

2005-37 and should be submitted on or before June 28, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51766; File No. SR-CBOE-2004-54]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change and Partial Amendment No. 1 To Amend Rules Relating to Margin Treatment on Stock Transactions Effected by an Options Market Maker to Hedge Options Positions

May 31, 2005.

I. Introduction

On July 30, 2004, 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")¹ and Rule 19b-4² thereunder, a proposed rule change seeking to amend rules relating to margin treatment on stock transactions effected by an options market maker to hedge options positions. On February 22, 2005, the CBOE filed a partial amendment to its proposed rule change.³ The proposed rule change, as amended, was published for comment in the **Federal Register** on April 13, 2005.⁴ The Commission received no comments on the proposal.

II. Description

The Exchange has proposed to eliminate a rule that essentially disallows favorable margin treatment on stock transactions initiated by options market makers to hedge an option position if the exercise price of the option is more than two standard exercise price intervals above the price of the stock in the case of a call option,

or below in the case of a put option. When options market makers hedge their option positions by taking a long or short position in the underlying security, the underlying security is allowed "good faith" margin treatment, provided the underlying security meets the definition of a "permitted offset." To qualify as a permitted offset, CBOE Rule 12.3(f)(3) requires, among other things, that the transaction price of the underlying security be not more than two standard exercise price intervals below the exercise price of the option being hedged in the case of a call option, or above in the case of a put option. The term "in-or-at-the-money" is used in CBOE Rule 12.3(f)(3) to refer to the two standard strike price interval requirement. Stated another way, "in-or-at-the-money" means the option being hedged cannot be "out-of-the-money" by more than two standard exercise price intervals.

The Exchange has stated that the intent of this requirement was to confine good faith margining of transactions in the underlying security to those that constituted meaningful hedges of an option position. The Exchange has proposed to remove the "in-or-at-the-money" requirement.⁵

The Exchange noted that the "in-or-at-the-money" requirement is not consistent with current options market-maker hedging technique. Options market-makers will take a less than 100 share position in the underlying security per option being hedged so that any gain/loss on that position in dollar terms closely tracks that of the dollar gain/loss on the option position. When options market-makers hedge in this manner, known as "delta neutral hedging," they cannot benefit from any gain on a position in the underlying security because it is equally offset by a loss in the option being hedged.

The Exchange further noted that the "in-or-at-the-money" requirement is unnecessary because, when a clearing firm extends good faith margin on a security underlying an option, it must reduce its net capital by any amount by which the deduction required by Rule 15c3-1 under the Securities Exchange Act of 1934 (the "haircut") exceeds the amount of equity in the options market maker's account.

⁵ The New York Stock Exchange ("NYSE") also has filed a proposed rule change to remove the "in-or-at-the-money" language from its rules on permitted offsets. Although the language of the NYSE's proposed rule change differs from the language of the CBOE's proposed rule change, the proposed changes from the two exchanges are substantively identical. The Commission is publishing a notice to solicit comments on the NYSE's proposed rule change.

III. Discussion and Commission Findings

After careful review, 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.⁶ In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act⁷, which requires that the rules of the exchange be designed, among other things, to remove impediments to and perfect the mechanisms of a free and open market, and, in general, to protect investors and the public interest. The Commission finds that amending the rules relating to margin treatment on stock transactions effected by an options market maker to hedge options positions, by eliminating the "in-or-at-the-money" requirement, is consistent with the requirements of Section 6(b)(5), in that the "in-or-at-the-money" requirement impedes options market makers from hedging, on a good faith margin basis, "out-of-the-money" options having standard exercise price intervals of less than five points.

IV. Conclusion.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,⁸ that the proposed rule change (File No. SR-CBOE-2004-54), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51763; File No. SR-CHX-2005-15]

Self-Regulatory Organizations; Chicago Stock Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto Relating to Participant Fees and Credits

May 31, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934

⁶ In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁷ 15 U.S.C. 78f(b)(5).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ SR-CBOE-2004-54: Amendment No. 1. Under the partial amendment, the options market maker must be able to demonstrate that it effected its permitted offset transactions for market-making purposes.

