providing a hedge for the issuer will incur position exposure. However, as the Commission has concluded in previous approval orders for other hybrid instruments issued by broker-dealers,[25] the Commission believes that this concern is minimal given the size of the Notes issuance in relation to the net worth of Merrill Lynch.

The Commission also believes that the listing and trading of the Notes should not unduly impact the market for the component securities of the Underlying Indices of the Biotech-Pharmaceutical Index or raise manipulative concerns. As discussed more fully above, the Biotech-Pharmaceutical Index is based upon the return of the Underlying Indices. Each of the Underlying Indices will have a weighting of 50% of the weight of the Biotech-Pharmaceutical Index, initially, and immediately following each annual rebalancing of the Biotech-Pharmaceutical Index. In addition, the Biotech Index's equal-dollar weighting and the Pharmaceutical Index's market-value (capitalization) weighting methodologies are commonly applied index calculation methods. Moreover, Amex's listing and trading of other products on both of the Underlying Indices have been previously approved by the Commission.[26] In approving the listing and trading of these other products on the Underlying Indices, the Commission noted in its approval orders that the Amex has developed several composition and maintenance criteria for the Underlying Indices that the Commission believes will minimize the potential for manipulation of the Underlying Indices.[27] In addition, the Amex's surveillance procedures will serve to deter as well as detect any potential manipulation.

Finally, the Commission notes that the value of the Biotech-Pharmaceutical Index will be disseminated at least once every fifteen seconds throughout the trading day. The Commission believes that providing access to the value of the Biotech-Pharmaceutical Index at least once every fifteen seconds throughout the trading day is extremely important and will provide benefits to investors in the product.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Amex has requested accelerated approval because this product is similar to several other instruments currently listed and traded on the Amex.[28] The Commission believes that the Notes will provide investors with an additional investment choice and that accelerated approval of the proposal will allow investors to begin trading Notes promptly. Additionally, the Notes will be listed pursuant to Amex's existing hybrid security listing standards as described above. Based on the above, the Commission believes that there is good cause, consistent with Sections 6(b)(5) and 19(b)(2) of the Act[29] to approve the proposal on an accelerated basis.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[30] that the proposed rule change (SR–Amex–2001–108), is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[31]

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 02–1905 Filed 1–24–02; 8:45 am]

BILLING CODE 8010–01–M

[25] *See, e.g.,* Securities Exchange Act Release Nos. 44913 (October 9, 2001), 66 FR 52469 (October 15, 2001) (order approving the listing and trading of notes whose return is based on the performance of the Nasdaq-100 Index) (File No. SR–NASD–2001–73); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (order approving the listing and trading of notes whose return is based on a portfolio of 20 securities selected from the Amex Institutional Index) (File No. SR–Amex–2001–40); and 37744 (September 27, 1996), 61 FR 52480 (October 7, 1996) (order approving the listing and trading of notes whose return is based on a weighted portfolio of healthcare/biotechnology industry securities) (File No. SR–Amex–96–27).

[26] *See* Biotech LEAPS Order, *supra* note 10; and Pharmaceutical LEAPS Order, *supra* note 12.

[27] Among other things, the Amex would be required to submit a rule filing with the Commission pursuant to Section 19(b) of the Act prior to expanding either of the Underlying Indices to greater than twenty stocks or reducing either of the Underlying Indices to less than ten stock. The Commission finds that this requirement will protect against the design of the Underlying Indices from being materially changed without Commission review and approval, and that it is unlikely that attempted manipulations of prices of the issues in the Underlying Indices would affect significantly the Underlying Indices' value. *See* Biotech LEAPS Order, *supra* note 10; and Pharmaceutical LEAPS Order, *supra* note 12.

[28] *See supra* note 20.

[29] 15 U.S.C. 78f(b)(5) and 78s(b)(2).

[30] 15 U.S.C. 78s(b)(2).

[31] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45309; File No. SR–CBOE–2001–44]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Increasing Position and Exercise Limits on QQQ Options

January 18, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange act of 1934,[1] and rule 19b–4 thereunder,[2] notice is hereby given that on August 9, 2001, the Chicago Board Options Exchange, Incorporated (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CBOE. On December 19, 2001, the CBOE filed Amendment No. 1 to the proposed rule change,[3] and on January 14, 2002, the CBOE filed Amendment No. 2 to the proposed rule change.[4]

The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change, as amended.

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

The Exchange hereby proposes to increase position and exercise limits for Nasdaq-100 Index Tracking Stock℠ (''QQQ'') options. The Exchange represents that its reporting requirements for QQQ options will serve to identify options holdings and information concerning the hedging of these positions.

