

submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File No. SR-CBOE-2004-61 and should be submitted on or before October 26, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. E4-2491 Filed 10-4-04; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50403A; File No. SR-NASD-2004-110]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by National Association of Securities Dealers, Inc. Relating to Divestiture of American Stock Exchange; Correction

September 29, 2004.

In FR Doc. E4-2354, issued on September 23, 2004,<sup>1</sup> the Commission notes that the proposed rule text in subsection (cc) on page 57120, column 3 should state as follows below.

Proposed new language is in italics; proposed deletions are in brackets.

“(cc) “Non-Industry Governor” or “Non-Industry committee member” means a Governor (excluding the Chief Executive Officer and any other officer of the NASD, the President of NASD Regulation), any Floor Governor, and the Chief Executive Officer of Amex)] or committee member who is: (1) A Public Governor or committee member; (2) an officer or employee of an issuer of securities listed on [Nasdaq or Amex, or] *a market for which NASD provides regulation*; (3) *an officer or employee of an issuer of unlisted securities that are traded in the over-the-counter market*; or ([3]4) any other individual who would not be an Industry Governor or committee member;”

In the corresponding paragraph describing the proposed rule text, appearing on page 57124, beginning in column 1, the first, second and third complete sentences in column 2 should read as follows:

“Under the proposed amendments, the “Industry Governor” definition will include persons with a consulting or employment relationship with “a market for which NASD provides regulation,” a term that embraces both

markets with which NASD has entered a contract to provide regulatory services, and those in which NASD has an ownership interest. Because NASD has entered into a regulatory services agreement with Amex, and continues both to maintain an ownership interest in and to provide regulatory services to Nasdaq, the amended definition of “Industry Governor” will continue to encompass individuals who have a consulting or employment relationship with Amex or Nasdaq. NASD believes that, given the difficulty and expense involved in amending the NASD By-Laws when regulatory clients are added or deleted, substituting “a market for which NASD provides regulation” is preferable to identifying such clients by name in the By-Laws.”

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>2</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

[FR Doc. E4-2487 Filed 10-4-04; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50468; File No. SR-NASD-2004-144]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change by the National Association of Securities Dealers, Inc., Relating to the Listing and Trading of Theravance, Inc., Common Stock

September 29, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on September 24, 2004, the National Association of Securities Dealers, Inc. (“NASD” or “Association”), through its subsidiary, The Nasdaq Stock Market, Inc. (“Nasdaq”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by Nasdaq. The Commission is publishing this notice and order to solicit comments on the proposed rule change from interested persons and to grant accelerated approval to the proposed rule change.

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

Nasdaq proposes to list and trade the common stock (“Common Stock”) of Theravance, Inc. (“Theravance”). The Common Stock includes call and put rights.

### II. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq 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. Nasdaq 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

Nasdaq proposes to list and trade the Common Stock under the NASD rules that generally apply to the listing, designation for the Nasdaq National Market, and trading of the first class of common stock.<sup>3</sup> As described more fully below, the Common Stock currently includes an unusual feature, call and put rights. Nasdaq believes that the call and put rights make it desirable to apply certain additional requirements in connection with the listing of the Common Stock. Pursuant to its authority under NASD Rule 4300, “Qualification Requirements for Nasdaq Stock Market Securities,” to apply additional or more stringent criteria for the initial or continued inclusion of particular securities, Nasdaq proposes to apply to the Common Stock certain requirements of NASD Rule 4420(f), “Other Securities,” in addition to all of the other requirements normally applicable to common stock. Under NASD Rule 4420(f), Nasdaq may approve for listing and trading innovative securities that cannot be readily categorized under traditional listing guidelines.<sup>4</sup>

Theravance has entered into an agreement with GlaxoSmithKline

<sup>3</sup> See the 4300 and 4400 series of the NASD’s rules.

<sup>4</sup> See Securities Exchange Act Release No. 32988 (September 29, 1993); 58 FR 52124 (October 6, 1993) (File No. SR-NASD-93-15) (order approving listing standards for hybrid securities products) (“1993 Order”).

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> See Exchange Act Release No. 50403 (September 16, 2004), 69 FR 57119.

