

do not have boards of directors, the Managers of each Company will fulfill the responsibilities assigned to a Company's board of directors under the rule, and (b) because all Managers would be considered interested persons of the Companies, approval by a majority of disinterested directors required by rule 38a-1 will not be obtained.

#### Applicants' Conditions

Applicants agree that any order granting the requested relief will be subject to the following conditions:

1. Each proposed transaction involving a Company otherwise prohibited by section 17(a) or section 17(d) of the Act and rule 17d-1 thereunder (each, a "Section 17 Transaction") will be effected only if the Managers determine that:

(a) The terms of the Section 17 Transaction, including the consideration to be paid or received, are fair and reasonable to the Members and do not involve overreaching of the Company or its Members on the part of any person concerned; and

(b) the Section 17 Transaction is consistent with the interests of the Members, the Company's organizational documents and the Company's reports to its Members.

In addition, the Managers will record and preserve a description of all Section 17 Transactions, their findings, the information or materials upon which their findings are based, and the basis therefor. All such records will be maintained for the life of the Companies and at least six years thereafter, and will be subject to examination by the Commission and its staff. Each Company will preserve the accounts, books, and other documents required to be maintained in an easily accessible place for the first two years.

2. In connection with the Section 17 Transactions, the Managers will adopt, and periodically review and update, procedures designed to ensure that reasonable inquiry is made, before the consummation of any such transaction, with respect to the possible involvement in the transaction of any affiliated person or promoter of or principal underwriter for the Companies, or any affiliated person of an affiliated person, promoter, or principal underwriter.

3. The Managers of each Company will not invest the funds of any Company in any investment in which an Affiliated Co-Investor (as defined below) has acquired or proposes to acquire the same class of securities of the same issuer, where the investment involves a joint enterprise or other joint arrangement within the meaning of rule

17d-1 in which the Company and an Affiliated Co-Investor are participants, unless any such Affiliated Co-Investor, prior to disposing of all or part of its investment, (a) gives the Managers sufficient, but not less than one day's, notice of its intent to dispose of its investment and (b) refrains from disposing of its investment unless the Company has the opportunity to dispose of the Company's investment prior to or concurrently with, on the same terms as, and pro rata with the Affiliated Co-Investor. The term "Affiliated Co-Investor" with respect to a Company means: (a) An "affiliated person," as such term is defined in the Act, of the Company; (b) the Stephens Group; (c) an officer, director or employee of the Stephens Group; (d) an investment vehicle offered, sponsored or managed by the Stephens Group, or (e) an entity in which a member of the Stephens Group acts as a general partner or has a similar capacity to control the sale or other disposition of the entity's securities. The restrictions contained in this condition, however, will not be deemed to limit or prevent the disposition of an investment by an Affiliated Co-Investor: (a) To its direct or indirect wholly-owned subsidiary, to any company (a "Parent") of which the Affiliated Co-Investor is a direct or indirect wholly-owned subsidiary, or to a direct or indirect wholly-owned subsidiary of its Parent; (b) to Immediate Family Members of the Affiliated Co-Investor or a trust established for any Affiliated Co-Investor or any such family member; or (c) when the investment is comprised of securities that are (i) listed on any national securities exchange registered under section 6 of the Exchange Act; (ii) national market system securities pursuant to section 11A(a)(2) of the Exchange Act and rule 11Aa2-1 thereunder; or (iii) government securities as defined in section 2(a)(16) of the Act.

4. Each Company and its Managers will maintain and preserve, for the life of each Company and at least six years thereafter, all accounts, books, and other documents as constitute the record forming the basis for the audited financial statements that are to be provided to the Members, and each annual report of such Company required to be sent to the Members, and agree that all such records will be subject to examination by the Commission and its staff.<sup>4</sup>

<sup>4</sup> Each Company will preserve the accounts, books and other documents required to be maintained in an easily accessible place for the first two years.

5. The Managers will send to each Member who had an Interest in the Company, at any time during the fiscal year then ended, Company financial statements that have been audited by that Company's independent accountants. At the end of each fiscal year, the Managers will make a valuation or have a valuation made of all of the assets of the Company as of such fiscal year end in a manner consistent with customary practice with respect to the valuation of assets of the kind held by the Company. In addition, within 120 days after the end of each fiscal year of the Company or as soon as practicable thereafter, the Managers of the Company shall send a report to each person who was a Member at any time during the fiscal year then ended setting forth tax information necessary for the preparation by the Member of his or her federal and state income tax returns and a report of the investment activities of the Company during that year.

6. Whenever a Company makes a purchase from or sale to an entity that is affiliated with the Company by reason of a Stephens Group director, officer, or employee (a) serving as an officer, director, general partner or investment adviser of the entity or (b) having a 5% or more investment in the entity, that individual will not participate in the determination by the Managers of whether or not to effect the purchase or sale.

