

Florence E. Harmon,

Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-56350; File No. SR-CBOE-2007-79]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 Thereto To Eliminate Position and Exercise Limits for Options on the Russell 2000 Index, and To Specify That Certain Reduced-Value Options on Broad-Based Security Indexes Have No Position and Exercise Limits

September 4, 2007.

#### I. Introduction

On July 17, 2007, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to eliminate position and exercise limits for options on the Russell 2000 Index ("RUT") and to specify that reduced-value options on broad-based security indexes for which full-value options have no position and exercise limits similarly have no position and exercise limits. On August 2, 2007, the Exchange filed Amendment No. 1 to the proposed rule change. The proposed rule change was published for comment in the *Federal Register* on August 9, 2007 for a 15-day comment period.<sup>3</sup> The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as modified by Amendment No. 1, on an accelerated basis.

#### II. Description of the Proposal

CBOE proposes to amend Rules 24.4 and 24.5 to eliminate position and exercise limits for options on RUT, a broad-based security index. In connection with this change, RUT options would be subject to specific reporting requirements and additional margin provisions imposed by CBOE with respect to options on the Standard & Poor's 500 Index ("SPX"), the

Standard & Poor's 100 Index ("OEX"), the Dow Jones Industrial Average ("DJX"), and the Nasdaq-100 Index ("NDX"), other broad-based index options that, under the Exchange's current rules, are not subject to position and exercise limits.

The Exchange notes that in approving the elimination of position and exercise limits for SPX, OEX, DJX, and NDX options, the Commission considered the enormous capitalization of each of these indexes and the deep and liquid markets for the securities underlying each index that significantly reduced concerns of market manipulation or disruption in the underlying markets.<sup>4</sup> CBOE noted that the market capitalization of RUT, as of the date of filing of the proposed rule change, was \$1.73 trillion and the average daily trading volume ("ADTV"), in the aggregate, for the component securities of RUT, for the period as of three months prior to the date of filing of the proposed rule change, was 535 million shares. For the same period, the ADTV for options on RUT was 79,000 contracts.

The Exchange also states that in the SPX/OEX/DJX/NDX Approval Orders, the Commission noted that the financial requirements imposed by both the Exchange and the Commission serve to address any concerns that an Exchange member or its customer(s) may try to maintain an inordinately large unhedged position in the index options. CBOE notes that these same financial requirements would apply equally to RUT options. The Exchange further notes that it has the authority to impose additional margin upon accounts maintaining underhedged positions and is able to monitor accounts to determine when such action is warranted. As noted in the Exchange's rules, the clearing firm carrying such an account would be subject to capital charges under Rule 15c3-1 under the Act<sup>5</sup> to the extent of any resulting margin deficiency.<sup>6</sup>

CBOE indicates that the Commission, in the SPX/OEX/DJX/NDX Approval Orders, relied substantially on the Exchange's ability to provide surveillance and reporting safeguards to

detect and deter trading abuses arising from the elimination of position and exercise limits on SPX, OEX, DJX, and NDX options. The Exchange represents that it monitors the trading in RUT options in the same manner as trading in SPX, OEX, DJX, and NDX options and that the current CBOE surveillance procedures are adequate to continue monitoring RUT options. In addition, the Exchange intends to impose a reporting requirement on CBOE members or member organizations (other than CBOE market-makers) that trade RUT options. This reporting requirement, which is currently imposed on members who trade SPX, OEX, and NDX options, would require members or member organizations who maintain in excess of 100,000 RUT option contracts on the same side of the market, for their own accounts or for the account of customers, to report information as to whether the positions are hedged and provide documentation as to how such contracts are hedged, in a manner and form required by the Exchange's Department of Market Regulation.<sup>7</sup> The Exchange also would be permitted to specify other reporting requirements, as well as the limit at which the reporting requirement may be triggered.<sup>8</sup>

In addition, CBOE proposes to amend Rule 24A.7 relating to the trading of FLEX broad-based index options to eliminate position and exercise limits on FLEX RUT options, and to adopt for FLEX RUT options the same 100,000 contract reporting requirement and the additional margin provisions that currently apply to FLEX SPX, OEX, and NDX options. The Exchange believes that eliminating position and exercise limits for RUT options and FLEX RUT options is consistent with CBOE rules relating to similar broad-based indexes and also would allow CBOE members and their customers greater hedging and investment opportunities.

The Exchange notes that it lists and trades several reduced-value options on broad-based indexes for which the Exchange also lists and trades full-value options (e.g., Mini-SPX Index ("XSP") options, Mini-Russell 2000 Index ("RMN") options, and Mini-Nasdaq-100 Index ("MNX") options). The Exchange states that when it received approval to list and trade reduced-value options on broad-based indexes, the proscribed position and exercise limits were equivalent to the reduced-value contract

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

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

<sup>3</sup> See Securities Exchange Act Release No. 56191 (August 2, 2007), 72 FR 44894.

