

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-51426; File No. SR-Amex-2005-022)

March 23, 2005

Self-Regulatory Organizations; American Stock Exchange LLC; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change Relating to the Listing and Trading of Notes Linked to the Performance of the CBOE S&P 500 BuyWrite Index(sm)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934, as amended (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on February 11, 2005, the American Stock Exchange LLC (“Amex” 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 prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

The Exchange proposes to list and trade notes, the performance of which is linked to the S&P 500 BuyWrite Index(sm) (“BXM Index” or “Index”). The text of the proposed rule change is available on the Amex’s Web site [<http://www.amex.com>], at the principal offices of the Amex, and at the Commission’s Public Reference Room.

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 Amex included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the

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

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

proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Amex 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

Under Section 107A of the Amex Company Guide ("Company Guide"), the Exchange may approve for listing and trading securities that cannot be readily categorized under the listing criteria for common and preferred stocks, bonds, debentures, or warrants.<sup>3</sup> The Amex proposes to list for trading under Section 107A of the Company Guide notes linked to the performance of the BXM Index (the "Notes"). The BXM Index is determined, calculated, and maintained solely by the Chicago Board of Options Exchange ("CBOE").<sup>4</sup>

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<sup>3</sup> See Securities Exchange Act Release No. 27753 (Mar. 1, 1990), 55 FR 8626 (Mar. 8, 1990) (order approving File No. SR-Amex-89-29).

<sup>4</sup> If the BXM Index is discontinued or suspended, the calculation agent, in its sole discretion, may substitute the BXM Index with an index substantially similar to the discontinued or suspended BXM Index (the "Successor Index"). The Successor Index may be calculated and/or published by the CBOE or any other third party. If the calculation agent is unable to identify a Successor Index, then the Maturity Valuation Date will be accelerated to the last scheduled trading day prior to the expiration of the call option positions of the BXM Index (the "Roll Date"). The calculation agent will accordingly determine the Entitlement Value on such date. Under certain circumstances, the calculation agent or an affiliate will calculate the Index value until a Successor Index is substituted. This may occur if adequate notice of the Index's discontinuance or suspension is not provided to the calculation agent. The calculation agent will then undertake to identify and designate, in its sole discretion, a Successor Index prior to the Roll Date that falls at least one (1) month following the discontinuance or suspension of the BXM Index. If the calculation agent is unable to identify a Successor Index five (5) days prior to the Roll Date that falls at least one (1) month following such discontinuance or suspension, the Maturity Valuation Date will be accelerated to the last scheduled trading day prior to the Roll Date following such discontinuance or suspension. In calculating the Index value, the calculation agent or affiliate will use the current method employed prior to the discontinuance or suspension. The Exchange agrees to delist the Notes (or seek Commission approval pursuant to Rule 19b-4 to list and trade a Note that

Morgan Stanley will issue the Notes under the name “8% Targeted Income Strategic Total Return Securities.”<sup>5</sup>

The Notes will conform to the initial listing guidelines under Section 107A<sup>6</sup> and continued listing guidelines under Sections 1001-1003<sup>7</sup> of the Company Guide. The Notes are a series of medium-term debt securities of Morgan Stanley that provide for a cash payment at

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reflects the Successor Index) in the event that CBOE stops calculating and disseminating the value of the BXM Index. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division of Market Regulation (“Division”), Commission, on February 18, 2005.

<sup>5</sup> Morgan Stanley and Standard & Poor’s (“S&P”), a division of the McGraw-Hill Companies, Inc., have entered into a non-exclusive license agreement providing for the use of the BXM Index by Morgan Stanley in connection with certain securities, including the Notes. S&P is responsible for and will not participate in the issuance and creation of the Notes.

