

The Exchange's proposal to make the new transfer fee effective as of October 20, 2000 is reasonable. According to the Exchange, if the proposal is not effective retroactively, only one change in capitalization would be subject to the current transfer fee. The Commission agrees that this result would be inequitable, and therefore believes that it is appropriate to make the new transfer fee effective as of October 20, 2000. In addition, this proposed change should promote uniformity of treatment for all evaluations of transfers of interest in DPMs.

The Commission believes that the rule, as amended, should preserve the original purposes of the transfer fee. Thus, the amended rule should still serve the CBOE's interest in securing long-term commitments to the Exchange, and thereby ensure the orderly and effective operation of the market. Further, the fee should still provide incentives of DPMs to maintain sufficient capital to operate as a DPM, thereby ensuring greater liquidity and investor protection. Finally, the amended transfer fee should serve to compensate the Exchange for the fee allocation of a business that was established by a person or entities other than the DPM when the DPM sells its interest to other parties.

## V. Conclusion

For the foregoing reasons, the Commission finds that CBOE's proposal to change the capitalization transfer fee applicable to DPMs 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>17</sup> that the proposed rule change (SR-CBOE-00-61), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44037; File No. SR-ISE-01-08]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment No. 1 by the International Securities Exchange LLC, Relating to Listing and Trading of Options on Exchange-Traded Fund

**DATE:** March 2, 2001.

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 March 2, 2001, the International Securities Exchange LLC ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the ISE. The same day, March 2, 2001, the ISE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule changes from interested persons and to approve the proposal, as amended, on an accelerated basis.

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

The Exchange is proposing to amend ISE Rules 502, 503 and 504 to adopt listing and maintenance standards for options on Fund Shares (as defined below), as well as to permit the Exchange to trade options on Fund Shares in various exercise price increments. The text of the proposed rule change is available at the ISE or the Commission.

#### 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 ISE included statements concerning the purpose of and basis for the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The ISE has prepared summaries, set forth in sections A, B

and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

The purpose of the proposed rule change, as amended, is to provide for the trading of options on shares or other securities ("Fund Shares") that represent interests in registered investment companies organized as open-end management investment companies, unit investment trusts or similar entities that are principally traded on a national securities exchange or through the facilities of a national securities association and reported as "national market" securities, and that hold portfolios of securities comprising or otherwise based on or representing investments in broad-based indexes or portfolios of securities ("Funds"). Fund Shares are issued in exchange for an "in kind" deposit of a specified portfolio of securities, together with a cash payment, in minimum size aggregations or multiples thereof ("Creation Units"). The size of the applicable Creation Unit size aggregation is set forth in the Fund's prospectus, and varies from one series of Fund Shares to another, but generally is of substantial size (e.g., value in excess of \$450,000 per creation Unit). A fund, generally, will issue and sell Fund Shares in Creation Unit size through a principal underwriter on a continuous basis at the net asset value per share next determined after an order to purchase Fund Shares and the appropriate securities are received. Following issuance, Fund Shares are traded on an exchange like other equity securities, and equity trading rules apply. Likewise, redemption of Fund Shares is made in Creation Unit size and "in kind," with a portfolio of securities and cash exchange for the Fund Shares that have been tendered for redemption.

Generally, options on Fund Shares are proposed to be traded on the Exchange pursuant to the same rules and procedures that apply to trading in options on equity securities.<sup>4</sup> The position, exercise and reporting limits for options on Fund Shares would be the same as those established for

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

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

<sup>3</sup> See letter to Heather Traeger, Special Counsel, Division of Market Regulation ("Division"), SEC, from Katherine Simmons, Vice President and Associate General Counsel, ISE, dated March 2, 2001 ("Amendment No. 1"). In Amendment No. 1, the ISE added proposed margin requirements for options on Fund Shares.

<sup>4</sup> Fund Shares are a type of security. The Exchange's proposed change to Rule 502, discussed infra, states: "securities deemed appropriate for options trading shall include [Fund Shares]." Accordingly, all of the Exchange's rules referring to "securities" would cover Fund Shares unless they were specifically excluded.