⁴ See Securities Exchange Act Release No. 51497 (April 6, 2005), 70 FR 19536 (April 13, 2005).

("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 2, 2005, the Chicago Stock Exchange, Inc. ("CHX" 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 prepared by the Exchange. On May 23, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ 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 CHX proposes to amend its Participant Fee Schedule (the "Fee Schedule") to (1) eliminate the assignment fee for listed securities that are not assigned in competition; and (2) modify the Exchange's fixed fee for specialists trading Nasdaq/NM securities. The text of the proposed rule change is available on the CHX's Web site (www.chx.com), at the CHX'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 CHX 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 CHX 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 Exchange proposes to modify its Fee Schedule in two ways. Specifically, the Exchange proposes to (1) eliminate

the assignment fee for listed securities that are not assigned in competition; and (2) modify the Exchange's fixed fee for specialists trading Nasdaq/NM securities.

Eliminating certain assignment fees. Under the current Fee Schedule, the Exchange charges a fee to a specialist that receives the assignment of a listed security when other firms are not competing for the assignment. To encourage firms to trade additional listed securities by reducing their costs of doing so, the Exchange proposes to eliminate this assignment fee.⁴ The Exchange previously had waived this fee on a temporary basis, through the end of 2004; the current proposal would eliminate the fee altogether.⁵

Modifying the fixed fee. The Exchange currently charges specialists trading Nasdaq/NM securities a base fixed fee that is the greater of (a) \$20,000 or (b) the firm's pro rata share of \$60,000. The Exchange now believes that it is appropriate to modify the calculation to impose a flat base fee of \$20,000. This modified calculation allows the Exchange to recoup many of the fixed costs of running its OTC specialist program, while not imposing unnecessary fees on specialist firms.⁶

The Exchange believes that these changes to the Fee Schedule represent a fair allocation of the costs associated with the Exchange's specialist programs. As noted above, the changes are also intended to provide specialists with an appropriate incentive to increase the number of issues that they trade (consistent with the specialist's duties as a specialist), which could allow the Exchange's participants to offer their customers access to a wider array of specialist-traded securities.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,⁷ in general, and furthers the objectives of Section 6(b)(4)

of the Act,⁸ in particular, in that it provides for the equitable allocation of reasonable dues, fees, and other charges among its members.

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

The Exchange 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

No written comments were either solicited or received.

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

The proposed rule change has become effective upon filing pursuant to Section 19(b)(3)(A)(ii) of the Act⁹ and subparagraph (f)(2) of Rule 19b-4 thereunder,¹⁰ because it establishes or changes a due, fee, or other charge imposed by the CHX. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such 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.¹¹

IV. 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. 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. Please include File Number SR-CHX-2005-15 on the subject line.

Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CHX-2005-15. This file

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, the Exchange made technical corrections to the rule text of the proposed rule change. The effective date of the original proposed rule change is May 2, 2005, and the effective date of the amendment is May 23, 2005. For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change, as amended, under Section 19(b)(3)(C) of the Act, the Commission considers the period to commence on May 23, 2005, the date on which the Exchange submitted Amendment No. 1. See 15 U.S.C. 78s(b)(3)(C).

⁴ The Exchange would continue to charge specialist assignment fees with respect to securities that are assigned to a specialist firm in competition with other firms, reflecting the increased administrative costs associated with allocating stocks in competition.

⁵ See Securities Exchange Act Release No. 50657 (November 12, 2004), 69 FR 67615 (November 18, 2004) (SR-CHX-2004-34).

⁶ At a basic level, many of the Exchange's costs of supporting the OTC specialist program do not vary based on the number of OTC specialist firms or the number of issues traded. These costs, however, can increase with substantial increases in trading volume or can decrease with substantial decreases in trading volume or in the number of firms that trade Nasdaq/NM securities. The Exchange's proposed changes to the fixed fee are consistent with these principles.

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(4).

⁹ 15 U.S.C. 78s(b)(3)(A)(ii).

¹⁰ 17 CFR 240.19b-4(f)(2).

¹¹ See *supra* note 3.