<sup>2</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> U.S.C. 78s(b)(1).

<sup>17</sup> 17 CFR 240.19b-4.

("GSK"), whereby GSK has the right to require Theravance to redeem 50% of the Common Stock held by each holder of Common Stock. Upon notice of such a redemption, each stockholder will automatically be deemed to have submitted for redemption 50% of the Common Stock held by the stockholder at \$54.25 per share. This right is referred to as the "call." If GSK does not exercise this right, each holder of Common Stock has the right in August 2007 to require Theravance to redeem up to 50% of the holder's Common Stock at \$19.375 per share. This right is referred to as the "put." In either case, GSK is contractually obligated to pay Theravance the funds necessary to redeem the shares of Common Stock from Theravance's stockholders. However, GSK's maximum obligation for the shares of Common Stock subject to the put is \$525 million.

As described in the registration statement filed by Theravance,<sup>5</sup> if GSK elects to exercise its call right, it must provide written notice to Theravance between June 1, 2007, and July 1, 2007, and must provide adequate funds in cash to pay the aggregate redemption price of the shares of Common Stock to be called. GSK must specify the date that the call will occur, which must be no later than July 31, 2007. Upon receipt of notice from GSK to effect the call, Theravance must provide notice by mail of the proposed call to holders of record of Common Stock between ten and 30 days prior to the call date specified by GSK.

If GSK does not exercise its call right, each holder of Common Stock may exercise the put right described above during the period beginning on August 1, 2007, and ending on the 30th business day thereafter or as may be required under the Act or under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("Hart-Scott-Rodino Act").<sup>6</sup>

As set forth in the registration statement,<sup>7</sup> prior to the expiration of the put period, the existence of the put right will likely be influential in determining the market price at which the Common Stock will trade. However, the market price of the Common Stock is not guaranteed and may be adversely affected in the event that the ability of Common Stock holders to exercise the put right or to receive proceeds upon exercise of the call right is impaired or diminished. After the expiration of the put period, the market price of the Common Stock, to the extent still

outstanding, may decline significantly. Although shareholders are granted the option to exercise their put rights of Common Stock during the period described above, provided that GSK has opted not to exercise its call right, there are no price protections after that period.

After September 1, 2012, GSK will have no restrictions on its ability to sell or transfer the Common Stock in the open market, in privately negotiated transactions or otherwise, and these sales or transfers could create a substantial decline in the price of the outstanding shares of Common Stock or, if these sales or transfers are made to a single buyer or group of buyers, could transfer control of the Common Stock to a third party.

In addition, the existence of the call right may limit the Common Stock from trading much above the call price of \$54.25 per share even if Theravance's future growth and/or market conditions were to otherwise warrant a per share valuation in excess of that price. If the call right is exercised, the holders of Common Stock would participate in this increased valuation only to the extent of the \$54.25 per share Common Stock redemption price for 50% of their shares.

Upon the occurrence of a triggering event (an insolvency event as described in the registration statement), the right of Theravance's shareholders to exercise the put with respect to 50% of their Common Stock will accelerate and commence immediately and continue for the 65 business days after such event or until a later date as required under the Act or under the Hart-Scott-Rodino Act. In the event the put notification is accelerated due to an insolvency event, GSK remains obligated to provide Theravance the funds necessary to effect the redemption of all shares of the Common Stock that are properly put or elect and arrange to purchase the Common Stock at the expiration of the period in which the put can be exercised, in compliance with applicable law.<sup>8</sup>

In addition to all of the requirements normally applicable under Nasdaq rules to the listing and trading of common stock, the Common Stock initially will be made subject to certain additional listing criteria, which are essentially the listing criteria for "other securities" under NASD Rule 4420(f). Specifically, under NASD Rule 4420(f)(1):

(A) The issuer shall have assets in excess of \$100 million and stockholders' equity of at least \$10 million. In the case of an issuer which is unable to satisfy the income criteria set forth in paragraph (a)(1), Nasdaq generally will require the issuer to have the following:

(i) assets in excess of \$200 million and stockholders' equity of at least \$10 million; or (ii) assets in excess of \$100 million and stockholders' equity of at least \$20 million;

(B) There must be a minimum of 400 holders of the security, provided, however, that if the instrument is traded in \$1,000 denominations, there must be a minimum of 100 holders;

(C) For equity securities designated pursuant to this paragraph, there must be a minimum public distribution of 1,000,000 trading units; and

(D) The aggregate market value/principal amount of the security will be at least \$4 million.