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</sup> 17 CFR 200.30-3(a)(2).

options on single stocks.<sup>5</sup> The Exchange will list option contracts covering either 100 or 1000 Fund Shares, or both, depending on the price and volatility of the underlying Fund Shares and the popularity of the options.<sup>6</sup> Options on Fund Shares will be physically-settled and will have the American-style exercise feature used on all standardized equity options.<sup>7</sup> The Exchange is not proposing at this time to list FLEX options on Fund Shares.

The proposed margin requirements for options on fund shares are at the same levels that apply to options generally under ISE Rule 1202,<sup>8</sup> except, with respect to Fund Shares based on a broad-based index or portfolio, minimum margin must be deposited and maintained equal to 100% of the current market value of the option plus 15% of the market value of equivalent units of the underlying security value. Fund Shares that hold securities based upon a narrow-based index or portfolio must have options margin that equals at least 100% of the current market value of the contract plus 20% of the market value of equivalent units of the underlying security value. In this respect, the margin requirements that currently apply to broad-based and narrow-based index options on the NYSE and CBOE.<sup>9</sup>

To accommodate the listing of Fund Shares, the Exchange proposes changes to rule 502 (Criteria for Underlying Securities). The Exchange proposes to list options only on Fund Shares that are principally traded on a national securities exchange or through the facilities of a national securities association and reported as national market securities. In addition, the initial listing standards will require that Fund Shares either: (1) meet the uniform options listing standards currently contained in Rule 502, which include minimum public float, trading volume, and share price of the underlying

security,<sup>10</sup> or (2) be available for creation or redemption each business day from or through the Fund in cash or in kind at a price related to net asset value, and the Fund is obligated to issue Fund Shares in a specified aggregate number even if some or all of the securities required to be deposited have not been received by the Fund.<sup>11</sup>

In addition, the proposed initial listing standards require that: (1) Any non-U.S. component stocks of the index or portfolio on which the Fund Shares are based that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.

The Exchange also proposes to amend Rule 503 (Withdrawal of Approval of Underlying Securities) to establish maintenance standards for Fund Shares. The proposed maintenance standards provide that if a particular series of Fund Shares should cease to trade on an exchange or as national market securities traded through the facilities of a national securities association, there will be no opening transactions in the options on the Fund shares, and all such options will trade on a liquidation-only basis. In addition, the Exchange will consider the suspension of opening transactions in any series of options on Fund Shares if: (1) The options on the Fund Shares fail to meet the uniform equity maintenance standards contained in ISE Rule 503 when the Fund Shares were approved pursuant to the uniform initial listing standards for equities options in ISE Rule 502;<sup>12</sup> (2) following

the initial twelve-month period beginning upon the commencement of trading in the Fund Shares on a national securities association there were fewer than 50 record and/or beneficial holders of such Fund Shares for 30 or more consecutive trading days; (3) the value of the index or portfolio of securities on which the Fund Shares are based is no longer calculated or available; or (4) such other event occurs or condition exists that in the opinion of the Exchange makes further dealing in such options on the Exchange inadvisable.

Finally, the Exchange proposes to amend Rule 504 (Series of Options Contracts Open for Trading). Rule 504 specifies the uniform minimum strike price intervals for options on single stock, which are \$2.50 where the strike price is \$25 or less, \$5 where the strike price is greater than \$25 and \$10 where the strike price is greater than \$200. Options on some Fund Shares, however, currently trade at lesser intervals on other options exchanges. Accordingly, the Exchange proposes to adopt language similar to that contained in Rules of the American Stock Exchange ("Amex") stating that the interval between strike prices of series of options on Fund Shares will be fixed at a price per share which is reasonably close to the price per share at which the underlying security is traded in the primary market at or about the same time such series of options in first open for trading on the Exchange, or at such intervals as may have been established on another options exchange with respect to options on a particular Fund Share prior to the initiation of trading of such options on the Exchange.<sup>13</sup> This change is necessary to allow the ISE to trade the same options classes as are traded on other options exchanges.

The Exchange believes it has the necessary systems capacity to support

public-held shares; (2) there were fewer than 1,600 holders; (3) trading volume was less than 1,800,000 shares in the preceding twelve months; or (4) the share price of the underlying security closed below \$5 on a majority of the business days during the preceding 6 months.

