is above the strike price at expiration, and Finish Low<sup>SM</sup> ("Finish Low") FROs, which will return \$100 per contract if the settlement price of the underlying security is below the strike price at expiration.<sup>5</sup> Any in-the-money FRO will be exercised automatically at expiration.<sup>6</sup>

##### B. Listing Standards

The initial listing criteria for FROs require that an individual stock underlying an FRO meet the criteria for underlying securities in Amex Rule 915, "Criteria for Underlying Securities," and, in addition, have: (1) Minimum market capitalization of at least \$40 billion; (2) minimum trading volume, in all markets in which the security trades, of at least one billion shares in the preceding 12 months; (3) minimum average daily trading volume of four million shares; (4) minimum average daily trading value of at least \$200 million during the previous six months; and (5) a minimum market price per share of at least \$10, as measured by the closing price reported in the primary listed market in which the security is traded, over the previous five consecutive business days preceding the date on which Amex submits a certificate to the Options Clearing Corporation ("OCC") for listing and trading.<sup>7</sup> An ETF underlying an FRO would have to meet these five additional criteria along with the requirements of Amex Rule 915, except for the minimum market capitalization requirement.<sup>8</sup>

The continued listing criteria for FROs require that an individual stock underlying an FRO satisfy the requirements of Amex Rule 916, "Withdrawal of Approval of Underlying Securities," and, in addition, have: (1) Minimum market capitalization of at least \$30 billion; (2) minimum trading volume, in all markets trading the security, of at least one billion shares in the preceding 12 months; (3) minimum average daily trading volume of four million shares; (4) minimum average daily trading value of at least \$125 million during the last six months; and (5) an underlying market price per share

of at least \$5 at the time additional series are listed for trading.<sup>9</sup> An ETF underlying an FRO would have to meet these five additional criteria along with the requirements of Amex Rule 916, except for the minimum market capitalization requirement.<sup>10</sup>

##### C. Role of OCC

The OCC plans to file a proposal to issue, clear, and settle FROs. According to Amex, the OCC also plans to file a proposal to revise the Options Disclosure Document ("ODD") required under Rule 9b-1 of the Act<sup>11</sup> to incorporate FROs.

##### D. Volume Weighted Average Price Settlement

To reduce concerns regarding potential price manipulation at expiration due to the "all-or-nothing" return provided by an FRO, Amex proposes to settle FROs using an all-day volume weighted average price ("VWAP") based on trading in the underlying security on the last trading day prior to expiration.<sup>12</sup> To calculate the VWAP, Amex will use composite prices during regular trading hours as reported by industry price vendors.<sup>13</sup> If the security underlying an FRO does not trade or is unavailable during regular trading hours at expiration, the settlement price may be fixed pursuant to the OCC's rules on a basis that the OCC believes is appropriate under the circumstances, including using the last sale price during regular trading hours on the most recent trading day for which a last sale price is available.<sup>14</sup>

Amex will publish and disseminate the current value of the VWAP calculation for FROs at least every 15 seconds throughout the last trading day prior to expiration. Amex will disseminate the VWAP settlement price as the official settlement price for FROs and will make it publicly available

<sup>9</sup> See Amex Rule 916FRO, Commentary .01.

<sup>10</sup> See Amex Rule 916FRO, Commentary .03.

<sup>11</sup> 17 CFR 240.9b-1.

<sup>12</sup> See Amex Rule 910FRO(a). The VWAP for an underlying security is the sum of the dollar value of reported trades (price multiplied by the number of shares traded), divided by the total number of shares traded during the entire last day of trading prior to expiration. See Amex Rule 900FRO(b)(4).

<sup>13</sup> See Amex Rule 910FRO(a). Composite prices are prices reported to the consolidated tape from any participating exchange or market. Amex notes that the OCC currently uses composite pricing in connection with the settlement of expiring equity options. The composite closing price is the last reported sale price from any eligible trade source (*i.e.*, primary listing market or participating regional market). It is not an average price. See Securities Exchange Act Release No. 49045 (January 8, 2004), 69 FR 2377 (January 15, 2004) (notice of filing and immediate effectiveness of File No. SR-OCC-2003-01).

<sup>14</sup> See Amex Rule 910FRO(a), Commentary .01.

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

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

<sup>3</sup> Amendment No. 2 replaced the original filing and Amendment No. 1 in their entirety. Amendment No. 3 revised the rule text relating to margin requirements. Amendment No. 4 corrected minor errors in the text of the proposed rules, provided representations concerning surveillance procedures and systems capacity, clarified the use of composite prices in calculating the volume weighted average price ("VWAP"), and clarified the proposed position reporting requirements.

