

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E8-4401 Filed 3-6-08; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57413; File No. SR-FINRA-2008-007]

### Self-Regulatory Organizations; Financial Industry Regulatory Authority, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Make Permanent a Pilot Program That Increases Options Position and Exercise Limits

March 3, 2008.

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 February 28, 2008, the Financial Industry Regulatory Authority, Inc. (“FINRA”) (f/k/a National Association of Securities Dealers, Inc. (“NASD”)) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by FINRA. FINRA has designated this proposal as non-controversial under Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposed 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

FINRA seeks to amend NASD Rule 2860 (Options) to make permanent a pilot program that increases options position and exercise limits. In addition, FINRA proposes to amend NASD IM-2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the proposed permanent position limits. The text of the proposed rule change is available on FINRA’s Web site (<http://www.finra.org>), at FINRA’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, FINRA 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. FINRA 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

FINRA is proposing amendments to its options position and exercise limits in NASD Rule 2860 to make permanent a pilot program that increases position and exercise limits for both standardized and conventional options.<sup>5</sup> In addition, FINRA proposes to amend NASD IM-2860-1 (Position Limits) to revise the examples that illustrate the operation of position limits with the proposed permanent position limits.

NASD Rule 2860(b)(3) subjects standardized and conventional options to one of five different position limits. Options exercise limits, which are set forth in NASD Rule 2860(b)(4), and which incorporate by reference the position limits in Rule 2860(b)(3), also would increase. The original pilot program became effective on March 30, 2005, and has been extended five times. It was scheduled to expire on March 1, 2008.<sup>6</sup> FINRA is proposing to make the

<sup>5</sup> A “conventional option” is an option contract not issued, or subject to issuance by, the Options Clearing Corporation. See NASD Rule 2860(b)(2)(O). Currently, position limits for standardized and conventional options are the same with respect to the same underlying security. The proposed rule change would maintain this parity between standardized and conventional options. FINRA has maintained parity between conventional and standardized options since 1999. See Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930, 2931 (January 19, 1999) (SR-NASD-98-92). Before 1999, position limits on conventional options were three times greater than the limits for standardized options. See Securities Exchange Act Release No. 40087 (June 12, 1998), 63 FR 33746 (June 19, 1998) (SR-NASD-98-23).

FINRA’s limits on standardized equity options are applicable only to those members that are not also members of the exchange on which the option is traded; the limits on conventional options are applicable to all FINRA members. NASD Rule 2860(b)(1)(A); see also Securities Exchange Act Release No. 40932 (January 11, 1999), 64 FR 2930, 2931 (January 19, 1999) (SR-NASD-98-92).

<sup>6</sup> See Securities Exchange Act Release Nos. 52271 (August 16, 2005), 70 FR 49344 (August 23, 2005) (SR-NASD-2005-097); 53346 (February 22, 2006),

pilot program permanent in order to preserve the benefits to the marketplace from the higher levels. The proposed rule change also is substantively identical to a proposal by the Chicago Board Options Exchange, Inc. recently approved by the Commission.<sup>7</sup> FINRA anticipates all other self-regulatory organizations (“SROs”) with the pilot program also will seek to make their program permanent. Thus, the proposed rule change will ensure that FINRA’s position limits are consistent with those of other SROs.

###### Position and Exercise Limits

The standard position limits were last increased nine years ago, on December 31, 1998.<sup>8</sup> Since that time, there has been a steady increase in the number of accounts that approach the position limit or have been granted an exemption to the applicable position limit. To the best of FINRA’s knowledge, during the operation of the pilot program, there have been very few violations of the position limits or exercise limits and none of these violations were deemed to be a result of manipulative activities.

###### Growth in Options Market

Since the last position limit increase, there has been an exponential increase in the overall volume in options trading. Part of this volume is attributable to a corresponding increase in the number of overall market participants. This growth in market participants has in turn brought about additional depth and increased liquidity in options trading. FINRA has no reason to believe that the current trading volume in equity options will not continue. Rather, FINRA expects continued options volume growth as opportunities for investors to participate in the options markets increase and evolve. FINRA believes that the non-pilot position and exercise limits might constrain liquidity in the options markets.

