

found in the rules listed in NASD Rule 9610(a).

## 2. Statutory Basis

NASD Regulation believes that the proposed rule change is consistent with the provisions of section 15A(b)(6) of the Act,<sup>8</sup> which requires, among other things, that the Association's 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. NASD Regulation believes that the proposed rule change is designed to accomplish these ends by clarifying the applicability of NASD Rule 1022(b) and (c) to members by making the citations in the rules consistent with the Net Capital Rule and by eliminating the ability of brokers or dealers that are subject to the Net Capital Rule from operating without a FINOP or Introducing FINOP. The proposed rule change also would help members by clarifying the circumstances under which a FINOP must have taken and passed either Series 27 or Series 28 Examination.

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

NASD Regulation 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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change; or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## 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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-00-77 and should be submitted by March 2, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 01-3361 Filed 2-8-01; 8:45 am]

**BILLING CODE 8010-01-M**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43921; File No. SR-Phlx-00-107]

### **Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Philadelphia Stock Exchange, Inc., Relating to Listing and Trading of Options on Exchange-Traded Fund Shares**

February 2, 2001.

Pursuant to section 19(b)(91) 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 21, 2000, the Philadelphia Stock Exchange, Inc. ("Phlx" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Phlx. The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons and to

approve the proposal on an accelerated basis.

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

The Phlx proposes to amend its rules to create listing criteria and amend trading rules to allow the Exchange to list options on Exchange-Traded Fund Shares. The text of the proposed rule change is available at the Phlx or the Commission.

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

In its filing with the Commission, the Phlx included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Phlx 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 provide for the trading of options and FLEX options on Exchange-Traded Fund Shares.<sup>3</sup> As noted above, Exchange-Traded Fund Shares are exchange-listed securities representing interests in open-end unit investment trusts or open-end management investment companies ("Funds") that hold securities based on an index or a portfolio of securities.<sup>4</sup> Exchange-Traded Fund Shares are issued in exchange for an "in kind" deposit of a specified portfolio of securities, together with a cash payment, in minimum size aggregations or multiples thereof ("Creation Units"). The size of the applicable Creation Unit size aggregation is set forth in the Fund's prospectus, and varies from one series

<sup>3</sup> In general, FLEX options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. See Phlx Rule 1079.

<sup>4</sup> Currently, the Exchange trades unit investment trust securities known as Trust Shares. The Exchange has also just received approval to trade Index Fund Shares which are issued by an open-end management investment company. Trust Shares and Index Fund Shares are listed on the Phlx pursuant to Rule 803(i) and 803(l), respectively, and trade like shares of common stock. The Commission notes that not all Trust Shares or Index fund shares trading on the Phlx may meet the standards for options trading approved by this order.

<sup>9</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>8</sup> 15 U.S.C. 78o-3(b)(6).

of Exchange-Traded Fund Shares to another, but generally is of substantial size (e.g., value in excess of \$450,000 per Creation Unit). A Fund, generally, will issue and sell Exchange-Traded Fund Shares in Creation Unit size through a principal underwriter on a continuous basis at the net asset value per share next determined after an order to purchase Exchange-Traded Fund Shares and the appropriate securities are received. Following issuance, Exchange-Traded Fund Shares are traded on an exchange like other equity securities, and equity trading rules apply. Likewise, redemption of Exchange-Traded Fund Shares is made in Creation Unit size and "in kind," with a portfolio of securities and cash exchange for the Exchange-Traded Fund Shares that have been tendered for redemption.

Generally, options on Exchange-Traded Fund Shares are proposed to be traded on the Exchange pursuant to the same rules and procedures that apply to trading in options on equity securities. However, the Exchange is also proposing to list FLEX options on Exchange-Traded Fund Shares and some options will have a unit of trading of 1000 Exchange-Traded Fund Shares. The Exchange will list option contracts covering either 100 or 1000 Exchange-Traded Fund Shares, or both, depending on the price and volatility of the underlying Exchange-Traded Fund Shares and the popularity of the options.<sup>5</sup>

The proposed position, exercise and reporting limits for options on Exchange-Traded Fund Shares would be the same as those established for stock options as set forth in Phlx Rules 1001, 1002 and 1003. The Phlx anticipates that most options on Exchange-Traded Fund Shares initially will qualify for only the lowest position limit. As with other equity options, the position limits will be increased for options if the volume of trading in the Exchange-Traded Fund Shares increases to meet the requirements of a higher limit. As is currently the case for all FLEX options, no position or exercise limits will be

applicable to FLEX options overlying Exchange-Traded Fund Shares.