As envisioned in NASD Rule 4420(f)(3), prior to the commencement of trading of the Common Stock, Nasdaq will distribute a circular to members providing guidance regarding the features of the Common Stock and members' responsibilities, including suitability recommendations, when handling transactions and highlighting the characteristics and risks of the Common Stock. In particular, Nasdaq will inform members that customer confirmations involving the Common Stock should identify the security as a callable and puttable instrument and that a customer may contact the member for more information concerning the security.<sup>9</sup>

Furthermore, given the put and call features of the Common Stock, the circular will indicate that Nasdaq suggests that transactions in the Common Stock be recommended only to investors whose accounts have been approved for options trading. If a customer has not been approved for options trading, or does not wish to open an options account, the member should ascertain whether the Common Stock is suitable for the customer. Pursuant to NASD Rule 2310, "Recommendations to Customers (Suitability)," and IM-2310-2, "Fair Dealing with Customers," members must have reasonable grounds for believing that a recommendation to a customer regarding the purchase, sale or exchange of any security is suitable for such customer upon the basis of the facts, if any, disclosed by such customer as to his other security holdings and as to his financial situation and needs. In addition, members recommending a transaction in the Common Stock must, among other things, have a reasonable basis for believing that the customer can

<sup>8</sup> Nasdaq clarified two minor typographical errors in this sentence. Telephone conversation between Alex Kogan, Associate General Counsel, Nasdaq, and Yvonne Fraticelli, Special Counsel, Office of Market Supervision, Division of Market Regulation, Commission, on September 28, 2004.

<sup>5</sup> See File No. 333-116384.

<sup>6</sup> 15 U.S.C. 18a.

<sup>7</sup> See note 5, supra.

<sup>9</sup> See IM-2110-6, "Confirmation of Callable Common Stock."

evaluate the special characteristics of, and is able to bear the financial risks of, such transaction.

The circular will identify the following specific risks associated with the Common Stock. The circular will note that members should inform their customers that the price at which the Common Stock will trade may be influenced, prior to the expiration of the put period, by the existence of the put right. The circular will also note that the final rate of return on the Common Stock may be less than the market price of the Common Stock, and that after the expiration of the put period the market price of the Common Stock may decline significantly. Furthermore, customers should be aware that after September 1, 2012, GSK will have no restrictions on its ability to sell or transfer the Common Stock in the open market, in privately negotiated transactions or otherwise, and that these sales or transfers could create a substantial decline in the price of the outstanding shares of the Common Stock or, if these sales or transfers were made to a single buyer or group of buyers, could transfer control of the Common Stock to a third party.

The Common Stock will be subject to all of the initial and continued listing requirements otherwise applicable to the first class of common stock designated for the Nasdaq National Market under NASD Rule 4420(a), (b) or (c), including, but not limited to, all otherwise applicable corporate governance requirements.<sup>10</sup> The Common Stock will be subject to all applicable fees set forth in NASD Rule 4310, "Qualification Requirements for Domestic and Canadian Securities."<sup>11</sup> Nasdaq will rely on its current surveillance procedures governing equity securities, and it represents that its surveillance procedures are adequate to properly monitor the trading of the Common Stock.

## 2. Statutory Basis

Nasdaq believes the proposal is consistent with the provisions of Section 15A of the Act,<sup>12</sup> in general, and with Section 15A(b)(6) of the Act,<sup>13</sup> in particular, in that the proposal is designed to prevent fraudulent and manipulative acts and practices, to

promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest. Nasdaq believes that the callable and puttable feature of the Common Stock justify the additional listing requirements described in the proposal, and that investors will benefit from the application of the requirements.

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

Nasdaq does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

### *C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others*

No written comments were solicited or received.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-NASD-2004-144 on the subject line.