For the Commission, by the Division of Investment Management, under delegated authority.

**Florence E. Harmon,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55843; File No. SR-Amex-2004-27]

#### Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing of a Proposed Rule Change as Modified by Amendment Nos. 2 and 3 Thereto Relating to the Listing and Trading of Fixed Return Options

June 1, 2007.

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 April 29, 2004, the American Stock Exchange LLC ("Amex" or "Exchange") filed with the Securities and Exchange Commission

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

<sup>2</sup> 17 CFR 240.19b-4.

("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by Amex. Amex filed Amendment No. 1 to the proposed rule change on September 26, 2006.<sup>3</sup> Amex filed Amendment No. 2 to the proposed rule change on April 19, 2007.<sup>4</sup> Amex filed Amendment No. 3 to the proposed rule change on May 23, 2007.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to list and trade options having a fixed return in cash based on a set strike price ("Fixed Return Options" or "FROs").

The text of the proposed rule change is available at Amex, from the Commission's Public Reference Room, and on Amex's Web site at <http://www.amex.com>.

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

In its filing with the Commission, Amex 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. The Exchange 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**

##### **Introduction**

The Exchange proposes to list and trade options, called Fixed Return Options, having a fixed return in cash based on a set strike price.<sup>6</sup> The proposed Fixed Return Options would initially consist of two types as follows: (1) "Finish High"<sup>SM</sup>—Each contract returns \$100 if the underlying settlement value is above the strike

price at expiration and (2) "Finish Low"<sup>SM</sup>—Each contract returns \$100 if the underlying settlement value is below the strike price at expiration. The Finish High and Finish Low FROs are similar to existing long calls and long puts traded on the Exchange.

The structure of the FRO is commonly referred to as a "binary" option.<sup>7</sup> Although FROs would be based on the same underlying securities and in the same framework as existing standardized options traded on Amex and the other options exchanges, the amount of the payout or profit of an FRO is based on whether the option is in the money, not by the degree it is in the money. As a result, the payout at expiration is an "all-or-nothing" occurrence. As with a standard European-style option, the payoff is based on the price of the underlying asset at expiration. However, unlike standard options currently traded on the Exchange, the payoff would be a fixed amount as of the writing of the option contract. In addition, an FRO would be automatically exercised at expiration if the price of the underlying security settles above the pre-defined strike price, in the case of a Finish High, or below the pre-defined strike price, in the case of a Finish Low.<sup>8</sup>

Binary options have been traded in the over-the-counter ("OTC") market for many years.<sup>9</sup> However, OTC binary

options have certain disadvantages. OTC binary options are typically offered by an institution on a non-fungible basis so the customer can purchase the option from or close out the option with only the particular institution that issued the option. As a result, OTC binary options lack both a trading market (liquidity) as well as transparency. The Exchange proposal to list and trade FROs is intended to provide the market for binary options with a standardized, fungible product without the credit risk of an individual issuer. By providing a listed or standardized market for a class of binary options named FROs, the Exchange seeks to attract investors who desire a binary option but at the same time prefer the certainty and safeguards of a regulated and standardized marketplace.

The FROs that the Exchange proposes to list and trade would be European-style<sup>10</sup> with expirations based on existing option cycles. Strike prices would be quoted based on existing intervals with minimum price variations ("MPVs") expected to be \$0.05 (except for those option classes that are part of the Penny Quoting Pilot Program, where the MPV would be \$0.01). Strike prices initially would be established at approximate levels up to 20% above and below the price of the underlying asset. The Exchange is proposing in this filing to allow individual stocks and exchange-traded fund shares ("ETFs") that meet the listing criteria set forth below to underlie an FRO.

##### **Benefits and Uses**

FROs are designed to be a simplified version of traditional, exchange-traded options. The inherent benefit of FROs is largely associated with the certainty provided writers and purchasers, *i.e.*, a known maximum payout or liability at the time the contract is entered into. For investors, Amex believes that three positive attributes relating to FROs are apparent: (i) Simplicity; (ii) risk transparency; and (iii) liquidity. First, an FRO is easier to understand and utilize than a traditional equity option largely based on the certain payment amount and cash settlement. Second, unlike traditional options where a writer has unlimited risk, the maximum obligation in connection with an FRO is known at \$100. Third, as an exchange-traded option, the FRO would have the advantage of liquidity provided by specialists and market makers; therefore, spreads should be tighter than exists in the OTC market. In addition,

<sup>3</sup> Amendment No. 1 replaces the original filing in its entirety.

<sup>4</sup> Amendment No. 2 replaces the original filing and Amendment No. 1 in their entirety.

