

trading these securities, and thus enhances investors' opportunities. The Exchange, however, must maintain regulatory oversight over any products listed under the generic listing standards through adequate surveillance. ISE represents that its surveillance procedures are sufficient to detect fraudulent trading among members in the trading of narrow-based index options pursuant to the generic listing and maintenance standards. The Commission believes that these surveillance procedures are adequate to address concerns associated with listing and trading of the narrow-based index options.

The Commission believes that the listing and maintenance standards set forth herein are consistent with the listing and maintenance standards for narrow-based index options that the Amex, CBOE, PCX and the Phlx have developed and are reasonably designed to ensure the protection of investors and the public interest. Specifically, the Commission finds that the generic standards covering minimum capitalization, monthly trading volume, and relative weightings of component stocks are designed to ensure that the trading markets for component stocks are adequately capitalized and sufficiently liquid, and that no one stock or stock group dominates the index. Thus, the Commission believes that the satisfaction of these requirements significantly minimizes the potential for manipulation of the index.

Two other important requirements included in the proposal are that at least 90 percent of the component securities, by weight, and 80 percent of the total number of component securities, must be eligible individually for options trading, and that no more than 20 percent of the weight of the index may be comprised of ADRs that are not subject to a comprehensive surveillance sharing agreement. The Commission believes that these standards are necessary to ensure that index options are not used as surrogate instruments to trade options on stocks and/or ADRs that otherwise are not eligible for options trading.

The Commission also believes that the number of securities required to constitute the narrow-based index is large enough to ensure that an index is not created for the purpose of obtaining more favorable regulatory treatment, e.g., with respect to position and exercise limits, as compared with the trading of options in the underlying stocks.

The Commission also finds the requirements that all securities comprising the index be "reported

securities," as defined in Rule 11Aa3-1 under the Act,²⁴ and that the index value be disseminated at least once every 15 seconds during trading hours of the index, will contribute significantly to the transparency of the market for such index options. The Commission further believes that basing the settlement value of expiring index options upon the opening prices of the component securities on the primary market on which they are listed and traded may help contain the volatility of related markets upon their expiration.

The Commission further notes that ISE's rules that are applicable to narrow-based index options, including provisions addressing sales practices, floor trading procedures, position and exercise limits, margin requirements, and trading halts and suspensions, will continue to apply to any narrow-based index listed pursuant Rule 19b-4(e) under the Act.

The Commission believes that a surveillance sharing agreement between an Exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. The Commission believes that such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation. When a new derivative securities product based upon domestic securities is listed and traded on an exchange pursuant to Rule 19b-4(e) under the Act, the exchange should determine that the markets upon which all of the U.S. component securities trade are members of the Intermarket Surveillance Group ("ISG"),²⁵ which provides information relevant to the surveillance of the trading of securities on other market centers.²⁶ In this regard, all of the registered national securities exchanges, including the ISE, as well as the National Association of Securities Dealers, Inc. ("NASD"), are members of the ISG.

For new derivative securities products based on securities from a foreign market, the SRO should have a comprehensive Intermarket Surveillance Agreement with the market for the securities underlying the new securities

product.²⁷ Accordingly, the Commission finds that the requirement that no more than 20 percent of the weight of the index may be comprised of ADRs that are not subject to a comprehensive surveillance sharing agreement between the particular U.S. exchange and the primary market of the underlying security will continue to ensure that the Exchanges have the ability to adequately surveil trading in the narrow-based index options and the ADR components of the index.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,²⁸ that the proposed rule change, as amended, (File No. SR-ISE-2003-05) be, and it hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁹

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 03-22236 Filed 8-29-03; 8:45 am]

BILLING CODE 8010-01-P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48407; File No. SR-NASD-00-08]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 by the National Association of Securities Dealers, Inc. Relating to Margin Requirements

August 25, 2003.

I. Introduction

On March 3, 2000, the National Association of Securities Dealers, Inc. ("NASD") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")¹ and Rule 19b-4 thereunder,² a proposal to amend NASD Rule 2520, "Margin Requirements." The NASD's proposal was published for comment in the **Federal Register** on May 26, 2000.³ The Commission received one comment

²⁴ 17 CFR 240.11Aa3-1.

²⁵ ISG was formed on July 14, 1983, to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets.

²⁶ See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98).

²⁷ *Id.*

²⁸ 15 U.S.C. 78s(b)(2).

²⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 42801 (May 19, 2000), 65 FR 34240 ("2000 Release").