

statements may be examined at the places specified in Item IV below. The PHLX 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 purpose of the proposed rule change is to list for trading cash-settled, European-style Full-Size Index Options, Mini Index Options, FLEX Index Options, and Mini FLEX Index Options on the Nasdaq Composite Index. The PHLX believes that the Index Options should provide an important hedging vehicle for traders who engage in trading securities that comprise the Index. The following is a more detailed description of the Index and the proposed Index Options.

Composition of the Index

The Index is a capitalization-weighted index designed to measure the performance of stocks listed and traded on Nasdaq. The Index includes both Nasdaq National Market issues and Nasdaq SmallCap Market issues. As described more fully below, the Index is comprised of all of the securities traded on Nasdaq that are not otherwise excluded on the basis of their security type.

The inclusion of a Nasdaq National Market security or Nasdaq SmallCap Market security in the Index is determined by the type of security. Issues included in the Index include domestic or foreign common stocks, ordinary shares, American Depositary Receipts, shares of beneficial interest, real estate investment trust securities, and tracking stocks<sup>5</sup> (collectively, "Common-Type Securities"). Issues not included in the Index are convertible debentures, preferred stocks, rights, warrants, units, closed-end funds, exchange-traded funds ("ETFs"), and other derivative securities.

Index-eligible securities are added to the Index on the business day immediately after a last sale is established. If at any time a component security is no longer traded on Nasdaq or no longer meets the security-type eligibility criteria, the security is removed from the Index. The Index is

updated on a daily basis and there is no periodic rebalancing of Index components.

As of July 31, 2003, the capitalization of the Index's 3,408 components ranged from \$284 billion to \$55,000,<sup>6</sup> and the market capitalization of the Index totaled \$2.6 trillion. The largest Index component accounted for 11.12% of the weight of the Index and the smallest component accounted for less than 1% of the weight of the Index. The median capitalization of the Index's components was \$110 million.

A total of ten industry groups are represented in the Index. The top five industry groups and their weights in the Index are: (1) Computer software and hardware, 52%; (2) healthcare, 14%; (3) financials, 11%; (4) consumer discretionary, 8%; and (5) telecommunications and media, 6%. During the period from January 1, 2003, through July 31, 2003, the average daily trading volume for the component stocks representing 95% of the weight of the Index was 850,000 shares, and the average daily volume for all of the Index's component stocks was 485,000 shares. The top 100 stocks accounted for 64% of the weight of the Index and the bottom 100 stocks accounted for 0.01% of the weight of the Index. The prices of the Index's components ranged from \$0.11 per share to \$780.00 per share. The average share price was \$14.15. The shares outstanding for each of the Index's component stocks ranged from 10,000 shares to 11 billion shares, with an average of 43 million shares outstanding. Options-eligible stocks represented 95% of the weight of the Index.

The Index includes most of the stocks listed and traded on the Nasdaq SmallCap Market, except those issues excluded based on security type. Nasdaq SmallCap Market stocks are "eligible securities" within the meaning of the Joint Self-Regulatory Organization Plan Governing the Collection, Consolidation and Dissemination of Quotation and Transaction Information for Nasdaq-Listed Securities Traded on Exchanges on an Unlisted Trading Privilege Basis ("Nasdaq UTP Plan" or "Plan").<sup>7</sup> Because Nasdaq SmallCap

<sup>6</sup> For companies that list American Depositary Shares, these values represent only the value of the outstanding American Depositary Shares and not the global market capitalization of the issuer, which is the basis for listing on Nasdaq. Nasdaq's minimum listing and maintenance standard for global market capitalization is \$50 million.

<sup>7</sup> The Nasdaq UTP Plan initially was approved in 1990. See Securities Exchange Act Release No. 28146 (June 26, 1990), 55 FR 27919 (July 6, 1990). The Plan was amended in 2001 to include Nasdaq SmallCap Market stocks. See Securities Exchange Act Release 45081 (November 19, 2001), 66 FR

Market securities are "reported securities" for purposes of Rule 11Aa3-1 under the Act,<sup>8</sup> the PHLX and Nasdaq believe that they may be included in the Index for purposes of index option trading.<sup>9</sup> According to the PHLX, Nasdaq SmallCap Market securities are subject to stronger quantitative listing standards, stronger governance criteria, and stronger initial listing standards than those that were in place prior to 1997, and Nasdaq SmallCap Market securities therefore should qualify as forming part of the basis for cash-settled Index Options. Further, the PHLX maintains that the listing requirements of the Nasdaq SmallCap Market are more stringent than those of the Amex. The PHLX also notes that Nasdaq SmallCap Market stocks comprise only 1.3% of the capitalization of the Index.

Calculation of the Index

As noted above, the Index is a market capitalization-weighted index comprised of all Common-Type Securities listed on Nasdaq. The value of the Index equals the aggregate value of the Total Shares Outstanding ("TSO") of each Index component security multiplied by each security's respective price on Nasdaq, divided by the Adjusted Base Period Market Value ("ABPMV"), and multiplied by the Base Value. The ABPMV scales the Index's aggregate value (otherwise in trillions)

49273 (November 27, 2001). The Plan governs the collection, processing, and dissemination on a consolidated basis of quotation and last sale information for each of its participants (the Cincinnati Stock Exchange, Inc., the National Association of Securities Dealers, Inc., the American Stock Exchange LLC ("Amex"), the Boston Stock Exchange, Inc., the Chicago Stock Exchange, Inc., the Pacific Exchange, Inc., and the PHLX). The consolidated information informs investors of the current quotation and recent trade prices of Nasdaq securities. It enables investors to ascertain from one data source the current prices in all the markets trading Nasdaq securities. The Plan serves as the required transaction reporting plan for its participants, which is a prerequisite for their trading Nasdaq securities.

<sup>8</sup> See 17 CFR 240.11Aa3-1.

<sup>9</sup> A "reported security" is defined in Rule 11Aa3-1(a)(4) under the Act as "any listed equity security or Nasdaq security for which transaction reports are required to be made on a real-time basis pursuant to an effective transaction reporting plan." An "effective transaction reporting plan" is defined in Rule 11Aa3-1(a)(3) under the Act as a transaction reporting plan approved by the Commission under Rule 11Aa3-1 under the Act. A "transaction reporting plan" is defined in Rule 11Aa3-1(a)(2) under the Act as "any plan for collecting, processing, making available or disseminating transaction reports with respect to transactions in reported securities filed with the Commission pursuant to, and meeting the requirements of, this section." With the extension of the Nasdaq UTP Plan to include Nasdaq SmallCap Market securities, Nasdaq SmallCap Market securities became securities reported pursuant to an effective transaction reporting plan approved by the Commission.

<sup>5</sup> Tracking stocks are publicly traded securities issued by a parent company to monitor or "track" the underlying performance and/or earnings potential of a subsidiary. Tracking stocks allow the parent company to maintain control over the tracked unit while permitting investors to value the unit as a separate entity.