<sup>5</sup> Amendment No. 3 made changes to the proposed rule text relating to minimum margin requirements.

<sup>6</sup> Patent Pending. The contract specifications for a FRO are set forth in *Exhibit A* to the proposal.

<sup>7</sup> A "binary option" is an option with a fixed, pre-determined payoff if the underlying security or index is in the money at expiration. The value of the payoff is not affected by the magnitude of the difference between the underlying and the strike price. A binary option is characterized by a discontinuous or non-linear payoff (*i.e.*, an "all-or-nothing" feature).

<sup>8</sup> Currently, the Exchange lists and trades Index Flex Options that are automatically exercised pursuant to Rule 1804(c) of The Options Clearing Corporation ("OCC"). Automatic exercise in this context refers to the fact that all in the money options are automatically exercised with the holder of such option having no choice to not exercise. This differs significantly from the "Ex-by-Ex" procedure (often inaccurately referred to as "automatic exercise") employed by OCC in OCC Rule 805, which always allows an OCC Clearing Member to effect a choice not to exercise an option that is in the money by the exercise threshold amount or more, or to exercise an option which has not reached the exercise threshold amount. The exercise threshold amount set forth in OCC Rule 805 is \$0.25 per share in the money for customer accounts and \$0.15 per share in the money for firm and market maker accounts. The exercise threshold amount employed in the "Ex-by-Ex" procedure triggers the automatic exercise only in the absence of contrary instructions from the Clearing Member. See also Amex Rule 980.

<sup>9</sup> As reported by the Bank for International Settlements ("BIS"), the worldwide OTC equity-linked derivatives market was estimated on a notional amount basis to be \$6.8 trillion as of June 2006. As of the same time period, OTC equity-based options were estimated on a notional amount basis to amount to \$5.3 trillion. See BIS, OTC Derivatives Market Activity in the First Half of 2006 (November 2006).

<sup>10</sup> A "European style" option is an option where the holder may exercise the contract only on the last business day prior to expiration.

the structure of an FRO eliminates the potential counterparty risk inherent in OTC products.

Amex believes that a significant benefit of an FRO is that the purchaser and writer of the FRO know the expected return at the time of purchase if the underlying security performs as expected. In contrast, the "traditional" option does not typically have a known return at the time of purchase, *i.e.*, the return cannot be accurately determined until the option is nearing expiration due to price movements. In addition, because the return on the FRO is a fixed amount, a buyer of the FRO would not need to determine the absolute magnitude of the underlying security's price movement relative to the strike price, as is the case with traditional options. Yet another benefit of the FRO is the limited risk/return to the writer/purchaser because of the payout being a known, fixed dollar amount. A systemic benefit provided by the FRO versus its OTC counterpart is the ability of standardized clearing and settlement systems to be programmed to recognize FROs based on their unique underlying symbols and segregation for particular treatment by systems used for calculating permissible margin as well as final payout amounts due at settlement.

Amex believes that investors will want to utilize FROs to earn additional income on securities they own. An "FRO Call Writing" strategy describes a situation where an investor is long stock and writes a Finish High FRO on that same security. In this instance, the writer has earned premium while risking a fixed and known portion of the upside should the stock close above the FRO strike price at expiration. The amount at risk is the difference between \$100 and the premium received.

In contrast, if a holder of a long stock position employs a "Call Writing" strategy by writing a traditional call covered by the corresponding long stock position, up to 100% of the potential upside may be given up if the stock moves up beyond the option strike price. A holder of stock, particularly stock that has depreciated, may lock in a loss by selling traditional "covered calls"—there is no potential for upside, beyond the premium received, if the stock moves up and closes above the strike at expiration.

With the "FRO Call Writing" strategy, an investor believing his long stock position would remain stagnant in the short term may further choose to write more than one Finish High FRO, increasing the short-term return potential by receiving more premium for the additional calls sold. The investor

by engaging in this FRO Call Writing strategy would maintain certainty of stock ownership while knowing the total capital or funds at risk if the stock exceeds the strike price of the Finish High sold.

On the buy side, Amex believes that the decision process is made simpler for the investor with the advent of the FRO. To profit from buying a traditional call, an investor must be correct in his prediction that the underlying security will appreciate within a given period of time. In addition, due to the linear payoff nature of the traditional call, the investor must also be correct about the amount of time erosion or "decay" of the position in the time he holds the call. Thus, with a traditional long call purchase, if the investor is correct in his prediction that the stock will appreciate within a set period of time, there are still other factors, such as volatility and time premium, that could affect potential returns.