The listing and maintenance standards proposed for options on Exchange-Traded Fund Shares are set forth in proposed Commentary .06 under Phlx Rule 1009 and in proposed Commentary .08 under Phlx Rule 1010, respectively. Pursuant to the proposed initial listing standards, Phlx will only list options on Exchange-Traded Fund Shares that are principally traded on a national securities exchange or through the facilities of a national securities association and reported as national market securities. In addition, the initial listing standards require that either: (1) The Exchange-Traded Fund Shares meet the uniform options listing standards in Commentary .01 to Rule 1009, which include minimum public float, trading volume, and share price of the underlying security in order to list the option,<sup>6</sup> or (2) the Exchange-Traded Fund Shares must be available for creation or redemption each business day in cash or in kind from the Fund at a price related to the net asset value, and the Exchange will require that the investment company shall provide that Exchange-Traded Fund Shares may be created even through some or all of the securities needed to be deposited have not been received by the Fund.<sup>7</sup>

In addition, the initial listing standards require that: (1) Any Exchange-Traded Fund Share with non-U.S. stocks in the underlying index or portfolio that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index or portfolio; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.

The Exchange's proposed maintenance standards provide that if a

particular series of Exchange-Traded Fund Shares should cease to trade on an exchange or as national market securities traded through the facilities of a national securities association, there will be no opening transactions in the options on the Exchange-Traded Fund Shares, and all such options will trade on a liquidation-only basis. In addition, the Phlx will consider the suspension of opening transactions in any series of options of the class covering Exchange-Traded Fund Shares if: (1) The options fail to meet the uniform equity option maintenance standards in Commentary .01 to Rule 1010,<sup>8</sup> when the options were listed pursuant to the equity option listing standards of Commentary .01 to Rule 1009; (2) following the initial twelve-month period beginning upon the commencement of trading of the Exchange-Traded Fund Shares on a national securities exchange or as national market securities through the facilities of a national securities association there are fewer than 50 record and/or beneficial holders of Exchange-Traded Fund Shares for 30 or more consecutive trading days; (3) the value of the index or portfolio of securities on which the Exchange-Traded Fund Shares are based is no longer calculated or available; or (4) such other event shall occur or condition exist that in the opinion of the Exchange makes further dealing in such options on the Exchange inadvisable.

Options on Exchange-Traded Fund Shares will be physically-settled and will have the American-style exercise feature used on all standardized equity options. The Exchange, however, also proposes to trade FLEX options, which will be available with both the American-style and European-style exercise feature, as well as other FLEX option features.<sup>9</sup>

The proposed margin requirements for options on Exchange-Traded Fund Shares are at the same levels that apply to options generally under Exchange Rule 722, except, with respect to Exchange-Traded Fund Shares based on a broad-based index or portfolio, minimum margin must be deposited

<sup>5</sup> This 1000 share feature was proposed and approved by the American Stock Exchange and The Options Clearing Corporation. Securities Exchange Act Release Nos. 40157 (July 1, 1998), 63 FR 37426 (July 10, 1998) (SR-Amex-96-44) and 40132 (June 25, 1998), 63 FR 36467 (June 25, 1998) (SR-OCC-97-02). In the event the Exchange lists options covering both 100 and 1000 of the same underlying Exchange-Traded Fund Shares, the Exchange will assign separate trading symbols to the options and will issue an Information Circular to all its members advising of the trading symbols. Telephone conversation between John Dayton, Assistant Secretary and Counsel, Phlx, and Heather Traeger, Special Counsel, Division of Market Regulation, Commission, on January 31, 2001.

<sup>6</sup> Specifically, Commentary .01 to Rule 1009 requires the underlying security to have a public float of 7,000,000 shares, 2,000 holders, trading volume of 2,400,000 shares in the preceding 12 months, a share price of \$7.50 for the majority of the business days during the three calendar months preceding the date of the selection, and that the issuer of the underlying security is in compliance with the Act.

<sup>7</sup> This assumes that the authorized creation participant has undertaken to deliver the shares as soon as possible and such undertaking has been secured by the delivery and maintenance of collateral consisting of cash or cash equivalents satisfactory to the Fund which underlies the option, as described in the Fund prospectus.

<sup>8</sup> Specifically, Commentary .01 to Rule 1010 provides that an underlying security will not meet the Exchange's requirements for continued listing when, among other things; (1) There are fewer than 6,300,000 publicly-held shares; (2) there are fewer than 1,600 holders; (3) trading volume was less than 1,800,000 shares in the preceding twelve months; or (4) the share price of the underlying security closed below \$5 on a majority of the business days during the preceding 6 months.