<sup>4</sup> See Securities Exchange Act Release No. 55843 (June 1, 2007), 72 FR 31636.

<sup>5</sup> See Amex Rule 900FRO(b)(2) and (3).

<sup>6</sup> See Amex Rule 980FRO.

<sup>7</sup> See Amex Rule 915FRO, Commentary .01.

<sup>8</sup> See Amex Rule 915FRO, Commentary .02.

through various market data vendors and on the Amex Web site at <http://www.amex.com>.

#### E. Position and Exercise Limits

The position limits for FROs will be 25,000 contracts on the same side of the market, and positions in FROs will not be aggregated with positions in other options on the same underlying stock or ETF for purposes of determining compliance with the position limits.<sup>15</sup> Amex is not proposing exercise limits for FROs because FROs will be exercised automatically at expiration if the settlement price of the underlying security is greater than the strike price of a Finish High FRO or less than the strike price of a Finish Low FRO.<sup>16</sup> FROs will not be subject to any qualified hedge exemptions from position limits.

Positions in FROs must be reported to Amex when an account establishes an aggregate position on the same side of the market of 200 or more contracts,<sup>17</sup> and the provisions of Amex Rule 906, "Reporting of Options Positions," will apply to FROs.<sup>18</sup> Amex Rule 906(b) requires that a member, other than an Amex market maker, that maintains an FRO position in excess of 10,000 contracts on the same side of the market, for its own account or the account of its customer, report certain information to Amex, including whether the position is hedged, a description of the hedge, and, if applicable, a description of the collateral. Amex believes that the reporting requirements under Amex Rule 906 and the surveillance procedures for hedged positions will enable Amex to closely monitor sizable FRO positions and corresponding hedges.<sup>19</sup>

#### F. Margin

The minimum margin on any FRO carried short in a customer's account is the difference between \$100 and the proceeds from the sale of the FRO, which must remain in the customer's account.<sup>20</sup> A customer account with a long position in an FRO must initially deposit and maintain margin equal to at least 100% of the purchase price of the FRO.<sup>21</sup>

No margin is required for an FRO position carried short against an existing long position in the same FRO, or when the writer's obligation is secured by a specific deposit or escrow deposit meeting the entire \$100 obligation under the FRO.<sup>22</sup>

#### G. Bid-Ask Differentials and Minimum Price Variations

A specialist or registered trader is expected to quote with no more than \$0.25 between the bid and the offer for each FRO contract, except during the last trading day prior to expiration, when the maximum width may be \$0.50.<sup>23</sup> In addition, when the bid/ask differential in the underlying security is greater than \$0.25, or \$0.50 on the last trading day prior to expiration, the permissible quote width for an in-the-money FRO series may be identical to the quote width in the underlying security.<sup>24</sup>

Amex Rule 952, "Minimum Price Variations," generally provides that the minimum price variation ("MPV") for an option is: (i) \$0.05 for options quoted under \$3 a contract; and (ii) \$0.10 for options quoted at \$3 a contract or greater. For the options classes included in the Penny Quoting Pilot Program, the MPV is: (i) \$0.01 for options quoted under \$3 a contract; and (ii) \$0.05 for options quoted at \$3 a contract or greater.<sup>25</sup> The MPV for FROs in classes not included in the Penny Quoting Pilot Program will be \$0.05, and \$0.01 for classes in the Penny Quoting Pilot Program.

Amex will apply to FROs the existing industry convention of multiplying an option's quoted price by \$100 to determine its premium. For example, for an FRO that is quoted at \$0.50, an investor would pay \$50.00 (\$0.50 × 100).

#### H. Other Considerations

Amex Rule 903, "Series of Options Open for Trading," will apply to FROs.<sup>26</sup> Pursuant to Amex Rule 903, Amex generally opens up to four expiration months for an options class when it initially lists the class for trading. Amex will use the same expiration cycle for FROs as it uses for traditional options.

Similarly, Amex will use the strike price intervals provided in Amex Rule

903, "Series of Options Open for Trading," and the related commentaries for FROs. Securities underlying options classes included in the \$1 strike price pilot program<sup>27</sup> and the 2½-point strike price program<sup>28</sup> may underlie FROs, provided that they meet the listing standards for FROs.

Amex represents that symbols will be created for FROs that represent the underlying security, the fact that the option is an FRO rather than a traditional put or call, the expiration date, strike price, and the exchange(s) trading the FRO.