If the purchaser of a long FRO position is correct about the prediction that the stock will appreciate and also correct about the timeframe within which this appreciation will occur, he then has a known risk/return profile, due to the non-linear relationship between the Fixed Return Option payoff amount and the price of the underlying at expiration. This offers the investor the ability to make an exact risk/reward analysis of the investment if he is correct in his assumption on the underlying stock at expiration. In contrast, the traditional call buyer can make only estimates of risk/reward based on multiple assumptions.

The Exchange believes that FROs would also provide investors with an efficient way to establish various strategies and enhance portfolio performance. For example, the Finish High FRO has characteristics similar to a bull call spread; however, in the case of the FRO, an investor could accomplish the strategy with reduced execution cost. We believe that such unique uses for FROs would provide investors with greater opportunities to effectively use options as part of an investment strategy. In sum, the Exchange believes that the simple structure of FROs will attract investors to the benefits of options trading.

#### Standardization

The Exchange in proposing FROs is attempting to list a binary option in an exchange-traded environment.<sup>11</sup> In this

manner, the Exchange intends, to the extent possible, to have FROs recognized and treated like existing standardized options. Standardized systems for listing, trading, transmitting, clearing, and settling options, including systems used by OCC, would be employed in connection with FROs. As a result, FROs would have symbology based on the current system so that symbols are created that represent the underlying security, the fact that the option is a "Finish High" or "Finish Low" FRO as opposed to a traditional put or call, the expiration date, the strike price, and the exchange trading FROs.

#### Options Contract Multiplier

The standardized option contract traded by all U.S. options exchanges typically is quoted in amounts that are multiplied by "100" due to the fact that the option represents rights associated with 100 shares of the underlying security upon exercise. The multiplier of 100 has also been carried over to index options. The Exchange has proposed to continue this industry convention for FROs. For example, an option that currently is quoted at \$0.50 actually costs the investor \$50.00 ( $\$0.50 \times 100$ ).

#### Minimum Price Variation

Amex Rule 952 generally provides that the MPV for an option on a stock or ETF shall be: (i) For option issues quoted under \$3 a contract, \$0.05; (ii) for option issues quoted at \$3 a contract or greater, \$0.10. However, in connection with those options classes included within the Penny Quoting Pilot Program,<sup>12</sup> the MPV is as follows: (iii) For option issues quoted under \$3 a contract, \$0.01; (iv) for option issues quoted at \$3 a contract or greater, \$0.05. In addition, options on the Power Shares QQQ Trust (formerly, the QQQQ) trade at an MPV of \$0.01 for all options premiums.

The MPV for FROs would be \$0.05 (and \$0.01 for those options classes in the Penny Quoting Pilot Program) because, by definition, an FRO would never be quoted over \$1.00.

#### Maximum Bid/Ask Differentials

To contribute to the maintenance of a fair and orderly market, specialists and registered options traders ("ROTs") are typically expected to bid and offer so as to create differences of no more than: (i) \$0.25 between the bid and offer for each option contract for which the prevailing

<sup>11</sup> The Exchange to its knowledge is the first national securities exchange to propose the listing and trading of a binary option in a standardized environment. The Exchange has pending a patent

application for trading binary options in an exchange-traded environment.

<sup>12</sup> See Securities Exchange Act Release No. 55162 (January 24, 2007), 72 FR 5738 (February 1, 2007).

bid is less than \$2; (ii) \$0.40 where the prevailing bid is \$2 but does not exceed \$5; (iii) \$0.50 where the prevailing bid is more than \$5 but does not exceed \$10; (iv) \$0.80 where the prevailing bid is more than \$10 but does not exceed \$20; and (v) \$1 where the last prevailing bid is more than \$20.<sup>13</sup> With respect to FROs, the Exchange believes that the maximum bid/ask differential should typically be \$0.25. However, due to the non-linear payoff nature of FROs, we believe that during the last day of trading prior to expiration, the maximum bid/ask differential should be \$0.50.<sup>14</sup>

In terms of the maximum bid-ask differential, existing options with a prevailing bid of \$1 equate to the \$100 value of an FRO and, therefore, a maximum bid-ask differential of \$0.25 or \$25.00 (\$0.25 × 100). Accordingly, Amex believes, consistent with existing rules, that the maximum bid-ask differential for FROs should generally be \$0.25.

#### Expiration Cycles and Strike Price Intervals

Pursuant to Amex Rule 903, the Exchange generally opens up to four expiration months for each options class upon the initial listing of such class for trading. Upon expiration of the near-term month, the Exchange will then list an additional expiration month. FROs would use the same expiration cycle as currently is the case for traditional options listed on the Exchange, consistent with Amex Rule 903.