<sup>9</sup> An American-style option may be exercised at any time prior to its expiration. A European-style option, however, may be exercised only on its expiration date.

and maintained equal to 100% of the current market value of the option plus 15% of the market value of equivalent units of the underlying security value. Exchange-Traded Fund Shares that hold securities based upon a narrow-based index or portfolio must have options margin that equals at least 100% of the current market value of the contract plus 20% of the market value of equivalent units of the underlying security value. In this respect, the margin requirements proposed for options on Exchange-Traded Fund Shares are comparable to margin requirements that currently apply to broad-based and narrow-based index options.

The Exchange believes it has the necessary systems capacity to support the additional series of options that would result from the introduction of options on Exchange-Traded Fund Shares, and it has been advised that the Options Price Reporting Authority ("OPRA") also will have the capacity to support these additional series due to recent enhancements.

## 2. Statutory Basis

The Phlx believes that the listing and trading of options on Exchange-Traded Fund Shares should provide investors with another choice of venue to conduct trading in these products. Thus, the Exchange believes that the proposed rule change is consistent with section 6(b)(5) of the Act<sup>10</sup> in that it is designed 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.

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

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

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

The Phlx has neither solicited nor received written comments on the proposed rule change.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies

thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Phlx. All submissions should refer to File No. SR-Phlx-00-107 and should be submitted by March 2, 2001.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

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, and, in particular, with the requirements of section 6(b)(5).<sup>11</sup> Specifically, the Commission believes that providing for the listing and trading of options and FLEX Equity options<sup>12</sup> on Exchange-Traded Fund Shares should give investors a better means to hedge their positions in the underlying Fund Shares. Further, the Commission believes that pricing of the underlying Fund Shares may become more efficient and market makers in these shares, by virtue of enhanced hedging opportunities, may be able to provide deeper and more liquid markets. In sum, the Commission believes that options on Fund Shares likely will engender the same benefits to investors and the market place that exist with respect to options on common stock, thereby serving to promote the public interest and remove impediments to a free and open securities market.<sup>13</sup>

As a general matter, the Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments,

such as options on Fund Shares, can commence trading on a national securities exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) The special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. With regard to position and exercise limits, the Commission finds that it is appropriate to adopt the tiered approach used in setting position and exercise limits for standardized stock options. This approach should serve to minimize potential manipulation and market impact concerns. In addition, the Commission believes that the rationale for allowing FLEX Equity options generally to trade without position and exercise limits is equally applicable in the context of FLEX Equity options on Fund Shares.

Accordingly, because options and FLEX Equity options on Fund Shares will be subject to the same regulatory regime as the other options and FLEX Equity options currently traded on the Phlx, the Commission believes that adequate safeguards are in place to ensure the protection of investors in options and FLEX Equity options on Fund Shares.

The Commission also believes that it is appropriate to permit the Phlx to list and trade options, including FLEX Equity options, on Exchange-Traded Fund Shares given that these options must meet specific requirements related to the protection of investors.<sup>14</sup> First, the Exchange's listing and delisting criteria for options on Fund Shares are adequate. With regard to initial listing, the proposal requires that either: (1) The underlying Fund Shares meet the Phlx's uniform options listing standards; or (2) the Exchange-Traded Fund Shares must be available for creation or redemption each business day in cash or in kind from the Fund at a price related to the net asset value, and the Exchange will require that the underlying Fund Shares may be created even though some or all

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>12</sup> The Commission hereby incorporates by reference its findings and conclusions with respect to the appropriateness of FLEX Equity options generally. See Securities Exchange Act Release No. 37336 (June 19, 1996), 61 FR 33558 (June 27, 1996).

<sup>13</sup> In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>14</sup> The Commission notes, and Phlx has verified, that holders of options on Fund Shares who exercise and receive the underlying Fund Shares must receive, like any purchaser of Fund Shares, a product description or prospectus, as appropriate. Telephone conversation between John Dayton, Assistant Secretary and Counsel, Phlx, and Geoffrey Pemble, Attorney, Division of Market Regulation, Commission, on February 2, 2001.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

of the securities needed to be deposited have not been received by the Fund.<sup>15</sup> This listing requirement should ensure that there exists sufficient supply of the underlying Fund Shares so that a short call writer, for example, will have the ability to secure delivery of the Fund Shares upon exercise of the option.