###### Manipulation

Since the last position limit increase, and throughout the duration of the pilot program, FINRA has not encountered any significant regulatory issues regarding the applicable position limits. Moreover, FINRA believes that there is a lack of evidence of market

71 FR 10580 (March 1, 2006) (SR-NASD-2006-025); 54334 (August 18, 2006), 71 FR 50961 (August 28, 2006) (SR-NASD-2006-097); 55225 (February 1, 2007), 72 FR 6634 (February 12, 2007) (SR-NASD-2007-007); and 56265 (August 15, 2007), 72 FR 47102 (August 22, 2007) (SR-FINRA-2007-002).

<sup>7</sup> See Securities Exchange Act Release No. 57352 (February 19, 2008), 73 FR 10076 (February 25, 2008) (SR-CBOE-2008-07).

<sup>8</sup> See Securities Exchange Act Release No. 40875 (December 31, 1998), 64 FR 1842 (January 12, 1999).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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

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

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

manipulation schemes, which justifies the proposed permanent approval of the pilot program. FINRA believes that its existing surveillance procedures and reporting requirements are reasonably designed to detect unusual and/or illegal trading activity. FINRA represents that its surveillance and reporting mechanisms (which have been significantly enhanced since the last position limit increase in 1999) will serve to adequately address any concerns the Commission may have with respect to account(s) engaging in any manipulative schemes resulting from position limit violations.

#### No Adverse Consequences from Past Increases

Equity option position limits have been gradually expanded from 1,000 contracts in 1973 to the current level of 75,000 contracts for the largest and most actively traded equity options. To date, FINRA is unaware of any adverse affects on the markets as a result of these past increases in the limits for equity option contracts.

#### 2. Statutory Basis

FINRA believes that the proposed rule change is consistent with the provisions of Section 15A(b)(6) of the Act,<sup>9</sup> which requires, among other things, that FINRA rules must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest. The proposed rule change would make permanent a pilot program increasing options position and exercise limits. FINRA's experience administering the higher limits of the pilot program over the past three years has not revealed any adverse concerns or any other reasons to suggest that such limits should not be made permanent.

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

FINRA does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

Written comments were neither solicited nor received.

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

FINRA has designated the proposed rule change as one that: (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 of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest. Therefore, the foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>11</sup> FINRA notes that the proposed rule change is based on a similar proposal recently approved by the Commission.<sup>12</sup> FINRA has asked the Commission to waive the operative delay to permit the proposed rule change to become operative prior to the 30th day after filing.

The pilot program expanding position and exercise limits on standardized and conventional options was scheduled to expire on March 1, 2008. The Commission believes that waiving the 30-day operative delay of FINRA's proposal is consistent with the protection of investors and the public interest because it will allow the position and exercise limits to remain at consistent levels during the transition from the pilot program to permanent status.<sup>13</sup> Therefore, the Commission designates the proposal to be operative upon filing.

At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate the 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.

### 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 No. SR-FINRA-2008-007 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-FINRA-2008-007. 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 FINRA. 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-FINRA-2008-007 and should be submitted on or before March 28, 2008.

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to provide the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. FINRA has fulfilled this requirement.

<sup>12</sup> See Securities Exchange Act Release No. 57352 (February 19, 2008), 73 FR 10076 (February 25, 2008) (order granting accelerated approval to SR-CBOE-2008-07).

<sup>13</sup> For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>9</sup> 15 U.S.C. 78o-3(b)(6).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

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[FR Doc. E8-4513 Filed 3-6-08; 8:45 am]

BILLING CODE 8011-01-P

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57416; File No. SR-ISE-2008-20]

### Self-Regulatory Organizations; International Securities Exchange, LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, To Make Permanent Two Pilot Programs That Increase Position and Exercise Limits on Equity Options

March 3, 2008.

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 February 28, 2008, the International Securities Exchange, LLC (“Exchange” or “ISE”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the Exchange. On February 29, 2008, NYSE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Exchange has designated this proposal as non-controversial under Section 19(b)(3)(A)(iii) of the Act<sup>4</sup> and Rule 19b-4(f)(6) thereunder,<sup>5</sup> which renders the proposed rule change effective upon filing with the Commission. 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 seeks to make permanent two pilot programs that increase position and exercise limits for equity options. To permanently establish the two pilot programs, the Exchange proposes to amend Rule 412, Position Limits, and Rule 414, Exercise Limits. The text of the proposed rule change is available on the Exchange’s Web site (<http://www.ise.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.