<sup>6</sup> The initial listing standards for the Notes require: (1) a minimum public distribution of one million units; (2) a minimum of 400 shareholders; (3) a market value of at least \$4 million; and (4) a term of at least one year. In addition, the listing guidelines provide that the issuer has assets in excess of \$100 million, stockholder’s equity of at least \$10 million, and pre-tax income of at least \$750,000 in the last fiscal year or in two of the three prior fiscal years. In the case of an issuer which is unable to satisfy the earning criteria stated in Section 101 of the Company Guide, the Exchange will require the issuer to have the following: (1) assets in excess of \$200 million and stockholders’ equity of at least \$10 million; or (2) assets in excess of \$100 million and stockholders’ equity of at least \$20 million.

<sup>7</sup> The Exchange’s continued listing guidelines are set forth in Sections 1001 through 1003 of Part 10 to the Exchange’s Company Guide. Section 1002(b) of the Company Guide states that the Exchange will consider removing from listing any security where, in the opinion of the Exchange, it appears that the extent of public distribution or aggregate market value has become so reduced to make further dealings on the Exchange inadvisable. With respect to continued listing guidelines for distribution of the Notes, the Exchange will rely, in part, on the guidelines for bonds in Section 1003(b)(iv). Section 1003(b)(iv)(A) provides that the Exchange will normally consider suspending dealings in, or removing from the list, a security if the aggregate market value or the principal amount of bonds publicly held is less than \$400,000.

maturity, or upon earlier exchange at the holder's option or the earlier redemption of the issue,<sup>8</sup> based on the performance of the BXM Index adjusted by the Adjustment Amount.<sup>9</sup> The principal amount of each Note is expected to be \$10. The Notes will not have a minimum principal amount that will be repaid and, accordingly, payment on the Notes prior to or at maturity may be less than the original issue price of the Notes. In fact, the value of the BXM Index must increase for the investor to receive at least the \$10 principal amount per security at maturity or upon exchange or redemption. If the value of the BXM Index decreases or does not increase sufficiently, the investor will receive less, and possibly significantly less, than the \$10 principal amount per security.<sup>10</sup> The Notes will have a term of at least one (1) but no more than ten (10) years.<sup>11</sup>

Commencing on March 30, 2005, holders of the notes will receive interim payments on a monthly basis at the rate of \$0.0667 per note (8% on the principal amount per year or \$0.80 per Note per year). In addition, beginning in June 2005 and ending in December 2009, on a quarterly basis during the first ten (10) calendar days of March, June, September, and December, holders of the Notes will have the right to exchange the Notes for a cash amount equal to the Net Entitlement Value on the valuation date for such exchange date and any accrued interim

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<sup>8</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division, Commission, on February 18, 2005.

<sup>9</sup> The Adjustment Amount on any trading day will equal \$0.00274 each day multiplied by the number of calendar days since the immediately preceding trading day, and this will reduce the Net Entitlement Amount by \$1.00 each year per Note. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

<sup>10</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division, Commission, on February 18, 2005.

<sup>11</sup> The term of the Notes is expected to be five years and will be disclosed in the pricing supplement.

payments from and including the last payment date to and including the applicable valuation date for such exchange date. The minimum exchange amount is 10,000 Notes.<sup>12</sup> Commencing in September 2007, or earlier if the Net Entitlement Value is below \$2.00, Morgan Stanley will have the right to redeem the Notes for the Net Entitlement Value, upon at least ten (10) calendar days' but no more than thirty (30) calendar days' notice to holders, on any quarterly exchange date. The Notes will mature on March 30, 2010.<sup>13</sup>

The "Net Entitlement Value" on any trading day (other than the day the Notes are initially sold to the public) equals (i) the "Net Entitlement Value" on the previous trading day multiplied by the "BXM Index Performance" on that trading day, minus (ii) the "Adjustment Amount" as of that trading day. The Initial Net Entitlement Value is equal to \$9.88 (i.e., 1.20% less than the original issue price of the Notes). The BXM Index Performance on any trading day is equal to the "Index Value" on that trading day divided by the "Index Value" on the previous trading day (the "Previous Index Value"). The "Index Value" on any trading day is the closing value of the BXM Index on that trading day. The Initial Index Value is the closing value of the BXM Index on the date Morgan Stanley prices the Notes for initial sale to the public. The Adjustment Amount, by which the investor's return is also reduced, will be equal to

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<sup>12</sup> There will be no minimum exchange amount during a "credit exchange event," which is defined in the prospectus as the period during which Morgan Stanley's senior debt is downgraded below A- by Standard & Poor's Rating Services or below A3 by Moody's Investors Service, Inc. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division, Commission, on February 18, 2005.