### *Paper Comments*

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-NASD-2004-144. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than

those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the NASD. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-NASD-2004-144 and should be submitted on or before October 26, 2004.

## IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

Nasdaq has asked the Commission to approve the proposal on an accelerated basis to enable Nasdaq to accommodate the timetable for listing the Common Stock. In addition, Nasdaq believes that the proposal raises no new or novel issues. In this regard, Nasdaq notes that a national securities exchange previously has listed and traded callable puttable common stock.<sup>14</sup> Nasdaq also states that it previously has listed callable puttable common stock and callable common stock.<sup>15</sup>

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 association and, in particular, with the requirements of Section 15A(b)(6) of the Act<sup>16</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market

<sup>14</sup> According to Nasdaq, Genentech, Inc. callable puttable common stock was listed on the New York Stock Exchange, Inc. ("NYSE") from October 1995 through July 2000.

<sup>15</sup> According to Nasdaq, Dreyer's Grand Ice Cream Holding, Inc. callable puttable common stock was listed on Nasdaq in February 2003; Genomic Solutions callable common stock was listed on Nasdaq in May 2000; Spiros Development Company, Inc. units, consisting of one warrant and one share of callable common stock, were listed on Nasdaq in December 1997; Aramed, Inc. units, consisting of one warrant and one share of callable common stock, were listed on Nasdaq from October 1993 through November 1995; SciGenics, Inc. units, consisting of one warrant and one share of callable common stock, were listed on Nasdaq from September 1991 through December 1995; and Neozyme Corporation units, consisting of one warrant and one share of callable common stock, were listed on Nasdaq from January 1991 through December 1993. In addition, AT&T Canada, Inc. callable Deposit Receipts were listed on Nasdaq in June 1999.

<sup>16</sup> 15 U.S.C. 78o-3(b)(6).

<sup>10</sup> Pursuant to Rule 10A-3 under the Act, 17 CFR 240.10A-3, and Section 3 of the Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (2002), Nasdaq will prohibit the initial or continued listing of any security of an issuer that is not in compliance with the requirements set forth therein.

<sup>11</sup> Because the Common Stock is not being designated under NASD Rule 4420(f), it will not be subject to the fee schedule for "other securities" contained in NASD Rule 4530, "Other Securities."

<sup>12</sup> 15 U.S.C. 78o-3.

<sup>13</sup> 15 U.S.C. 78o-3(b)(6).

and a national market system and, in general, to protect investors and the public interest.<sup>17</sup>

The Commission notes that the Common Stock has both call and put features. In particular, as described more fully above, GSK has the right to require Theravance to redeem 50% of the Common Stock held by each stockholder at \$54.25 per share. If GSK elects to exercise its call right, it must provide written notice of its election to Theravance between June 1, 2007, and July 1, 2007, and the call must occur no later than July 31, 2007. If GSK declines to exercise its call right, each holder of Common Stock has the right to require Theravance to redeem up to 50% of the holder's Common Stock at \$19.375 per share. Upon the occurrence of an insolvency event, as described in the registration statement filed by Theravance,<sup>18</sup> the put rights of the holders of Common Stock will accelerate and commence immediately.

The listing and trading of a non-traditional equity security like the Common Stock raises several regulatory issues. For the reasons discussed below, the Commission believes that Nasdaq's proposal adequately addresses the concerns raised by the listing and trading of the Common Stock.

As noted above, in addition to being subject to the Nasdaq rules applicable to the initial and continued listing and trading of common stock, the Common Stock initially also will be subject to certain listing criteria applicable to "other securities" under NASD Rule 4420(f). The Commission notes that the protections of NASD Rule 4420(f) were designed to address the concerns attendant to the trading of innovative securities like the Common Stock.<sup>19</sup> By imposing the listing criteria and compliance requirements described above, as well as heightened suitability for recommendations,<sup>20</sup> the Commission believes that Nasdaq has adequately addressed the potential issues that

could arise from the listing and trading of the Common Stock.

