

to a lower order of magnitude, which is more desirable for Index reporting purposes.

The Index Value calculation can be summarized as follows: (Aggregate Market Value/ABPMV) × Base Value.

The Index began on February 5, 1971, at a Base Value of 100.00.

Each Index component's influence on the value of the Index is directly proportional to the value of its Index share weight.

The Index is disseminated every 15 seconds through the Nasdaq Index Dissemination ServicesSM ("NIDS") during normal Nasdaq trading hours (9:30 A.M. to 4:00 P.M. ET). NIDS is a Nasdaq data feed carrying intra-day index values and valuation data for ETFs listed on Nasdaq. The NIDS data feed is carried by all major market data vendors.

The Index is calculated using Nasdaq prices (not consolidated) during the day and the Nasdaq Official Closing Price ("NOCP") for the close.¹⁰ The NOCP is based on the price of the last unmodified trade reported to Nasdaq's Automated Confirmation Transaction ServiceSM at or before 4:00:02 P.M. ET (the "Predicate Trade"). Nasdaq systems will "normalize" the price of the Predicate Trade by comparing it to Nasdaq's best bid and offer prices ("BBO") (i.e., the best prices displayed by all SuperMontage participants) at the time the Predicate Trade was reported, or by comparing it to the Nasdaq BBO at 4:00:00 P.M. ET for trades reported after that time (the "Predicate BBO"). Subject to review by Nasdaq Market Watch, if the price of the Predicate Trade falls at or within the Predicate BBO, that price becomes the NOCP. If the price of the Predicate Trade falls outside the Predicate BBO, Nasdaq will adjust it up to the Predicate BBO bid if it is below the bid price or adjust it down to the Predicate BBO ask if it is above the ask price. The NOCP methodology will only impact the individual market close for the Nasdaq; it will not impact the consolidated close or individual market closes of the UTP exchanges. The PHLX notes that the NOCP should not be confused with the consolidated last sale price, which is comprised of the final last sale eligible trade report submitted to the securities information processor during the regular trading session by any market center, including Nasdaq.

Although the Index is calculated until 4:00 P.M. ET, the Index's closing value

may change up until 5:15 P.M. ET due to changes or corrections to the last sale in the Index's component securities.

Maintenance

Nasdaq will maintain the Index, and the PHLX represents that it will not influence any Nasdaq decisions concerning maintenance of the Index.

Changes in the number of shares outstanding driven by corporate events such as stock dividends, splits, and certain spin-offs and rights issuances will be adjusted on the ex-date. A change in the TSO arising from other corporate actions including secondary offerings, stock repurchases, conversions, and acquisitions is ordinarily made to the Index on the evening prior to the effective date of the corporate action or as soon as practicable thereafter. Changes are made after the market close and are reflected on <http://www.nasdaqtrader.com/asp/nasdaqcomp.asp> the following morning.

Index-eligible security additions to Nasdaq (either an initial public offering or a seasoned security) will be included in the Index once there is a Nasdaq last sale established (usually day two of listing on Nasdaq). As stated above, if at any time a component security is no longer traded on Nasdaq or no longer meets the eligibility criteria, the security is removed from the Index.

Ordinarily, whenever there is a change in a component security's TSO, a component addition or deletion, or changes due to certain spin-offs and rights offerings, Nasdaq adjusts the ABPMV to ensure that there is no discontinuity in the value of the Index.

The ABPMV can be determined as follows: (Market Value after Adjustments/Market Value before Adjustments) × ABPMV before Adjustments.

Although the PHLX is not involved in the maintenance of the Index, it has represented that it will monitor the Index on a semi-annual basis and will notify Commission staff if and when: (1) 10% of the capitalization of the Index comprises securities with a market capitalization of less than \$100 million; or (2) when 10% of the capitalization of the Index is made up of components with an average daily trading volume of less than 10,000 shares over the previous six months. As of July 31, 2003, 2.56% of the capitalization of the Index was made up of securities with a market capitalization of less than \$100 million, and 2.19% of the capitalization of the Index was made up of components with an average daily trading volume of less than 10,000 shares over the previous six months.

Index Option Trading

As noted above, the Exchange proposes to trade Full-Size Index Options, Mini Index Options, FLEX Index Options, and Mini FLEX Index Options. The contract multiplier for Full-Size Index Options will be \$100 and the contract multiplier for Mini Index Options will be \$10. Each contract will trade under separate ticker symbols and will not be fungible with the other. The size of the underlying Index will remain the same for each contract (i.e., Mini Index Options will not overlie a separate Index calculation reduced by 1/10th), and therefore the Exchange will list similar strikes for each and the settlement value will be uniform for each.

According to the PHLX, the proposed Mini FLEX Index Options are designed to provide small institutional and high net-worth customers with the ability to tailor their notional value exposure with a greater degree of precision than would be available with Full-Size Index Options. For example, the PHLX notes that the minimum opening transaction for FLEX index options is \$10 million. At an index level of 1900 points, this would represent 53 full-size FLEX Index options and 527 Mini-FLEX index options. For the full-size FLEX index option, each additional contract would increase the notional exposure by \$190,000, which is nearly 2% of the notional value of the opening position, while each additional Mini-FLEX index option contract increases the notional exposure by \$19,000. The PHLX notes that for customers who have specific investment objectives with acceptable margins of error of less than \$190,000, or 2%, the Mini-FLEX index option would represent the preferred product.

The Exchange will list strike prices in \$.00 intervals for Index Options. The minimum tick size for series quoted below \$3.00 (i.e., \$300 in premium after factoring in the \$100 contract multiplier for Full-Size Index Options and \$30 in premium after factoring in the \$10 contract multiplier for Mini Index Options) will be \$.05 (i.e., \$5.00 for Full-Size Index Options, and \$.50 for Mini Index Options), and for series quoted above \$3.00 the minimum tick size will be \$.10 (i.e., \$10.00 for Full-Size Index Options and \$1.00 for Mini Index Options). The trading hours for Index Options will be from 9:30 A.M. to 4:15 P.M. ET.

The PHLX represents that the Options Price Reporting Authority ("OPRA") has informed the Exchange that trading in Index Options will have a minimal

¹⁰ See Securities Exchange Act Release No. 47517 (March 18, 2003), 68 FR 14446 (March 25, 2003) (File No. SR-NASD-2002-158) (approving the establishment of the NOCP).