<sup>13</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

approximately \$1.00 or 10% per Note per year.<sup>14</sup> For purposes of determining the amount payable in respect of any exchange by the investor or upon early redemption of the Notes by Morgan Stanley,<sup>15</sup> the Net Entitlement Value will be determined on the last trading day immediately prior to the exchange date or early redemption date, as applicable. For the purposes of calculating the Net Entitlement Value payable on the maturity date, however, the “Maturity Valuation Date” will be the third scheduled trading day immediately prior to the maturity date, unless there is a market disruption event on that date.

The Net Entitlement Value that a holder of a Note will receive upon exchange, early redemption, or at maturity will depend on the relation of the current Index Value to the previous trading day’s Index Value of the BXM Index and will always be 1.20% less than the original issue price and include the Adjustment Amount.<sup>16</sup> If there is a “market disruption event”<sup>17</sup> when

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<sup>14</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005. See also supra note 9 (discussing the Adjustment Amount).

<sup>15</sup> Beginning in September 2007, Morgan Stanley may redeem the Notes for mandatory exchange on the fifth trading day after any exchange date. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

<sup>16</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

<sup>17</sup> A “market disruption event” is defined as (i) the occurrence of or existence of a suspension, absence or material limitation of trading of stocks then constituting 20% or more of the value of the S&P 500 Index on the Relevant Exchanges for such securities for the same period of trading longer than two hours or during the one-half hour period preceding the close of the principal trading session on such Relevant Exchange; (ii) a breakdown or failure in the price and trade reporting systems of any Relevant Exchange as a result of which the reported trading prices for stocks then constituting 20% or more of the value of the S&P 500 Index during the last one-half hour preceding the close of the principal trading session on such Relevant Exchange are materially inaccurate; (iii) the suspension, material limitation, or absence of trading on any major U.S. securities market for trading in futures or options contracts or exchange traded funds related to the BXM Index or the S&P 500 Index for more than two hours of trading or during the one-half

determining the Index Value, the Index Value will be determined on the next available trading day during which no “market disruption event” occurs. Thus, the Net Entitlement Value (on any trading day other than the day the Notes are initially priced for sale to the public) per Note will equal:

$$\text{Net Entitlement Value}_{t-1} \left( \frac{\text{Index Value}}{\text{Previous Index Value}} \right) - \text{Adjustment Amount, where the Net}$$

Entitlement Value<sub>t-1</sub> is the Net Entitlement Value on the previous trading day.

The Notes are cash-settled in U.S dollars and do not give the holder any right to receive any of the component securities, dividend payments, or any other ownership right or interest in the securities comprising the BXM Index. The Notes are designed for investors who want to participate in the exposure to the S&P 500 Index (the “S&P 500”) that the BXM Index provides while limiting downside risk, and who are willing to forego principal protection on the Notes during their term.

The Commission has previously approved the listing on the Amex of securities with structures similar to that of the proposed Notes.<sup>18</sup>

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hour period preceding the close of the principal trading session on such market; and (iv) a determination by the calculation agent that any event described in clauses (i)-(iii) above materially interfered with the ability of Morgan Stanley or any of its affiliates to unwind or adjust all or a material portion of the hedge position with respect to the Notes.