The Commission believes the Phlx has adequately addressed potential concerns about the ability to produce Fund Shares upon exercise of the option through the adoption of the listing standards set forth above. In particular, options listed pursuant to the uniform options listing standards will have to meet the options maintenance listing standards that require, among other things, that a minimum number of Fund Shares be outstanding to continue trading the options.<sup>16</sup> The alternative listing criteria, noted above, should also help to ensure that the underlying Fund Shares will be available upon exercise by requiring the Fund to allow market participants to create Fund Shares even though some or all of the necessary securities needed to be deposited are not available.<sup>17</sup> Although there is no absolute assurance that market participants will go ahead and create Fund Shares in the event a short call writer needs to purchase Fund Shares to meet an exercise notice, it is likely that arbitrage opportunities will create an incentive to do so. Further, in the event there are not enough Fund Shares to meet exercise requirements, as with other physically-settled equity options, the Options Clearing Corporation has rules that would apply to such situations.

Second, the Commission believes that the surveillance standard developed by the Phlx for options on Fund Shares is adequate to address the concerns associated with the listing and trading of such securities. Specifically, the Phlx has proposed that: (1) Any Fund Share with non-US stocks in the underlying index or portfolio that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index or portfolio; and (3) stocks for which the

primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.

As a general matter, the Commission believes that comprehensive surveillance agreements provide an important deterrent to manipulation because they facilitate the availability of information needed to fully investigate a potential manipulation if it were to occur. These agreements are especially important in the content of derivative products based on foreign securities because they facilitate the collection of necessary regulatory, surveillance and other information from foreign jurisdictions. In evaluating the current proposal, the Commission believes that requiring comprehensive surveillance agreements to be in place between the Phlx and the primary markets for foreign securities that comprise 50% or more of the weight of the underlying index or portfolio upon which Fund Shares are based, as well as the other conditions discussed above, provides an adequate mechanism for the exchange of surveillance sharing information necessary to detect and deter possible market manipulations. Although the Commission recognizes that up to 50% of the Portfolio's value may not be covered by comprehensive surveillance agreements, the other requirements will ensure that a significant percentage of the portfolio is not made up of securities from uncovered countries. Further, as to the domestically-traded Fund Shares themselves and the domestic stocks in the underlying index or portfolio upon which Fund Shares are based, the Intermarket Surveillance Group Agreement will be applicable to the trading of options on Fund Shares.

Finally, the Commission believes that it is appropriate to require minimum margin of 100% of the current market value of the option plus 15% of the market value of the underlying security value ("broad-based margin") for options on Fund Shares based on a broad-based index or portfolio and for options on Fund Shares which have been approved to date. Moreover, the Commission believes that requiring minimum margin of 100% of the current market value of the option plus 20% of the market value of the underlying security value ("narrow-based margin") for options on Fund Shares based on a narrow-based index or portfolio is appropriate. The Commission notes that these margin requirements for options on Exchange-Traded Fund Shares are comparable to margin requirements that currently apply to broad-based and narrow-based index options.

The Commission finds good cause for approving the proposed rule change (SR-Phlx-00-107), as amended, prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that the proposed rule change is based on Amex Rules 915 and 916, which the Commission approved previously.<sup>18</sup> The Commission also observes that the proposed rule change concerns issues that previously have been the subject of a full comment period pursuant to section 19(b) of the Act.<sup>19</sup> The Commission does not believe that the proposed rule change raises novel regulatory issues that were not addressed in the previous filings. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act, to approve the amended proposal on an accelerated basis.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>20</sup> that the proposed rule change (SR-Phlx-00-107), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>21</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

[FR Doc. 01-3341 Filed 2-8-01; 8:45 am]

BILLING CODE 8010-01-M

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43927; File No. SR-PHLX-01-07]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Philadelphia Stock Exchange, Inc. Relating to an Interpretation of Phlx Rule 237 Governing the eVWAP Morning Session

February 5, 2001.

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 11, 2001, the Philadelphia Stock Exchange, Inc. ("Exchange" or "Phlx") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described

<sup>15</sup> This assumes that the authorized creation participant has undertaken to deliver the shares as soon as possible and such undertaking has been secured by the delivery and maintenance of collateral consisting of cash or cash equivalents satisfactory to the Fund which underlies the option, as described in the Fund prospectus.

<sup>16</sup> See supra note 6.

<sup>17</sup> See supra note 16.

<sup>18</sup> See Securities Exchange Act Release No. 40157 (July 1, 1998), 63 FR 37426 (July 10, 1998) (SR-Amex-96-44).

<sup>19</sup> 15 U.S.C. 78s(b).

<sup>20</sup> 15 U.S.C. 78s(b)(2).

<sup>21</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.