Strike price intervals in connection with FROs also would employ the same procedure as exists for traditional options under Amex Rule 903 and related commentaries. Specifically, the interval between strike prices of series of options on individual stocks may be (i) \$2.50 or greater where the strike price is \$25 or less, provided that the Exchange may not list \$2.50 intervals below \$20 (e.g., \$12.50, \$17.50) for any class included within the \$1 Strike Price Pilot Program, if the addition of \$2.50 intervals would cause the class to have strike price intervals that are \$0.50 apart; (ii) \$5 or greater where the strike price is greater than \$25 but less than \$200; or (iii) \$10 or greater where the strike price is greater than or equal to

\$200. For series of options on ETFs that satisfy the criteria set forth in Commentary .06 to Amex Rule 915, the interval of strike prices would be \$1 or greater where the strike price is \$200 or less or \$5 or greater where the strike price is over \$200.<sup>15</sup>

The Exchange proposes that securities underlying options classes that currently are part of the \$1 Strike Price Pilot Program and the 2½ Point Strike Price Program also may underlie an FRO. Due to the heightened listing standards proposed by the Exchange in proposed Amex Rules 915FRO and 916FRO, the number of FROs available under these existing programs would be limited.<sup>16</sup> Accordingly, the Exchange proposes that the strike price intervals for FROs would be established under existing procedures as set forth in Amex Rule 903.

#### VWAP Settlement Pricing

To protect against any potential price manipulation that could occur at expiration due to the “all-or-nothing” nature of FROs, the Exchange has proposed that the expiration or settlement price for an underlying individual equity security be calculated as a “volume weighted average price” or “VWAP.” As provided below, FROs would be listed only on the most liquid and actively-traded equity securities. VWAP is a simple algorithm that is defined as the number of shares multiplied by the corresponding reported price of the security. The total number of shares reported divides the sum of these transactions during the time period used for the calculation. The VWAP calculation would be based on composite prices reported during regular trading hours for the underlying securities. In addition, the current value of the VWAP calculation for each series of FROs would be published and disseminated at least every 15 seconds throughout the trading day. The Exchange believes that a settlement price based on an “all-day” VWAP during the last trading day prior to expiration is appropriate for FROs based on individual stocks and ETFs. We believe that the use of an “all-day” VWAP for determining the settlement price of an FRO is sufficient to protect against concerns of manipulation, and that the publication and dissemination

of intraday updates of the current VWAP calculation would add greater transparency.

For purposes of the VWAP calculation, the Exchange believes that composite prices should be used. Composite pricing is currently employed by OCC in connection with the settlement of equity options.<sup>17</sup>

The VWAP settlement price would be disseminated by the Exchange as the official settlement price for FROs and would be made publicly available through various market data vendors as well as on the Amex Web site at <http://www.amex.com>.

#### Underlying Closing Price Methodology

In the money amounts for any option, including FROs, are a function of the underlying security price. For traditional equity and ETF options, OCC as the issuer of the options uses the “composite closing price” (i.e., the last reported sale price during regular trading hours) for the underlying security on the trading day immediately preceding the expiration date as reported by industry price vendors.<sup>18</sup> As noted above, the Exchange similarly believes, that for purposes of calculating the VWAP settlement price for FROs based on individual stocks and ETFs, “composite prices” should be used. As a result, the Exchange would use composite prices of the underlying securities to calculate the VWAP settlement price for FROs. In contrast to traditional options, the Exchange, not OCC, would determine the underlying security prices and calculate the VWAP settlement price.

In a case where the underlying security does not trade during regular trading hours on the last trading day prior to expiration or a last sale price is not obtainable either due to a trading halt or unreliable pricing, OCC has the discretionary authority to set a closing price on such basis as it believes appropriate under the circumstances.<sup>19</sup>

<sup>17</sup> See OCC Clearing Members Memorandum No. 18930 (May 29, 2003); and Securities Exchange Act Release No. 49045 (January 8, 2004), 69 FR 2377 (January 15, 2004).

<sup>18</sup> *Id.*

<sup>19</sup> OCC Rule 805(j) defines the term “closing price” to mean the last reported sale price for the underlying security on the trading day immediately preceding the expiration date on such national securities exchange or other domestic securities market as the Corporation shall determine. Notwithstanding the foregoing, if an underlying security was not traded on such market on the trading day immediately preceding the expiration date or if the underlying security was traded on such trading day but the Corporation is unable to obtain a last sale price, the Corporation may, in its discretion: (i) Fix a closing price on such basis as it deems appropriate in the circumstances

<sup>13</sup> If the bid/ask spread in the underlying security is greater than the bid/ask spread for the option, the permissible spread for any in the money option series may be identical to the underlying security market. We believe FROs should follow this existing practice for traditional options. See Amex Rule 958—ANTE(c).

<sup>14</sup> Where warranted by market conditions, the Exchange is proposing to be able to establish maximum bid/ask spreads other than those noted above for one or more series or classes of FROs.