The text of the proposed rule change is available at the Office of the Secretary, CBOE and at 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 CBOE included statements concerning the purpose of and basis for the

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Amendment No. 1 supercedes and replaces the original 19b–4 filing in its entirety.

[4] Amendment No. 2 removes language added to Rule 4.13(b) by the proposed rule change that increased the reporting requirement level specified in Rule 4.13 for QQQ options.

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 CBOE 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, Proposed Rule Change

1. Purpose

The Commission has stated that position and exercise limits "must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market-makers from adequately meeting their obligations to maintain a fair and orderly market." [5]

The Exchange represents that the QQQs are by far the most actively-traded options product. Average daily trading volumes for the QQQs and QQQ options from January 1, 2001 to April 30, 2001 were 70.5 million shares and 189,046 contracts, respectively. The current standard position and exercise limits for QQQ options were recently adjusted from 75,000 contracts to 150,000 contracts, due to a 2-for-1 split in the value of the underlying QQQ. In January 2002, however, the current limits are scheduled to revert to 75,000 contracts.

Based on the large trading volume in both the underlying QQQ and QQQ options, the Exchange believes that position and exercise limits of the QQQ option are too restrictive and may adversely affect the Exchange's ability to provide liquidity in this popular product. In addition, the CBOE believes that current base limits for the QQQ options may not be adequate in many instances for the hedging needs of certain institutions which engage in trading strategies differing from those covered under the equity hedge exemption policy in Interpretation .04 to Exchange Rule 4.11 (*e.g.,* delta hedges; OTC vs. listed hedges).

To accommodate the need for continued liquidity in this product, the Exchange proposes to increase position and exercise limits for QQQ options to 300,000 contracts. The Exchange will require both that member organizations report all QQQ options positions exceeding 200 contracts pursuant to existing Exchange Rule 4.13(a), and that they report information on the hedging of all positions in excess of 10,000 contracts on the same side of the market, pursuant to an amended Exchange Rule 4.13(b). The Exchange believes that increasing position limits for this product will lead to a more liquid and competitive market environment for QQQ options that will benefit customers interested in the product.

Reporting Requirements

Consistent with Exchange Rule 4.13(b), the Exchange will require that each member or member organization that maintains a position on the same side of the market in excess of 10,000 contracts in the QQQ option, for its own account or for the account of a customer report certain information. This data would include, but would not be limited to, the option position, whether such position is hedged and if so, a description of the hedge and if applicable, the collateral used to carry the position. Exchange market-makers (including DPMs) would continue to be exempt from this reporting requirement as market-maker information can be accessed through the Exchange's market surveillance systems. Once the 10,000 contract reporting threshold is attained, member or member organizations must similarly report each increase of 2,500 contracts on the same side of the market for customer accounts and each increase of 5,000 contracts on the same side of the market for proprietary accounts. In addition, the general reporting requirement for customer accounts that maintain a position in excess of 200 contracts will remain at this level for QQQ options.[6] Lastly, it is important to note that the 10,000 contract reporting requirement is above and beyond what is currently required in the OTC market. NASD member firms are only required to report options positions in excess of 200 contracts and are not required to report any related hedging information.

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)(5) [8] in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles 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, to protect investors and the public interest and is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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

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

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

No written comments were solicited or received with respect to 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 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 Section. Copies of such filing will also be available for inspection and copying at the office of the CBOE. All submissions should refer File No. SR–CBOE–2001–44 and should be submitted by February 15, 2002.

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

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 applicable to a national securities exchange. In particular, the Commission believes the proposal is consistent with the requirements of section 6(b)(5) of the Act [9] in that it is

[5] *See* H.R. Rep. No. IFC–3, 96th Cong., 1st Sess. At 189–91 (Comm. Print 1978).

[6] *See* Exchange Rule 4.13(a).

[7] 15 U.S.C. 78f(b).

[8] 15 U.S.C. 78f(b)(5).

[9] 15 U.S.C. 78f(b)(5). In approving this rule change, the Commission notes that it has considered the proposal's impact on efficiency,

designed to promote just and equitable principles of trades, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

Position and exercise limits serve as a regulatory tool designed to address potential manipulative schemes and adverse market impact surrounding the use of options. In the past, the Commission has stated that:

> 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 options position. In particular, position and exercise limits are designed to minimize the potential for mini-manipulations and for corners or squeezes of the underlying market. In addition such limits serve to reduce the possibility for disruption of the options market itself, especially in illiquid options classes.[10]

In general, the Commission has taken a gradual, evolutionary approach toward expansion of the position and exercise limits. The Commission has been careful to balance two competing concerns when considering the appropriate level at which to set position and exercise limits. The Commission has recognized that the limits must be sufficient to prevent investors from disrupting the market in the component securities comprising the indexes. At the same time, the Commission has determined that limits must not be established at levels that are so low as to discourage participation in the options market by institutions and other investors with substantial hedging needs or to prevent specialists and market makers from adequately meeting their obligations to maintain a fair and orderly market.[11]

