SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45312; File No. SR–Amex–2001–42]

Self-Regulatory Organizations; Order Granting Accelerated Approval To Proposed Rule Change by American Stock Exchange LLC To Increase Position And Exercise Limits For Nasdaq-100 Index Tracking Stock Options

January 18, 2002.

I. Introduction

On June 27, 2001, the American Stock Exchange LLC (the ''Amex'' or ''Exchnge'') filed with the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,[1] and Rule 19b–4 thereunder,[2] a proposed rule change relating to position and exercise limits for the Nasdaq-100 Index Trading Stock (''QQQ'') options. On December 26, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.

The proposed rule change, as amended, was published for comment in the **Federal Register** on January 10, 2002.[3] To date, no comment letters have been received. This order approves the proposal, as amended, on an accelerated basis.

II. Description of Proposal

The Exchange is proposing to increase position and exercise limits for QQQ options from 75,000 contracts to 300,000 contracts on the same side of the market. The Exchange will continue to require that member organizations report all QQQ options positions exceeding 200 contracts pursuant to Exchange Rule 906. Moreover, for accounts holding positions in excess of 10,000 contracts on the same side of the market, the Exchange will also continue to require information concerning the extent to which such positions are hedged. Finally, the Exchange will add a commentary to reiterate its authority under paragraph (d)(2)(K) of Rule 462 to impose a higher margin requirement upon a member or member organization when the Exchange determines that a higher requirement is warranted.

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 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[4] in that it is designed to promote just and equitable principles of trade, 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 liquid options classes.[5]

In general, the Commission has taken a gradual, evolutionary approach toward expansion of 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.[6]

The Commission has carefully considered the Amex'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 options or underlying cash markets. Specifically, 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 depth and liquidity of both the underlying cash and options market for QQQ options lessens 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 Amex notes that the average daily trading volumes for the QQQs and QQQ options from January 1, 2001 to November 30, 2001 were 71.21 million shares and 148,181 contracts, respectively. The Amex also notes 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.[7] 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 margin and/

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 45236 (January 4, 2002), 67 FR 1378.

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

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

[6] *Id.*

[7] The Amex has noted that the QQQ is designed to closely track the performance of the Nasdaq-100 Index. According to the Amex, as of November 30, 2001, the market capitalization of the securities underlying the Nasdaq-100 Index was $1.875 trillion. In its filing, the Amex stated that the Commission should apply an analysis similar to what was used in connection with broad-based index options. 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 capitalization's 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.

or capital that a member must maintain for a large position held by itself or by its customer. Further, the Amex, under its rules, may impose additional margin on options positions if it determines that this is warranted. The Commission believes that these financial requirements are sufficient 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 will help protect against potential manipulation. Under Amex Rule 906(b), 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 is required to report certain information. 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 Amex to monitor accounts and determine whether it is necessary to impose additional margin for under-hedged position, as provided under its rules. In this regard, the Commission believes the Amex's adoption of Commentary .11 under Amex Rule 906 is appropriate and will reiterate its authority under Amex Rule 462 to require additional margin for under-hedged positions.

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.[8]

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 Amex 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 Exchange has further represented that increasing position and exercise limits from 75,000 contracts to 300,000 contracts for QQQ options will provide greater flexibility for market participants attempting to hedge their market risks. The Commission, therefore, believes for the reasons noted above that it is appropriate to approve this proposed rule change increasing the position and exercise limit 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,[9] to approve the proposal on an accelerated basis.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[10] that the proposed rule change (SR–AMEX–2001–42), as amended, is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.[11]

J. Lynn Taylor,

Assistant Secretary.

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[8] Of course, the Commission expects that Amex will take prompt action, including timely communication 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.

[9] 15 U.S.C. 78f(b)(5).

[10] 15 U.S.C. 78s(b)(2).

[11] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–45305;File No. SR–Amex–2001–108]

Self Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the American Stock Exchange LLC Relating to the Listing and Trading of Biotech-Pharmaceutical Notes

January 17, 2002.

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 December 20, 2001, the American Stock Exchange LLC (''Amex'' 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 Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The Amex proposes to list and trade notes, the return on which is based upon the Biotech-Pharmaceutical Index. The Biotech-Pharmaceutical Index is based upon the blended performance of the Amex Biotechnology index (the ''Biotech Index'') and the Amex Pharmaceutical Index (the ''Pharmaceutical Index'') (each, an ''Underlying Index'' and together, the ''Underlying Indices''), discussed more fully below. Initially, the Underlying Indices will each have a weighting of 50% of the Biotech-Pharmaceutical Index, and the Biotech-Pharmaceutical Index will be rebalanced annually to reset the weighting of the Underlying Indices to 50% each.

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 Amex 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 Amex has prepared summaries, set forth in

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

[2] 17 CFR 240.19b–4.