<sup>15</sup> Commentaries .05 and .06 to Amex Rule 903 provide limited exceptions to the general strike price intervals in connection with the \$1 Strike Price Pilot Program and the 2½ Point Strike Price Program.

<sup>16</sup> As of March 5, 2007, the number of underlying stocks available under the \$1 Strike Price Pilot Program for FROs would be four, while the number of underlying stocks available under the 2½ Point Strike Price Program would be 39.

OCC currently performs this function for standardized options traded by all options exchanges. The Exchange believes that in most cases OCC will use the last sale price reported during regular trading hours on the most recent trading day for which a last sale price is available.

#### Listing Requirements

The Exchange proposes that, in addition to meeting the criteria set forth in Amex Rule 915 (Initial Listing), an FRO may be initially listed only on an individual stock issued by a company that has: (i) A market capitalization of at least \$40 billion; (ii) minimum trading volume over the last 12 months of at least one billion shares; (iii) minimum average daily trading volume of at least four million shares; (iv) minimum average daily value traded of at least \$200 million during the prior six months; and (v) the market price per share of the underlying security has been at least \$10 during the five consecutive business days preceding listing. The underlying security price per share is measured by the closing price reported in the primary listed market in which the underlying security is traded.<sup>20</sup>

With respect to ETFs, the Exchange proposes that, in addition to meeting the criteria set forth in Amex Rule 915 (Initial Listing), an FRO may be listed only on an ETF that has: (i) A minimum trading volume over the last 12 months of at least one billion shares; (ii) a minimum average daily trading volume of at least four million shares; (iii) a minimum average daily value traded of at least \$200 million during the prior six months; and (iv) the market price per share of the underlying security has been at least \$10 during the five consecutive business days preceding listing.

To be eligible for additional FRO series, the Exchange proposes that, in addition to meeting the criteria set forth in Amex Rule 916 (Continued Listing),<sup>21</sup> an underlying stock have: (i) A market capitalization of at least \$30 billion; (ii) a minimum trading volume over the last 12 months of at least one billion shares; (iii) a minimum average daily trading volume of four million shares; (iv) a minimum average daily value traded of

\$125 million during the prior six months; and (v) a market price per share of at least \$5. For intra-day series additions, the market price of an underlying security is measured by the last reported trade in the primary listed market in which the underlying security trades at the time the Exchange determines to add these additional series. In the case of next-day or expiration series additions, the market price of an underlying security is measured by the closing price reported in the primary listed market on the last trading day before the series are added.

For additional FRO series based on ETFs, the Exchange proposes that, in addition to meeting the criteria set forth in Amex Rule 916 (Continued Listing), an underlying ETF have: (i) A minimum trading volume over the last 12 months of at least one billion shares; (ii) a minimum average daily trading volume of four million shares; (iii) a minimum average daily value traded of \$125 million during the prior six months; and (iv) a market price per share of at least \$5.

Proposed Amex Rules 915FRO and 916FRO detail these requirements. The Exchange believes that this proposal for listing FROs on individual stocks and ETFs is consistent with current requirements for traditional options. In connection with individual stocks, Amex believes that a higher standard is appropriate for such listings. By providing heightened listing standards for underlying securities that may be the basis for FROs—consisting of market capitalization, 12-month trading volume, average daily trading volume, average daily trading value, and a minimum market price per share—the Exchange believes that the potential and/or susceptibility of manipulation is greatly reduced. In the case of ETFs, Amex has proposed that only actively traded and well capitalized ETFs may underlie an FRO. Amex believes that, based on the proposed initial and continued listing standards, the susceptibility to manipulation is severely dampened.

#### Position and Exercise Limits

Amex proposes that an FRO based on an individual stock or ETF have a position limit of 25,000 contracts. Existing hedge exemptions found in Amex Rules 904 and 904C would not apply to FROs; however, the facilitation exemption to position limits currently available to members would apply in the case of FROs in connection with facilitating customer FRO orders. FROs would not be subject to exercise limits due to the fact that FROs are European-

style options<sup>22</sup> and are automatically exercised only if the settlement price is in the money.

The Exchange believes that position limits for FROs should not be aggregated with the position limits of existing standardized options on the same underlying security. Amex believes that the non-linear (*i.e.*, “all-or-nothing”) nature of FROs as well as the risk/return profile for FROs provides significant differences to existing standardized options that render aggregation of position limits inconsistent. In addition, the automatic exercise feature of an FRO also supports Amex’s belief that an exercise limit should not be imposed because FROs by definition cannot be exercised over a five-day period.<sup>23</sup>

Position limits restrict the number of options contracts that an investor, or a group of investors acting in concert, may own or control. Similarly, exercise limits prohibit the exercise of more than a specified number of contracts on a particular instrument within five business days. Position limits on exchange-traded options are designed to: (i) Minimize the potential for mini-manipulations<sup>24</sup> as well as other forms of market manipulation; (ii) impose a ceiling on the position that an investor with inside corporate or market information can establish; and (iii) reduce the possibility of disruption in the options and underlying cash markets.