The Commission notes that Nasdaq will distribute a circular to its members that provides guidance regarding members' compliance responsibilities and requirements, including heightened suitability recommendations, when handling transactions in callable puttable common stock, and that highlights the special risks and characteristics associated with the Common Stock. Specifically, among other things, the circular will inform members that customer confirmations involving the Common Stock should identify the security as a callable and puttable instrument and that a customer may contact the member for more information concerning the security.

Nasdaq represents that the circular also will indicate that, given the put and call features of the Common Stock, Nasdaq will suggest that transactions in the Common Stock be recommended only to investors whose accounts have been approved for options trading. Nasdaq further represents that, if a customer has not been approved for options trading, or does not wish to open an options account, the member should ascertain whether the Common Stock is suitable for the customer pursuant to NASD Rule 2310 and IM-2310-2. The Commission believes that the distribution of the circular should help to ensure that only customers with an understanding of the risks attendant to the trading of the Common Stock and who are able to bear the financial risks associated with transactions in the Common Stock will acquire and trade the Common Stock.

As noted above, Nasdaq represents that the circular will identify certain specific risks associated with the Common Stock. Specifically, the circular will note that members should inform their customers that the price at which the Common Stock will trade may be influenced by the existence of the put right prior to the expiration of the put period. The circular also will note that the final rate of return on the Common Stock may be less than the market price of the Common Stock, and that after the expiration of the put period the market price of the Common Stock may decline significantly. In addition, customers should be aware that after September 1, 2012, GSK will have no restrictions on its ability to sell or transfer the Common Stock in the open market, in privately negotiated transactions or otherwise, and that these sales or transfers could create a substantial decline in the price of the outstanding shares of the Common Stock or, if these sales or transfers are

made to a single buyer or group of buyers, could transfer control of the Common Stock to a third party.

The Commission believes that, to some extent, the financial risks associated with the Common Stock could be minimized by the proposed listing criteria. In this regard, the Commission notes that in addition to satisfying the initial and continued listing requirements for the first class of common stock designated for the Nasdaq National Market under NASD Rule 4420(a), (b), or (c), including all otherwise applicable corporate governance requirements, the Common Stock also must meet the additional initial asset, equity, and distribution requirements described above.

The Commission notes that Nasdaq intends to rely on its current surveillance procedures governing equity securities to monitor trading in the Common Stock. Nasdaq represents that its surveillance procedures are adequate to properly monitor the trading of the Common Stock.

The Commission finds good cause for approving the proposal prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission believes that approving the proposal on an accelerated basis will accommodate the proposed timetable for listing the Common Stock. In addition, as described more fully above, the Commission notes that common stock with put and call features has been listed and traded on the NYSE and Nasdaq, and that the compliance and suitability requirements for the Common Stock are similar to those that Nasdaq adopted previously for a common stock with put and call features.<sup>21</sup> Accordingly, the Commission believes that good cause exists, consistent with Sections 15A(b)(6) and 19(b)(2) of the Act,<sup>22</sup> to approve the proposal on an accelerated basis.

## V. Conclusion

For the foregoing reasons, the Commission finds that the proposal is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>23</sup> that the proposed rule change (SR-NASD-2004-144) is approved on an accelerated basis.

<sup>17</sup> In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>18</sup> See note 5, *supra*.

<sup>19</sup> See 1993 Order, *supra* note 4. See also Securities Exchange Act Release No. 47350 (February 11, 2003), 68 FR 8061 (February 19, 2003) (File No. SR-NASD-2003-16) (order approving the listing standards applicable to Dreyer's Grand Ice Cream Holdings, Inc. callable puttable common stock) ("2003 Order").

<sup>20</sup> As discussed above, Nasdaq will advise members and employees thereof recommending a transaction in the Common Stock to: (1) determine that the transaction is suitable for the customer; and (2) have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of, the transaction.

<sup>21</sup> See 2003 Order, *supra* note 19.

<sup>22</sup> 15 U.S.C. 78o-3(b)(6) and 78s(b)(2).