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

###### 1. Purpose

The purpose of the proposed rule change is to make permanent two pilot programs that increase position and exercise limits for equity options. To permanently establish the two pilot programs, the Exchange proposes to amend Rule 412, Position Limits, and Rule 414, Exercise Limits. Rule 412 subjects equity options to one of five different position limits depending on the trading volume and outstanding shares of the underlying security. Rule 414 establishes exercise limits for the corresponding options at the same levels as the corresponding security’s position limits.

The first pilot program, the “Rule 412 Pilot Program,” commenced on March 2, 2005, and provides for an increase to the standard (or “non-pilot”) position and exercise limits for equity option contracts and for options on the PowerShares QQQ Trust (“QQQQ”).<sup>6</sup> The second pilot program, the “iShares Russell 2000 Index Fund (“IWM”)

Option Pilot Program,” commenced on January 25, 2007, and increases the position and exercise limits for IWM options from 250,000 contracts to 500,000 contracts.<sup>7</sup>

The standard position limits were last increased in 1998. Since that time, there has been a steady increase in the number of accounts that (a) approach the position limit; (b) exceed the position limits; and (c) are granted an exemption to the applicable position limit. The Exchange represents that over the course of the last year, when both pilot programs were in effect, the Exchange’s Market Surveillance Department encountered only a handful of violations. The Exchange believes that all of these violations were deemed inadvertent and were due primarily to miscounting, technical problems, or a misinterpretation of position limit calculation methodologies. None of these violations were deemed to be a result of manipulative activities.

Since the last position limit increase, there has been an exponential increase in the overall volume of exchange traded options. Part of this volume is attributable to a corresponding increase in the number of overall market participants. This growth in market participants has in turn brought about additional depth and increased liquidity in exchange traded options.

Further, since the last position limit increase, and throughout the duration of the two pilot programs, the Exchange has not encountered any regulatory issues regarding the applicable position limits, and states that there is a lack of evidence of market manipulation schemes, which justifies making permanent the Rule 412 and IWM Option Pilot Programs.

As the anniversary of listed options trading approaches its 35th year, the Exchange believes that the existing surveillance procedures and options reporting requirements at the ISE, at other options exchanges, and at the several clearing firms are capable of properly identifying unusual and/or illegal trading activity. The Exchange’s

<sup>6</sup> The Rule 412 Pilot Program was approved by the Commission on March 2, 2005. See Securities Exchange Act Release No. 51295 (March 2, 2005), 70 FR 11292 (March 8, 2005) (SR-ISE-2005-14). The Rule 412 Pilot Program has been extended five times for six month periods by the Commission, and expires on March 1, 2008. See Securities Exchange Act Release Nos. 52265 (August 15, 2005), 70 FR 48996 (August 22, 2005) (SR-ISE-2005-39); 53345 (February 22, 2006), 71 FR 10579 (March 1, 2006) (SR-ISE-2006-10); 54335 (August 18, 2006), 71 FR 50954 (August 28, 2006) (SR-ISE-2006-47); 55311 (February 16, 2007), 72 FR 8408 (February 26, 2007) (SR-ISE-2007-15); and 56263 (August 15, 2007), 72 FR 47105 (August 22, 2007) (SR-ISE-2007-69).

In connection with the March 21, 2007, transfer of sponsorship of the Nasdaq-100 Trust, the name of the trust was changed to the “PowerShares QQQ Trust.” See QQQQ prospectus available at <http://www.powershares.com/pdf/P-QQQ-PRO-1.pdf>.

<sup>7</sup> The IWM Option Pilot Program doubles the position and exercise limits for IWM options under the Rule 412 Pilot Program. See Rule 412, Supplementary Materials .01. Absent both of these pilot programs, the standard position and exercise limit for IWM options is 75,000 option contracts.

The proposal that established the IWM Option Pilot Program was effective upon filing. See Securities Exchange Act Release No. 55175 (January 25, 2007), 72 FR 4753 (February 1, 2007) (SR-ISE-2007-07). The IWM Option Pilot Program has been extended twice by the Commission and expires on March 1, 2008. See Securities Exchange Act Release Nos. 56020 (July 6, 2007), 72 FR 38109 (July 12, 2007) (SR-ISE-2007-56); and 57144 (January 14, 2008), 73 FR 3785 (January 22, 2008) (SR-ISE-2008-03).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> In Amendment No. 1, the Exchange made a technical correction to the proposed rule text.

<sup>4</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

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