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. Copies of the filing also will be available for inspection and copying at the principal offices of the CHX. 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-CHX-2005-15 and should be submitted on or before June 28, 2005.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-51769; File No. SR-ISE-2005-22]

Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change To Extend Until June 5, 2006, a Pilot Program for Listing Options on Selected Stocks Trading Below \$20 at One-Point Intervals

May 31, 2005.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² notice is hereby given that on May 10, 2005, the International Securities Exchange, Inc. ("ISE" 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 ISE. The ISE filed the proposal pursuant to Section 19(b)(3)(A) of the Act,³ and Rule 19b-4(f)(6) thereunder,⁴ which renders the proposal effective upon filing with the Commission.⁵ 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 ISE proposes to amend Supplementary Material .01 to ISE Rule 504, "Series of Options Contracts Open for Tracing," to extend until June 5, 2006, its pilot program for listing options series on selected stocks trading below \$20 at one-point intervals ("Pilot Program"). The text of the proposed rule change is available on the ISE's Web site (<http://www.iseoptions.com>), at the ISE'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 ISE 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 ISE 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

On June 16, 2003, the Commission approved the ISE's Pilot Program, which allows the ISE to list series with \$1 strike price intervals on equity option classes that overlie up to five individual stocks, provided that the strike prices are \$20 or less, but not less than \$3, subject to the terms of the Pilot Program.⁶ Although the ISE may select only up to five individual stocks to be

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ The ISE has asked the Commission to waive the five-day pre-filing notice requirement and the 30-day operative delay. See Rule 19b-4(f)(6)(iii), 17 CFR 240.19b-4(f)(6)(iii).

⁶ See Securities Exchange Act Release No. 48033 (June 13, 2003), 68 FR 37036 June 20, 2003) (order approving File No. SR-ISE-2003-17) ("Pilot Program Approval Order").

included in the Pilot Program, the ISE is also permitted to list options on other individual stocks at \$1 strike price intervals if other options exchanges listed those series pursuant to their respective rules. The ISE selected the following five options classes to participate in the Pilot Program: AMR Corp. [AMR], Clapine Corp. [CPN], EMC Corp. [EMC], El Paso Corp. [EP], and Sun Microsystems Inc. [SUNW]. The Pilot Program, after being extended on two prior occasions,⁷ is set to expire on June 5, 2005.⁸ The ISE believes the Pilot Program has been successful. Thus, the ISE proposes to extend the Pilot Program until June 5, 2006. In support of this proposed rule change, and as required by the Pilot Program Approval Order and the Pilot Extension Notices, the Exchange is submitting to the Commission a report (the "Pilot Program Report"), attached as Exhibit 3 to the proposal, that details the Exchange's experience with the Pilot Program. Specifically, the Pilot Program Report contains data and written analysis regarding the five options classes included in the Pilot Program for the period between May 1, 2004, and February 28, 2005.

The Exchange believes there is sufficient investor interest and demand to extend the Pilot Program for another year. The Exchange continues to believe that the Pilot Program has provided investors with greater trading opportunities and flexibility and the ability to more closely tailor their investment strategies and decisions to the movement of the underlying security. Furthermore, the Exchange has not detected any material proliferation of illiquid options series resulting from the narrower strike price intervals.

2. Statutory Basis

The ISE believes the proposed rule change is consistent with the Act and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.⁹ Specifically, the ISE believes the proposed rule change is consistent with the requirements under Section 6(b)(5) of the Act that the rules of a national securities exchange be designed to

⁷ See Securities Exchange Act Release Nos. 49827 (June 8, 2004), 69 FR 33966 (June 17, 2004) (notice of filing and immediate effectiveness of File No. SR-ISE-2004-21) (extending the \$1 Strike Pilot Program until August 5, 2004); and 50060 (July 22, 2004), 69 FR 45864 (July 30, 2004) (notice of filing and immediate effectiveness of File No. SR-ISE-2004-26) (extending the \$1 Strike Pilot Program until June 5, 2005) (collectively, the "Pilot Extension Notices").

⁸ See Securities Exchange Act Release No. 50060, *supra* note 7.

⁹ 15 U.S.C. 78f(b).

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.