The Commission has carefully considered the CBOE's proposal to increase position and exercise limits for QQQ options. At the outset, the Commission notes that it still believes the fundamental purpose of position and exercise limits are being served by their existence. However, given the surveillance capabilities of the Exchange and the depth and liquidity in both the QQQ options and the underlying cash market in QQQs, the Commission believes it is permissible to significantly raise position limits for QQQ options without risk of disruption to the options or underlying cash markets. Specially, the Commission believes that it is appropriate to increase position and exercise limits from 75,000 contracts to 300,000 contracts for QQQ options for several reasons.

First, the Commission believes that the structure of the QQQ options and the considerable liquidity of both the underlying cash and options market for QQQ options lessen the opportunity for manipulation of this product and disruption in the underlying market that a lower position limit may protect against. In this regard, the CBOE notes that the average daily trading volumes for the QQQs and QQQ options from January 1, 2001 to April 30, 2001 were 70.5 million shares and 189,046 contracts, respectively. CBOE has also noted that the QQQ option is the most actively-traded option in the U.S. markets, and the underlying QQQ is the most actively-traded equity security in the U.S. markets.[12] These factors provide support for higher limits for the QQQ options and differentiate them from other equity options.

Second, the Commission notes that current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margins and/or capital that a member must maintain for a large position held by itself or by its customer. Further, the CBOE, under CBOE Rules 4.13 and 12.10, may impose additional margin on options positions if it determines that this is warranted. The Commission believes that these financial requirements should help to address concerns that a member or its customer may try to maintain an inordinately large unhedged position in QQQ options and will help to reduce risks if such a position is established.

Finally, the Commission believes that the reporting requirements imposed by the Exchange under CBOE Rule 4.13, which will continue to require that each member or member organization that maintains a position on the same side of the market in excess of 10,000 contracts in the QQQ option, for its own account or for the account of a customer report certain information, will help protect against potential manipulation. The Exchange also requires members to report subsequent incremental increases in positions, thus assuring that positions are regularly monitored by the Exchange. In particular, information that must be reported includes, among other things, whether or not the options position is hedged, and if so, a description of the hedge. This information should help the CBOE to monitor accounts and determine whether it is necessary to impose additional margin for under-hedged positions, as provided under its rules.

In summary, the financial and reporting requirements noted above should allow the Exchange to detect and deter trading abuses arising from the increased position and exercise limits, and will also allow the Exchange to monitor large positions in order to identify instances of potential risk and to assess additional margin and/or capital charges, if deemed necessary. These requirements, coupled with the special trading characteristics of the QQQ options and the underlying QQQ noted above, warrant approval of the Exchange's proposal.[13]

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof in the **Federal Register**. The Commission notes that under the current CBOE rules, the position and exercise limits applicable to QQQ options is 75,000 contracts. However, due to a 50% reduction in the value of the underlying QQQ on March 20, 2000, the limit was adjusted to 150,000 contracts. The position and exercise limits are scheduled to revert back to 75,000 contracts after the January options expiration occurring on January 18, 2002. The Exchange has represented to the Commission that limits of 75,000 contracts for the QQQ options could substantially reduce depth and liquidity in the QQQ market. The Commission believes for the reasons noted above that it is appropriate to approve this proposed rule change increasing the position and exercise limits to 300,000 contracts on January 18, 2002. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act,[14] to approve the proposal on an accelerated basis.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[15] that the proposed rule change (SR–CBOE–2001–

competition, and capital formation, consistent with Section 3 of the Act. *Id.* at 78c(f).

[10] *See* Securities Exchange Act Release No. 39489 (December 24, 1997), 63 FR 276 (January 5, 1998).

[11] *Id.*

[12] As noted by the CBOE, the QQQ is designed to closely track the performance of the Nasdaq-100 Index. As of November 30, 2001, the market capitalization of the securities underlying the Nasdaq-100 Index was $1.875 trillion.

[13] Of course, the Commission expects that CBOE will take prompt action, including timely communicational with the Commission and other marketplace self-regulatory organizations responsible for oversight of trading in the underlying QQQ, should any unanticipated adverse market effects develop due to the increased limits.

[14] 15 U.S.C. 78f(b)(5).

[15] 15 U.S.C. 78s(b)(2).

44) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[16]

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 02–1906 Filed 1–24–02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45311; File No. SR–ISE–2001–26]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change by International Securities Exchange LLC To Increase Position and Exercise Limits for Nasdaq-100 Index Tracking Stock Options

January 18, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934,[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on October 8, 2001, the International Securities Exchange LLC (''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 Exchange. On January 16, 2002, 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 from interested persons. For the reasons discussed below, the Commission is granting accelerated approval of the proposed rule change, as amended.