<sup>4</sup> See Securities Exchange Act Release Nos. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (SR-CBOE-2001-22) ("SPX/OEX/DJX Permanent Approval Order"); and 52650 (October 21, 2005), 70 FR 62147 (October 28, 2005) (SR-CBOE-2005-41) ("NDX Approval Order") (collectively, "SPX/OEX/DJX/NDX Approval Orders"). See also Securities Exchange Act Release No. 40969 (January 22, 1999), 64 FR 4911 (February 1, 1999) (SR-CBOE-98-23) ("SPX/OEX/DJX Pilot Approval Order").

<sup>5</sup> 17 CFR 240.15c3-1.

<sup>6</sup> See Interpretation and Policy .04 to CBOE Rule 24.4.

<sup>7</sup> See Interpretation and Policy .03 to CBOE Rule 24.4. The reporting requirement for DJX options is triggered at 1 million contracts.

<sup>8</sup> *Id.*

factor (e.g., 10) multiplied by the applicable position and exercise limits for the full-value option on the same broad-based index. In other words, the Exchange's existing rules applicable to position and exercise limits for full-value broad-based index options are used to calculate the position and exercise limits for reduced-value options.

Conversely, when the Exchange's rules specifically state that certain full-value broad-based index options have no position and exercise limits, the same equally applies to reduced-value options on those same broad-based indexes. The Exchange proposes to amend Rules 24.4 and 24.5 in order to codify this provision. In addition, because position and exercise limits for reduced-value options are aggregated with full-value options for purposes of determining compliance with position and exercise limits, the Exchange proposes to amend Rules 24.4 and 24A.7 to reflect that such aggregation will apply when calculating reporting requirements.

Finally, the Exchange proposes to make technical changes to Rules 24.4, 24.5, and 24A.7 to specify that there are no position and exercise limits for European-Style Exercise S&P 100 Index options ("XEO") and FLEX XEO options, and to add XEO options to the position reporting and margin rules.<sup>9</sup> The Exchange notes that the only difference between OEX and XEO options is the manner in which the respective contracts are exercised (*i.e.* American-style versus European-style).

### III. Discussion

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

and a national market system, and in general to protect investors and the public interest.<sup>11</sup>

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

The Commission notes that it continues to believe that the fundamental purposes of position and exercise limits remain valid. Nevertheless, the Commission believes that experience with the trading of index options as well as enhanced reporting requirements and the Exchange's surveillance capabilities have made it possible to approve the elimination of position and exercise limits on certain broad-based index options. Thus, in 2001, the Commission approved a CBOE proposal to eliminate permanently position and exercise limits for options on SPX, OEX, and DJX,<sup>12</sup> and, in 2005, the Commission approved a CBOE proposal to eliminate permanently position and exercise limits for options on NDX.<sup>13</sup> The Commission believes that the considerations upon which it relied in approving the elimination of position and exercise limits for SPX, OEX, DJX, and NDX options equally apply with respect to options on RUT.

As noted by CBOE, the market capitalization of RUT as of the date of filing of the proposal was \$1.73 trillion. The ADTV for the period as of three months prior to the date of filing of the proposed rule change for all underlying components of the index was 535 million shares. The Commission believes that the enormous market capitalization of RUT and the deep, liquid market for the underlying component securities significantly reduce concerns regarding market manipulation or disruption in the underlying market. Removing position and exercise limits for RUT options may also bring additional depth and liquidity, in terms of both volume and open interest, to RUT options without significantly increasing concerns regarding intermarket manipulation or disruption of the options or the underlying securities.

In addition, the Commission believes that financial requirements imposed by both the Exchange and the Commission adequately address concerns that a CBOE member or its customer may try to maintain an inordinately large unhedged position in RUT options. Current risk-based haircut and margin methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer.<sup>14</sup> Under the proposal, CBOE also would have the authority under its rules to impose a higher margin requirement upon an account maintaining an under-hedged position when it determines a higher requirement is warranted. As noted in the CBOE rules, the clearing firm carrying the account would be subject to capital charges under Rule 15c3-1 under the Act to the extent of any margin deficiency resulting from the higher margin requirement.

In approving the elimination of position and exercise limits for options on the SPX, OEX, DJX, and NDX, the Commission took note of the enhanced surveillance and reporting safeguards that CBOE had adopted to allow it to detect and deter trading abuses that might arise as a result.<sup>15</sup> CBOE represents that it monitors trading in RUT options in much the same manner as trading in SPX, OEX, DJX, and NDX options. These safeguards, including the 100,000-contract reporting requirement described above, would allow CBOE to monitor large positions in order to identify instances of potential risk and to assess and respond to any market concerns at an early stage. In this regard, the Commission expects CBOE to take prompt action, including timely communication with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in component stocks, should any unanticipated adverse market effects develop. Moreover, as previously noted, the Exchange has the flexibility to specify other reporting requirements, as well as to vary the limit at which the reporting requirements may be triggered.