Amex believes that the structure of FROs—especially the “all-day” VWAP settlement pricing, heightened listing requirements for individual stocks and ETFs underlying FROs, and lower position limits—should allay regulatory concerns of potential manipulation. In particular, Amex notes that, for individual stocks underlying an FRO, in addition to the existing listing requirements, the Exchange has proposed heightened continuing or maintenance listing standards of: (i) At least \$30 billion in market capitalization; (ii) a minimum trading volume of at least one billion shares over the last 12 months; (iii) a minimum average daily trading volume of at least four million shares; (iv) a minimum average daily trading value of \$125 million; and (v) a minimum market price per share of the underlying

<sup>22</sup> See *supra* note 10.

<sup>23</sup> Unlike with traditional equity options, exercise instructions are not entered for FROs because the contract is automatically exercised pursuant to the contract if the settlement price exceeds the strike price.

<sup>24</sup> Mini-manipulation is an attempt to influence, over a relatively small range, the price movement in a stock to benefit a previously established options position.

(including, without limitation, using the last sale price during regular trading hours on the most recent trading day for which a last sale price is available); or (ii) suspend the application of the ex-by-ex procedure to option contracts for which that security is an underlying security.

<sup>20</sup> See Commentary .01 to Amex Rule 915 for the current options listing criteria.

<sup>21</sup> See Commentaries .01 and .02 to Amex Rule 916 for the current options continuing listing criteria.

security of \$5.<sup>25</sup> ETFs underlying an FRO would be subject to the same continued listing standards except for the minimum market capitalization requirement. These heightened listing requirements would provide that only the most highly liquid securities may underlie an FRO. In addition, Amex believes that the proposed FRO settlement pricing based on an “all-day” VWAP would greatly reduce the ability to use FROs for manipulative purposes.

FROs would not be subject to any “qualified hedge exemptions” from the standard position and exercise limits that currently exist for traditional options.

Consistent with non-FRO or traditional options, positions in FROs would have to be reported to the Exchange when an account establishes an aggregate same-side-of-the-market position of 200 or more FROs. The Exchange also would require that each member or member organization (other than an Exchange specialist or registered trader) that maintains a position on the same side of the market in excess of 25,000 FROs, for its own account or for the account of a customer, report certain information. This data would include, but would not be limited to, the FRO position, whether such position is hedged and, if so, a description of the hedge and, if applicable, the collateral used to carry the position. The Exchange believes that the reporting requirements under Amex Rule 906 and the surveillance procedures for hedged positions would enable the Exchange to closely monitor sizable FRO positions and corresponding hedges.<sup>26</sup>

The Exchange further believes that financial requirements imposed by the Exchange and by the Commission adequately address concerns that a member or its customer may try to maintain an inordinately large unhedged position in FROs. Current margin and risk-based haircut methodologies serve to limit the size of positions maintained by any one account by increasing the margin and/or capital that a member must maintain for a large position held by itself or by its customer. The Exchange has the

authority under paragraph (d)(2)(k) of Amex Rule 462 to impose a higher margin requirement upon the member or member organization when the Exchange determines a higher requirement is warranted.

#### Contract Adjustments

FROs will be subject to adjustments for corporate and other actions in accordance with the rules of OCC. The general rule for adjustments in connection with FROs is that, regardless of the corporate action, the settlement value (paid in cash) of the FRO would always be \$100.<sup>27</sup>

In the case of even splits<sup>28</sup> and uneven splits,<sup>29</sup> OCC and the Exchange believe that FROs should be adjusted by changing the strike price of the contract.

OCC submitted a proposed rule change with the Commission on November 18, 2004 (OCC File No. SR-OCC-2004-21) to enable it to issue, clear, and settle FROs. The OCC proposal would allow it to process FRO transactions in accordance with procedures that are substantially similar to its existing well established systems and procedures for the clearance and settlement of traditional exchange-traded options.