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

The ISE proposes to increase position and exercise limits for Nasdaq-100 Index Tracking Stock (''QQQ'') options to 300,000 contracts on the same side of the market. The text of the proposed rule change is available at the Office of the Secretary, ISE, and at 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 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 III 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

The Exchange is proposing to increase position and exercise limits for options on the Nasdaq 100 Index Tracking Stock (''QQQ options'') up to 300,000 contracts on the same side of the market. As discussed below, the Exchange believes that the current limits for non-flex equity options are no longer appropriate for QQQ options given the liquidity of the options, the underlying security, and the securities that comprise the Nasdaq-100 Index.

QQQ options are popular hedging instruments in today's market and by far the most active listed option product. The average daily trading volume for QQQ options was 243,763 contracts during the first quarter of 2001, 330,786 contracts during the second quarter, and 316,425 contracts during the third quarter. As of October 2001, the average daily trading volume of QQQ options is 298,858 contracts.[4]

One of the primary purposes for imposing position and exercise limits is to minimize the opportunity for mini-manipulation, which is an attempt to influence the price movement of an underlying stock to benefit a previously established options position.[5] The Nasdaq 100 Index Tracking Stock represents ownership in a long-term unit investment trust that holds a portfolio of the equity securities that track and Nasdaq-100 Index. Thus, while QQQ options are not technically index options (for which the Commission has previously approved the elimination of position limits for options on certain enormously capitalized indexes),[6] the ISE believes that they are economically similar and are used by investors in the same manner and with the same investment objectives as index options.[7] The Nasdaq-100 Index includes 100 of the largest non-financial companies listed on Nasdaq, each of which has an average daily trading volume of at least 100,000 shares and a market capitalization of at least $500 million.[8] The Exchange believes that it would be extremely difficult for an investor to influence the price of the Nasdaq-100 Index in order to benefit a previously established options position.

The reporting requirements in ISE Rule 415(b) will continue to apply to QQQ options.[9] Rule 415(b) requires Electronic Access Members to report end of day positions in all non-FLEX equity options in excess of 10,000 contracts on the same side of the market. The report must specify whether such position is hedged and provide documentation as to how such position is hedged, including a description of any collateral used to carry the position. This report is required at the time the account exceeds the 10,000 contract threshold and thereafter, for customer accounts, when

[16] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

[3] Amendment No. 1 supercedes and replaces the original 19b–4 filing in its entirety.

[4] The ISE notes that in comparison, the Commission approved the total elimination of position limits for options traded on the SPX, OEX and DJX, all of which are broadbased indexes traded solely on the Chicago Board of Options Exchange (''CBOE''). Year to date the average daily trading volume of options on these three indexes is 92,814 contracts, 43,544 contracts, and 35,365 contracts respectively. Thus, daily average volume in QQQ options is more than 3.2 times that of the SPX and nearly 8.5 times that of the DJX. *See* Securities Exchange Act Release No. 41011 (Feb. 1, 1999) (Order approving elimination of position and exercise limits for XMI and XII options on a two-year pilot basis); and Securities Exchange Act Release No. 40969 (Feb. 1, 1999) (Order approving the elimination of position and exercise limits for SPX, OEX, DJX on a two-year pilot basis).

[5] *See* Securities Exchange Act Release No. 39489 (Dec. 24, 1997), 63 FR 276 (Jan. 5, 1998)

[6] *See supra* note 4.

[7] The Commission notes that the elimination of position and exercise limits for certain broad-based index options was based on many factors including the enormous capitalizations of the indexes. For example, the market capitalization of the SPX, OEX and DJX as of October 2001 was $9.81 trillion, $5.7 trillion and $3.23 trillion, respectively. *See* Securities Exchange Act Release No. 44994 (October 26, 2001), 66 FR 55722 (November 2, 2001) (permanently approving the pilot to eliminate position and exercise limits for OEX, SPX and DJX Index options). In contrast, the market capitalization of the NASDAQ 100 as of November 2001 was 1.875 trillion. The Commission further notes that options on QQQs physically settle in the underlying QQQs, which had net assets of $23,96 billion as of November 30, 2001. In contrast, index options are cash settled based on the underlying value of the index.

[8] According to information available on Bloomberg, L.P., an information company, the average daily trading volume for the Nasdaq 100 Index Tracking Stock was 66.8 million shares during the first quarter of this year, 69.8 million shares during second quarter, and 64.6 million during the third quarter.

[9] The general reporting requirement contained in ISE Rule 415(a) for customer accounts that maintain a position in excess of 200 contracts also will remain applicable for QQQ options.