<sup>13</sup> The Amex currently trades options on a Fund Share called QQQ with a \$1.00 interval between strike prices. The release approving the Amex to trade options on Fund Shares states that strike prices "will be set to bracket the Fund Shares at one point intervals up to a share price of \$200." See Securities Exchange Act Release No. 40157 (July 1, 1998), 63 FR 37426 (July 10, 1998). In contrast, CBOE Rule 5.5, Interpretations and Policies .01 sets the minimum strike interval for Fund Shares at \$2.50 where the strike price is \$200 or less and at \$5 where the strike price is more than \$200. See Securities Exchange Act Release No. 40166 (July 2, 1998), 63 FR 37430 (July 10, 1998). Finally, the recent release approving Philadelphia Stock Exchange ("PHLX") to trade options on Fund Shares does not discuss trading intervals. See Securities Exchange Act Release No. 43921 (February 2, 2001), 66 FR 9739 (February 9, 2001).

<sup>5</sup> The Exchange's rules in these areas contain requirements with respect to "any option contract" and "any options class" traded on the Exchange, and therefore options on Fund Shares would be subject to such requirements.

<sup>6</sup> In the event the Exchange lists options covering both 100 and 1000 of the same underlying Fund Shares, the Exchange will assign separate trading symbols to the options and will issue an Information Circular to all its members advising of the trading symbols.

<sup>7</sup> An American-style option may be exercised at any time prior to its expiration.

<sup>8</sup> The Exchange's margin rules cross reference the rules of the Chicago Board Options Exchange ("CBOE") and New York Stock Exchange ("NYSE").

<sup>9</sup> The Exchange agrees to modify its margin rules to reflect the proposed margin requirements for options on fund Shares based on broad-based and narrow-based indexes, if necessary. See Amendment No. 1, *supra* note 3.

<sup>10</sup> Specifically, Rule 502 requires the underlying security to have a public float of 7,000,000 shares, 2,000 holders, trading volume of 2,400 holders, trading volume of 2,400,000 shares in the preceding 12 months, a share price of \$7.50 for the majority of the business days during the three calendar months preceding the date of the selection, and that the issuer of the underlying security is in compliance with the Exchange Act.

<sup>11</sup> This assumes that the authorized creation participant has undertaken to deliver the shares as soon as possible and such undertaking has been secured by the delivery and maintenance of collateral consisting of cash or cash equivalent satisfactory to the fund which underlies the option, as described in the fund prospectus.

<sup>12</sup> Specifically, Rule 503 provides that an underlying security will not meet the Exchange's requirements for continued listing when, among other things: (1) there are fewer than 6,300,000

the additional series of options that would result from the introduction of options on Fund Shares, and it has been advised that the Options Price Reporting Authority also will have the capacity to support these additional series.

## 2. Statutory Basis

The ISE believes that the basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)<sup>14</sup> that an exchange have rules that are 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 a national market system, and, in general, to protect investors and the public interest.

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

The ISE does not believe that the proposed rule change will place any burdens on competition.

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

The ISE has not solicited, and does not intend to solicit, comments on this proposed rule change. The ISE has not received any unsolicited written comments from members or other interested parties.

## III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609. 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 will also be available for inspection and copying at the principal office of the ISE. All submissions should refer to File No.

SR-ISE-01-08 and should be submitted by April 3, 2001.

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

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with the requirements of section 6(b)(5).<sup>15</sup> Specifically, the Commission believes that providing for the listing and trading of options on Fund Shares should give investors a better means to hedge their positions in the underlying Fund Shares. Further, the Commission believes that pricing of the underlying Fund Shares may become more efficient and market makers in these shares, by virtue of enhanced hedging opportunities, may be able to provide deeper and more liquid markets. In sum, the Commission believes that options on Fund Shares likely will engender the same benefits to investors and the market place that exist with respect to options on common stock, thereby serving to promote the public interest and remove impediments to a free and open securities market.<sup>16</sup>

As a general matter, the Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as options on Fund Shares, can commence trading on a national securities exchange. The Commission notes that the trading of standardized exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) The special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. With regard to position and exercise limits, the Commission finds that it is appropriate to adopt the tiered approach used in setting position and exercise limits for standardized stock options. This approach should serve to minimize potential manipulation and market impact concerns. Accordingly, because options on Fund Shares will be subject to the same regulatory regime as the other options currently traded on the ISE, the Commission believes that adequate safeguard are in place to

ensure the protection of investors in options on Fund Shares.