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

<sup>9</sup> See Securities Exchange Act Release No. 44556 (July 16, 2001), 66 FR 38046 (July 20, 2001) (SR-CBOE-2001-39) ("XEO Approval Order").

<sup>10</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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

<sup>12</sup> See SPX/OEX/DJX Permanent Approval Order, *supra* note 4.

<sup>13</sup> See NDX Approval Order, *supra* note 4.

<sup>14</sup> See SPX/OEX/DJX Pilot Approval Order, *supra* note 4.

<sup>15</sup> See *id.* and NDX Approval Order, *supra* note 4.

In addition, the Commission notes that the Exchange's existing rules applicable to position and exercise limits for full-value broad-based index options are used to calculate the position and exercise limits for reduced-value options. The Exchange proposes to amend its rules for those specified broad-based index options that do not have position and exercise limits to specifically state that there will not be position and exercise limits on the reduced-value options on those same broad-based index options. The Exchange also proposes to amend its rules to state that reduced-value options will be aggregated with full-value options when calculating reporting requirements.

The Exchange also is making technical corrections to its rules to reflect that there are no position and exercise limits for XEO options. The Commission notes that position and exercise limits for XEO options were previously eliminated and CBOE is simply updating its rules to reflect this fact.<sup>16</sup>

The Commission finds good cause, consistent with section 19(b)(2) of the Act,<sup>17</sup> to grant accelerated approval of the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes, as stated above, that RUT has similar characteristics to the other broad-based indexes for which position and exercise limits have been eliminated for options on those indexes. Specifically, the Commission believes that the enormous market capitalization of RUT and the deep, liquid market for the underlying component securities significantly reduce concerns regarding market manipulation or disruption in the underlying market. The Commission received no comments regarding the proposed rule change and the Commission believes that the proposed rule change raises no new regulatory issues of material concern. The Commission believes that accelerating approval of the proposed rule change will allow CBOE members and their customers greater hedging and investment opportunities with respect to RUT options without further delay.

#### IV. Conclusion

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>18</sup> that the proposed rule change (SR-CBOE-2007-

79), as modified by Amendment No. 1, be, and it hereby is, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>19</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34-56345; File No. SR-NASDAQ-2007-058]**

### Self-Regulatory Organizations; The NASDAQ Stock Market LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Step-Outs and Transfers of Sales Fees

August 31, 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 June 7, 2007, The NASDAQ Stock Market LLC ("Nasdaq") 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 primarily by Nasdaq. Nasdaq filed the proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6)<sup>4</sup> thereunder so that the proposal was 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

Nasdaq proposes to offer functionality to allow Nasdaq members to process (i) step-outs and (ii) transfers of Rule 7002 Sales Fees and similar fees of other self-regulatory organizations ("SROs") and proposes to establish fees for these services.

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

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Nasdaq is proposing to allow Nasdaq members to process step-outs and transfers of Rule 7002 Sales Fees and similar fees of other self-regulatory organizations ("SROs") through the Nasdaq Exchange and is proposing to establish fees for these services.

##### Step-Outs

A step-out is a mechanism for transferring a broker's position in a security in a manner that does not constitute a trade. In one form of a step-out, a party to a previously executed trade transfers its position in the trade to one or more other parties. For example, a broker that buys a large block of stock on behalf of several broker-dealer customers may "step-out" of the trade to transfer and allocate its position to the customers. Thus, under this form of a step-out, there is a single trade on a securities market, coupled with an arrangement between one of the trade counterparties and one or more additional parties to shift the settlement obligations for the trade to the additional parties. In another form of step-out, a broker uses a clearing-only report to transfer its position from an account at one clearing broker to an account at another clearing broker for its own internal accounting purposes.

Historically, when The Nasdaq Stock Market, Inc. ("Nasdaq Inc.") operated as a facility of the National Association of Securities Dealers ("NASD"), step-outs were effected through non-tape, clearing-only trade report entries into the Automated Confirmation Transaction Service ("ACT"). Now that Nasdaq is fully operational as a national securities exchange, ACT serves both as the mechanism for reporting trades that are automatically executed through the Nasdaq Market Center to the tape and has also been licensed for use by the NASD/NASDAQ Trade Reporting Facility ("NASD/NASDAQ TRF") as a technology platform for collecting over-the-counter ("OTC") trade reports and reporting them to the tape. In this dual role, ACT continues to accept step-out entries regardless of whether the underlying trade occurred on the

<sup>16</sup> See XEO Approval Order, *supra* note 9; see also SPX/OEX/DJX Permanent Approval Order, *supra* note 4.

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</sup> 15 U.S.C. 78s(b)(2).

<sup>19</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).