#### III. Discussion

The Commission 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.<sup>29</sup> Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>30</sup> which requires, among other things, 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 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. The Commission believes that FROs will provide investors with a potentially useful investment choice. The proposal will extend to certain binary options the benefits of a listed exchange market, which include: A centralized forum for price discovery; pre- and post-trade transparency; standardized contract specifications; and the guarantee of the OCC.

The Commission believes that the proposal is reasonably designed to address potential manipulation concerns associated with FROs' non-linear return. The initial and continuing listing standards for FROs should ensure that only highly capitalized, actively traded stocks and ETFs are eligible to underlie FROs, and the settlement price for FROs is based on an all-day VWAP during the last trading day prior to expiration. These elements should reduce the potential for manipulating the stock or ETF underlying an FRO to benefit an FRO position.

<sup>15</sup> See Amex Rule 904FRO(a) and (b).

<sup>16</sup> See Amex Rule 980FRO.

<sup>17</sup> See Amex Rule 906FRO.

<sup>18</sup> See Amex Rule 906FRO.

<sup>19</sup> Amex notes that hedge information for member firm and customer accounts with 200 or more contracts are reported electronically via the Large Options Position Report. In addition, Amex notes that specialist and registered options trader account information is reported to Amex by the member's clearing firm.

<sup>20</sup> See Amex Rule 462(d)(10)(D).

<sup>21</sup> See Amex Rule 462(d)(10)(B).

<sup>22</sup> See Amex Rule 462(d)(10)(F).

<sup>23</sup> See Amex Rule 958FRO.

<sup>24</sup> See Amex Rule 958FRO.

<sup>25</sup> See Securities Exchange Act Release No. 55162 (January 24, 2007), 72 FR 5738 (February 1, 2007). In addition, options on the Power Shares QQQ Trust trade at an MPV of \$0.01 for all options premiums.

<sup>26</sup> See Amex Rule 903FRO.

<sup>27</sup> See Amex Rule 903, Commentary .06.

<sup>28</sup> See Amex Rule 903, Commentary .07.

<sup>29</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>30</sup> 15 U.S.C. 78f(b)(5).

The Commission believes that the proposed position limits and margin rules for FROs are reasonable and consistent with the Act. The proposed position limit of 25,000 contracts in any FRO class appears to reasonably balance the promotion of a free and open market for these securities with minimization of incentives for market manipulation. The proposed margin rules appear reasonably designed to deter a member or its customer from assuming an imprudent position in FROs.

In support of this proposal, Amex made the following representations:

- Amex has in place an adequate surveillance program to monitor trading in FROs and intends to largely apply its existing surveillance program for options to the trading of FROs; and
- Amex has the necessary systems capacity to support the new options series that would result from the introduction of FROs.

This approval order is based on Amex's representations.

#### IV. 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:

##### *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-Amex-2004-27 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-Amex-2004-27. 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, on official business days between the hours of 10 a.m. and 3 p.m. Copies of such filing also will be available for inspection and copying at the principal office of 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 submissions should refer to File Number SR-Amex-2004-27 and should be submitted on or before September 10, 2007.

#### V. Accelerated Approval

The Commission finds good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice of filing of Amendment No. 4 in the **Federal Register**. In Amendment No. 4, Amex provided representations regarding surveillance and systems capacity and corrected minor errors in the text of the proposed rules. In addition, Amendment No. 4 clarified the use of composite prices in calculating the all-day VWAP that will be used to establish the settlement price for FROs, and clarified that positions of 10,000 contracts, rather than 25,000 contracts, will be subject to certain reporting requirements. The Commission believes that Amendment No. 4 clarifies and strengthens the proposal and raises no new regulatory issues. Accordingly, the Commission finds good cause for approving the proposal, as amended, on an accelerated basis, pursuant to Section 19(b)(2) of the Act.

#### VI. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>31</sup> that the proposed rule change (SR-Amex-2004-27), as amended, is approved, on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>32</sup>

**Florence E. Harmon,**  
Deputy Secretary.

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**BILLING CODE 8010-01-P**

<sup>31</sup> 15 U.S.C. 78s(b)(2).

<sup>32</sup> 17 CFR 200.30-3(a)(12).

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56245; File No. SR-CBOE-2006-104]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto To Codify the Hybrid Price Check Parameter

August 14, 2007.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 7, 2006, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. On August 1, 2007, the Exchange filed Amendment No. 1 to the proposed rule change. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend Rule 6.13, *CBOE Hybrid System's Automatic Execution Feature*, in order to codify an automated system feature that prevents executions at potentially erroneous prices.

The text of the proposed rule change is available on the Exchange's Web site (<http://www.cboe.com>), at the Exchange'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 Exchange 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 Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

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