The Commission also believes that it is appropriate to permit the ISE to list and trade options on Fund Shares given that these options must meet specific requirements related to the protection of investors.<sup>17</sup> First, the Exchange's listing and delisting criteria for options on Fund Shares are adequate. With regard to initial listing, the proposal requires that either: (1) The underlying Fund Shares meet the ISE's uniform options listing standards; or (2) the Fund Shares must be available for creation or redemption each business day in cash or in kind from the Fund at a price related to the net asset value, and the Exchange will require that the underlying Fund Shares may be created even though some or all of the securities needed to be deposited have not been received by the Fund.<sup>18</sup> This listing requirement should ensure that there exists sufficient supply of the underlying Fund Shares so that a short call writer, for example, will have the ability to secure delivery of the Fund Shares upon exercise of the option.

The Commission believes the ISE has adequately addressed potential concerns about the ability to produce Fund Shares upon exercise of the option through the adoption of the listing standards set forth above. In particular, options listed pursuant to the uniform options listing standards will have to meet the options maintenance listing standards that require, among other things, that minimum number of Fund Shares be outstanding to continue trading the options. The alternative listing criteria, noted above, should also help to ensure that the underlying Fund Shares will be available upon exercise by requiring the Fund to allow market participants to create Fund Shares even though some or all of the necessary securities needed to be deposited are not available. Although there is no absolute assurance that market participants will go ahead and create Fund Shares in the event a short call writer needs to purchase Fund Shares to meet an exercise notice, it is likely that arbitrage opportunities will create an incentive to do so. Further, in the event there are not enough Fund Shares to meet exercise requirement, as with other

<sup>17</sup> The Commission notes, and ISE has verified, that holders of options on Fund Shares who exercise and receive the underlying Fund Shares must receive, like any purchaser of Fund Shares, a product description or prospectus, as appropriate. Telephone conversation between Katherine Simmons, Vice President and Associate General Counsel, ISE, and Heather Traeger, Special Counsel, Division of Market Regulation, SEC, on March 2, 2001.

<sup>18</sup> See *supra* note 9.

<sup>14</sup> 15 U.S.C. 78f(b)(5).

<sup>15</sup> 15 U.S.C. 78f(b)(5).  
<sup>16</sup> In approving this rule, the Commission notes that it has also considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

physically-settled equity options, the options Clearing Corporation has rules that would apply to such situation. In addition, the Commission believes it is appropriate for the ISE to set strike prices for both 100 and 1000 shares contracts to bracket the Fund Shares price at one point intervals up to a share price of \$200.

Second, the Commission believes that the surveillance standard developed by the ISE for options on Fund Shares is adequate to address the concerns associated with the listing and trading of such securities. Specifically, the ISE has proposed that: (1) Any Fund Share with non-US stocks in the underlying index or portfolio that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 50% of the weight of the index or portfolio; (2) stocks for which the primary market is in any one country that is not subject to a comprehensive surveillance agreement do not represent 20% or more of the weight of the index or portfolio; and (3) stocks for which the primary market is in any two countries that are not subject to comprehensive surveillance agreements do not represent 33% or more of the weight of the index or portfolio.

As a general matter, the Commission believes that comprehensive surveillance agreements provide an important deterrent to manipulation because they facilitate the availability of information needed to fully investigate a potential manipulation if it were to occur. These agreements are especially important in the content of derivative products based on foreign securities because they facilitate the collection of necessary regulatory, surveillance and other information from foreign jurisdictions. In evaluating the current proposal, the Commission believes that requiring comprehensive surveillance agreements to be in place between the ISE and the primary markets for foreign securities that comprise 50% or more of the weight of the underlying index or portfolio upon which Fund Shares are based, as well as the other conditions discussed above, provides an adequate mechanism for the exchange of surveillance sharing information necessary to detect and deter possible market manipulations. Although the Commission recognizes that up to 50% of the portfolio's value may not be covered by comprehensive surveillance agreements, the other requirements will ensure that a significant percentage of the portfolio is not made up of securities from uncovered countries. Further, as to the domestically-traded Fund Shares themselves and the domestic stocks in the underlying index or portfolio upon

which Fund Shares are based, the Intermarket Surveillance Group Agreement will be applicable to the trading of options on Fund Shares.