<sup>23</sup> 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>24</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50466; File No. SR-OCC-2004-11]

### Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of a Proposed Rule Change Relating to Yield-Based Treasury Options

September 29, 2004.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on June 8, 2004, The Options Clearing Corporation ("OCC") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would update two sections of OCC's By-Laws pertaining to yield-based Treasury options. The proposed changes would conform those sections to the corresponding By-Law provisions governing index options.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, OCC 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 IV below. OCC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of such statements.<sup>2</sup>

#### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

Article XVI, Section 3(c) of OCC's By-Laws currently provides OCC with the authority to adjust outstanding options in a class of yield-based Treasury options in the event that an exchange decreases the multiplier. The proposed changes to Section 3(c) would simply provide for the possibility that an exchange might increase rather than decrease the multiplier and would grant OCC the flexibility to adjust any outstanding options accordingly. The proposed rule change is similar to a previously approved OCC rule change pertaining to the adjustment of index option contracts.<sup>3</sup>

Article XVI, Section 4 of OCC's By-Laws currently provides OCC with the authority to fix the exercise settlement amount for exercised yield-based Treasury option contracts "in accordance with the best information available as to the correct settlement value of the underlying yield" if OCC determines that the settlement value of the underlying yield is unreported or otherwise unavailable for purposes of calculating the settlement amount for exercised contracts. Until recently, the Chicago Board Options Exchange ("CBOE"), on which yield-based Treasury options are traded, had a rule setting forth a specific method for determining the settlement value of the yield in the event the reporting authority failed to supply a settlement value. The CBOE rule setting forth that method, a random poll of a minimum of ten primary government bond dealers, was eliminated on December 2, 2003, when the Commission accepted for immediate effectiveness a CBOE rule filing deleting it. In that filing, CBOE adopted a provision stating that the settlement value would be determined in accordance with OCC's By-Laws and Rules.<sup>4</sup>

The repeal of the CBOE rule prompted OCC to review its own rules governing the setting of exercise settlement values for yield-based Treasury options. OCC now proposes to amend Article XVI, Section 4 to give OCC substantially the same discretion in fixing exercise settlement values for yield-based Treasury options as it has under Article XVII, Section 4 governing index

options.<sup>5</sup> As noted in the order approving OCC's rule change for index options, OCC's authority to fix exercise settlement values in unusual market conditions should be sufficiently broad to ensure that such values are consistent with the settlement values established for related products in other markets whenever that result is deemed to be in the best interest of investors.<sup>6</sup> While Article VI, Section 4(a)(2) as currently drafted is also broad, OCC believes that its authority should be expressed in language parallel to other By-Laws provisions that expressly acknowledge that a settlement price may be fixed based either on the last reported price before a market disruption or the next reported price following the disruption or by some other method.

As with index options, under Revised Article XVI, Section 4(a)(2) the settlement value of yield-based Treasury options would be fixed by an adjustment panel consisting of representatives of the exchange or exchanges on which the affected series of options is traded. Additionally, under Section 4(a)(3), in the event the adjustment panel delays fixing a settlement value beyond the expiration date of the affected series, the normal exercise by exception procedures would not apply. Instead, options that are in the money by one dollar or more would be deemed to have been irrevocably exercised prior to the expiration time.

OCC believes that the proposed rule change is consistent with the purposes and requirements of Section 17A of the Act, as amended, because it is designed to promote the prompt and accurate clearance and settlement of securities transactions, foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, remove impediments to the mechanisms of a national system for the prompt and accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest. The proposed changes promote these objectives by providing OCC with flexibility in responding to unanticipated events.

<sup>5</sup> A draft supplement to the Options Disclosure Document ("ODD") that describes the substance of the By-Laws changes proposed herein will be filed with the Commission pursuant to Rule 9b-1 under the Act. Implementation of this rule change will be coordinated with the distribution of the related ODD supplement.

<sup>6</sup> Securities Exchange Act Release No. 47418 (February 27, 2003), 68 FR 11439 (March 10, 2003) [File No. SR-OCC-2002-09].

<sup>3</sup> Securities Exchange Act Release No. 44184 (April 16, 2001), 66 FR 20342 (April 20, 2001) [File No. SR-OCC-99-12].

<sup>4</sup> Securities Exchange Act Release No. 48865 (December 2, 2003), 68 FR 68676 (December 9, 2003) [File No. SR-CBOE-2003-48].

<sup>24</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> The Commission has modified parts of these statements.