

exercise limits for index options.<sup>9</sup> In addition, the proposed rules provide for exemption standards from position limits and procedures for requesting exemptions from those proposed rules.<sup>10</sup> The proposed position limits and exercise limits, as well as the proposed exemptions, are different for broad-based index options and narrow-based index options.<sup>11</sup> The proposed rules establish standards for when a member seeking to sell short a Nasdaq NMS security included in an index underlying an index option listed and traded on the Exchange is exempt from the NASD short sale rule.<sup>12</sup>

### *C. Generic Listing Standards and Maintenance Standards for Narrow-Based Index Options*

The ISE further proposes to establish generic listing and maintenance standards in Proposed ISE Rule 2002 to enable the Exchange to list and trade new narrow-based index options pursuant to Rule 19b-4(e) under the Act.<sup>13</sup> Proposed ISE Rule 2002 addresses both initial listing and maintenance standards for narrow-based index options.<sup>14</sup> The generic listing and maintenance standards are modeled after standards that the Commission originally approved for streamlined listing and trading pursuant to Section 19(b)(3)(A) of the Act.<sup>15</sup> The options

exchange subsequently filed proposed rule changes with the Commission to eliminate the Section 19(b)(3)(A) rule filing requirement from their existing SRO rules, after the Commission indicated that products meeting the listing criteria approved by the Commission in its 1994 Generic Narrow-Based Index Options Approval Order qualified for filing pursuant to Rule 19b-4(e) under the Act.<sup>16</sup>

Notwithstanding the generic listing standards for options on narrow-based indexes, the Exchange will need to file additional proposed rule changes with the Commission when the Exchange identifies specific products because the rules related to trading options on indices are product specific in many areas. For purposes of this proposed rule change, certain rules indicate that they apply to "specified" indices. ISE Rules 2001(l), 2004(a), 2006(a), 2007(a), 2009, and 2011 all contain provisions that are dependant upon the Exchange identifying specific index products in the rule. Accordingly, proposed ISE Rule 2000 states that where the rules in Chapter 20 indicate that particular indices or requirements with respect to particular indices will be "Specified," the ISE shall file a proposed rule change with the Commission pursuant to section 19(b)(1) of the Act<sup>17</sup> and Rule 19b-4 thereunder<sup>18</sup> to specify such indices or requirements.

### **III. Commission Findings and Order Granting Approval of the Proposed Rule Change**

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of section 6(b)(5) of the Act<sup>19</sup> and the rules and regulations thereunder applicable to a national securities exchange.<sup>20</sup> The Commission believes that the ISE's proposal to establish trading rules and procedures applicable to index options and establish generic listing and maintenance standards for narrow-based index options strikes a reasonable

balance between the Commission's mandates under section 6(b)(5) of the Act<sup>21</sup> to remove impediments to and perfect the mechanisms of a free and open market and a national market system while protecting investors and the public interest.

#### *A. Index Options Trading Rules*

The Commission believes that trading options on an index of securities (including a narrow-based index) permits investors to participate in the price movements of the index's underlying securities and allows investors holding positions in some or all of such securities to hedge the risks associated with their portfolios. The Commission further believes that trading options on an index provides investors with an important trading and hedging mechanism that is designed to reflect accurately the overall movement of the component stocks. In making this finding the Commission notes that all of the proposed new Exchange Rules and changes to existing Exchange Rules are based on the existing rules of the other four options exchanges.<sup>22</sup>

#### *B. Generic Listing and Maintenance Standards for Narrow-Based Index Options*

In approving the generic listing and maintenance standards for narrow-based index options, the Commission considered the structure of these securities, their usefulness to investors and to the markets and the ISE rules that govern their trading. The proposal to establish generic standards for narrow-based index options should reduce the ISE's regulatory burden, as well as benefit the public interest, by enabling the ISE to bring qualifying products to the market more quickly. Furthermore, the Commission notes that it has previously approved similar proposals by the Amex, CBOE, NYSE, PSE, and the Phlx to establish generic listing and maintenance standards for narrow-based index options.<sup>23</sup>

The Commission finds that adopting generic listing and maintenance standards for these securities and applying Rule 19b-4(e) should fulfill the intended objective of that rule by allowing those index option products that satisfy the generic standards to start trading, without the need for notice and comment and Commission approval. The Exchange's ability to rely on Rule 19b-4(e) for these products potentially reduces the time frame for listing and

<sup>9</sup> See Proposed ISE Rules 2004, 2005, and 2007.

<sup>10</sup> See Proposed ISE Rule 2006.

<sup>11</sup> See Proposed ISE Rules 2004 to 2007.

<sup>12</sup> See Proposed ISE Rule 1407(d)(1)(iii).

<sup>13</sup> 17 CFR 240.19b-4(e). Rule 19b-4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization ("SRO") shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4, if the Commission has approved, pursuant to Section 19(b) of the Act, the SRO's trading rules, procedures, and listing standards for the product class that includes the new derivative securities product and the SRO has a surveillance program for the product class. When relying on Rule 19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the exchange begins trading the new derivative securities products. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

<sup>14</sup> The proposed generic listing standards approved herein do not apply to the listing of options on broad-based indices.

<sup>15</sup> In 1994, the Commission approved a proposed rule change submitted by the American Stock Exchange, Inc. ("Amex"), the Chicago Board Options Exchange, Inc. ("CBOE"), the New York Stock Exchange, Inc. ("NYSE"), the Pacific Stock Exchange, Inc. ("PSE"), and the Philadelphia Stock Exchange, Inc. ("Phlx") (collectively the "options exchanges"), which permitted the options exchanges to list and trade options on narrow-based indexes thirty days after submitting a filing pursuant to Section 19(b)(3)(A) of the Act. The Commission found that such filings would constitute a stated policy, practice, or interpretation with respect to the administration of an existing Exchange rule, pursuant to Section 19(b)(3)(A) of the Act, relieving the Exchange of the former

requirement of obtaining specific Commission approval of such narrow-based index options pursuant to Section 19(b)(2) of the Act. See Securities Exchange Act Release No. 34157 (June 3, 1994), 59 FR 30622 (June 10, 1994) (SR-Amex-92-35) (SR-CBOE-93-59) (SR-NYSE-94-17) (SR-PSE-94-07) and (SR-Phlx-94-10) (the "1994 Generic Narrow-Based Index Options Approval Order").

<sup>16</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

<sup>17</sup> See note 1 *supra*.

<sup>18</sup> See note 2 *supra*.

<sup>19</sup> 15 U.S.C. 78f(b)(5).

<sup>20</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>21</sup> See note 19 *supra*.

<sup>22</sup> See, e.g., CBOE Rules 4.11, 4.16, 6.2, 6.7, 8.7, 11.1, 15.10, and 24.1 through 24.20, PCX Rules 7.11 and 13.2, Amex Rule 905C, and Phlx Rule 1033A.

<sup>23</sup> See note 15 *supra*.