Finally, the Commission believes that it is appropriate to require minimum margin of 100% of the current market value of the option plus 15% of the market value of the underlying security value ("broad-based margin") for options on Fund Shares based on a broad-based index or portfolio and for options on Fund Shares which have been approved to date. Moreover, the Commission believes that requiring minimum margin of 100% of the current market value of the option plus 20% of the market value of the underlying security value ("narrow-based margin") for options on Fund Shares based on a narrow-based index or portfolio is appropriate. The Commission notes that these margin requirements for options on Fund Shares are comparable to margin requirements that currently apply to broad-based and narrow-based index options on the CBOE and NYSE.<sup>19</sup>

The Commission finds good cause for approving the proposed rule change, as amended, (SR-ISE-01-08) prior to the thirtieth day after the date of publication of notice thereof in the **FEDERAL REGISTER**. The Commission notes that the proposed rule change, as amended, is similar to rules previously approved by the Commission for the Amex, CBOE, PHLX, and Pacific Exchange.<sup>20</sup> The Commission also observes that the proposed rule change concerns issues that previously have been the subject of a full comment period pursuant to section 19(b) of the Act.<sup>21</sup> The Commission does not believe that the proposed rule change raises novel regulatory issues that were not addressed in the previous filings. Moreover, the Commission believes that approving the listing and trading of Fund Shares on the ISE will increase industry competitiveness by providing an additional venue for the trading of such issues, to the benefit of the investor. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act, to

approve the proposal, as amended, on an accelerated basis.

*It is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change, as amended, (SR-ISE-01-08) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## DEPARTMENT OF TRANSPORTATION

### Federal Aviation Administration

[Docket No. 28895]

#### Airport Privatization Pilot Program

**AGENCY:** Federal Aviation Administration (FAA), DOT.

**ACTION:** Notice of public meeting for public comment on the final application of Niagara Falls International Airport, Niagara Falls, New York.

**SUMMARY:** On March 5, 2001, the Federal Aviation Administration (FAA) published a notice in the **Federal Register** (66 FR 133366) seeking information and comments from interested parties on the final application by the Niagara Frontier Transportation Authority (NFTA) for participation of Niagara Falls International Airport (IAG) in the Airport Privatization Pilot Program. The deadline for submitting comments is May 4, 2001. In an effort to provide the public the opportunity to comment on the final application, the FAA will conduct a public meeting on Monday, March 19, 2001, at Niagara Falls Community College.

**DATES:** The public meeting will be held on Monday, March 19, 2001, beginning at 7 p.m.

**ADDRESSES:** The public meeting will be held in the auditorium of the Niagara County Community College, 3111 Saunders Settlement Road, Sanborn, NY. IAG final application is available for public review in the Federal Aviation Administration, Office of Chief Counsel, Attention: Rules Docket (AGC-200), Docket No. 28895, 800 Independence Avenue, SW., Washington, DC 20591. NFTA, the airport sponsor, has also made a copy of the application available at the following locations:

<sup>19</sup> The Commission also notes the ISE will file a proposed rule change to amend its margin rules, if necessary. See Amendment No. 1, *supra* note 3.

<sup>20</sup> See Securities Exchange Act Release No. 40157 (July 1, 1998), 63 FR 37426 (July 10, 1998) (SR-Amex-96-44); Securities Exchange Act Release No. 43921 (February 2, 2001), 66 FR 9739 (February 9, 2001) (SR-PHLX-00-107); Securities Exchange Act Release No. 40166 (July 2, 1998), 63 FR 37430 (July 10, 1998) (SR-CBOE-97-03); and Securities Exchange Act Release No. 44025 (February 28, 2001).

<sup>21</sup> 15 U.S.C. 78s(b).

<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</sup> 17 CFR 200.30-3(a)(12).