#### Margin

Consistent with Amex Rule 462(c)(11) and proposed new paragraph (d)(10) of Amex Rule 462, the initial and maintenance margin for long positions in FROs would have to equal at least 100% of the purchase price of the option (*i.e.*, the premium).<sup>30</sup> In connection with short positions in FROs, the customer margin required is the difference between \$100 and the proceeds received from the sale of the FRO. Amex believes that this proposed margin treatment is adequate and should not be otherwise based on the behavior of the underlying security, given the fact that the greatest amount at risk for an option writer of an FRO

is the payout amount of \$100. As with existing equity options, short FRO positions could be carried in a cash account (not subject to margin) and deemed “covered,” provided that proposed new paragraph (d)(10)(F) of Amex Rule 462 were applicable. “Covered” for purposes of an FRO is deemed to exist where the writer’s obligation is secured by a specific deposit or escrow deposit meeting the entire obligation of \$100 on the FRO. This standard is similar to the available “cover” for existing exchange-traded options under Amex Rules 462(d)(2)(I) and 900(b)(23).

#### Options Disclosure Document

As noted above, the OCC submitted a proposed rule change with the Commission to accommodate the listing and trading of FROs.<sup>31</sup> In addition, the OCC will also seek a revision to the Options Disclosure Document (“ODD”) to incorporate FROs.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act,<sup>32</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>33</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and in general to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change would 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*

The Exchange has not received any written comments on the proposed rule change.

#### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

Within 35 days of the date of publication of this notice in the **Federal**

<sup>25</sup> As of March 5, 2007, 60 stocks and 11 ETFs would qualify for FROs.

<sup>26</sup> Hedge information for member firm and customer accounts having 200 or more contracts are electronically reported via the Large Options Positions Report. Specialist and registered options trader account information is also reported to Amex by such member’s clearing firm. In addition, a member firm is required to report hedge information for any proprietary or customer account that maintains an options position in excess of 10,000 contracts. These procedures would apply to FROs.

<sup>27</sup> Article VI, Section 11(c) of OCC’s By-Laws provide the general rule that there will be no adjustments to reflect ordinary cash dividends or distributions or ordinary stock dividends or distributions.

<sup>28</sup> An “even split” is a case where the stock distribution or stock split results in one or more whole numbers of shares of the underlying security issued with respect to each outstanding share.

<sup>29</sup> An “uneven split” is a case where the stock distribution or stock split results in other than whole numbers of shares of the underlying security issued with respect to each outstanding share.

<sup>30</sup> New York Stock Exchange Regulation (“NYSE”) confirmed to Amex that the proposed margin requirements are appropriate. NYSE represented that prior to the launch of FROs, a regulatory circular to members would be issued detailing the margin requirements in connection with FROs.

<sup>31</sup> See File No. SR-OCC-2004-21.

<sup>32</sup> 15 U.S.C. 78f(b).

<sup>33</sup> 15 U.S.C. 78f(b)(5).

**Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- A. By order approve such proposed rule change; or
- B. Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. 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-Amex-2004-27 on the subject line.

##### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090. All submissions should refer to File Number SR-Amex-2004-27. 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 Room. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. 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-Amex-2004-27 and should be submitted on or before June 28, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>34</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E7-10970 Filed 6-6-07; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55824; File No. SR-Amex-2007-52]

##### **Self-Regulatory Organization; American Stock Exchange LLC; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Floor Broker Zone Requirements in AEMI**

June 4, 2007.

##### **Correction**

In FR Doc. No. E7-10680, beginning on page 30891 for Monday, June 4, 2007, the release number was incorrectly stated as 34-58824. The correct release number appears above.

**Florence E. Harmon,**

*Deputy Secretary.*

[FR Doc. E7-10980 Filed 6-6-07; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55838; File No. SR-NYSEArca-2007-51]

##### **Self-Regulatory Organizations; NYSE Arca, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Extension of Pilot Program for Initial and Continued Financial Listing Standards for Common Stock Until November 30, 2007**

May 31, 2007.

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 May 30, 2007, NYSE Arca, Inc. ("NYSE Arca" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II below, which Items have been

substantially prepared by the Exchange. The Exchange filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposed rule change effective upon filing with the Commission. 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 Exchange proposes to extend until November 30, 2007, the six-month pilot program (the "Pilot Program") which amended the Exchange's financial listing standards for the common stock of operating companies.

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

In its filing with the Commission, the self-regulatory organization 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. The self-regulatory organization 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**

NYSE Arca has amended on a six-month pilot program basis the rules governing the NYSE Arca Marketplace to amend the financial listing standards for common stock of operating companies.<sup>5</sup> The Pilot Program expired on May 29, 2007. The Exchange proposes to extend the Pilot Program until November 30, 2007.

###### **2. Statutory Basis**

The proposed rule change is consistent with Section 6(b) of the Act<sup>6</sup> in general, and furthers the objectives of Section 6(b)(5)<sup>7</sup> in particular. The proposed rule change furthers these objectives by preventing fraudulent and

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> See Securities Exchange Act Release No. 54796 (November 20, 2006), 71 FR 69166 (November 29, 2006) (SR-NYSEArca-2006-85).

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

<sup>34</sup> 17 CFR 200.30-3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b-4.