<sup>18</sup> See Securities Exchange Act Release Nos. 50719 (Nov. 22, 2004), 69 FR 69644 (Nov. 30, 2004) (approving the listing and trading of non-principal protected notes linked to the BXM Index) (File No. SR-Amex-2004-55); 49548 (Apr. 9, 2004), 69 FR 20089 (Apr. 15, 2004) (approving the listing and trading of non-principal protected notes linked to the Select Utility Index) (File No. SR-Amex-2004-02); 45639 (Mar. 25, 2002), 67 FR 15258 (Mar. 29, 2002) (approving the listing and trading of non-principal protected notes linked to the Oil and Natural Gas Index) (File No. SR-Amex-2002-18); 45305 (Jan. 17, 2002), 67 FR 3753 (Jan. 25, 2002) (approving the listing and trading of non-principal protected notes linked to the Biotech-Pharmaceutical Index) (File No. SR-Amex-2001-108); 45160

## Description of the Index

The BXM Index is a benchmark index designed to measure the performance of a hypothetical “buy-write”<sup>19</sup> strategy on the S&P 500. Developed by the CBOE in cooperation with S&P, the Index was initially announced in April 2002.<sup>20</sup> The CBOE developed the BXM Index in response to several factors, including the repeated requests by options portfolio

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(Dec. 17, 2001), 66 FR 66485 (Dec. 26, 2001) (approving the listing and trading of non-principal protected notes linked to the Balanced Strategy Index) (File No. SR-Amex-2001-91); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (approving the listing and trading of non-principal protected notes linked to the Institutional Holdings Index) (File No. SR-Amex-2001-40); 44437 (June 18, 2001), 66 FR 33585 (June 22, 2001) (approving the listing and trading of non-principal protected notes linked to the Industrial 15 Index) (File No. SR-Amex-2001-39); and 44342 (May 23, 2001), 66 FR 29613 (May 31, 2001) (approving the listing and trading of non-principal protected notes linked to the Select Ten Index) (File No. SR-Amex-2001-28).

<sup>19</sup> A “buy-write” is a conservative options strategy in which an investor buys a stock or portfolio and writes call options on the stock or portfolio. This strategy is also known as a “covered call” strategy. A buy-write strategy provides option premium income to cushion decreases in the value of an equity portfolio, but will underperform stocks in a rising market. A buy-write strategy tends to lessen overall volatility in a portfolio.

<sup>20</sup> The BXM Index consists of a long position in the component securities of the S&P 500 and options on the S&P 500 (e.g., “writing” the near-term S&P 500 Index covered call option, generally on the third Friday of each month). The Commission has approved the listing of numerous securities linked to the performance of the S&P 500 as well as options on the S&P 500. See, e.g., Securities Exchange Act Release Nos. 48486 (Sept. 11, 2003), 68 FR 54758 (Sept. 18, 2003) (approving the listing and trading of CSFB Contingent Principal Protected Notes on the S&P 500) (File No. SR-Amex-2003-74); 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of UBS Partial Principal Protected Notes linked to the S&P 500) (File No. SR-Amex-2003-62); 47983 (June 4, 2003), 68 FR 35032 (June 11, 2003) (approving the listing and trading of CSFB Accelerated Return Notes linked to the S&P 500) (File No. SR-Amex-2003-45); 47911 (May 22, 2003), 68 FR 32558 (May 30, 2003) (approving the listing and trading of notes (Wachovia TEES) linked to the S&P 500) (File No. SR-Amex-2003-46); and 19907 (June 24, 1983), 48 FR 30814 (July 5, 1983) (approving the listing and trading of options on the S&P 500) (File No. SR-CBOE-83-8). In addition, the Commission previously approved the listing and trading of a packaged buy-write option strategy known as “BOUNDS.” See Securities Exchange Act Release No. 36710 (Jan. 11, 1996), 61 FR 1791 (Jan. 23, 1996) (File No. SR-Amex-94-56).

managers that the CBOE provide an objective benchmark for evaluating the performance of buy-write strategies, one of the most popular option trading strategies. Further, the CBOE developed the BXM Index to provide investors with a relatively straightforward indicator of the risk-reducing character of options that otherwise may seem complicated and inordinately risky.

The BXM Index is a passive total return index based on (1) buying a portfolio consisting of the component stocks of the S&P 500, and (2) “writing” (or selling) near-term S&P 500 call options (SPX), generally on the third Friday of each month. This strategy consists of a hypothetical portfolio consisting of a “long” position indexed to the S&P 500 on which are deemed sold a succession of one-month, at-the-money call options on the S&P 500 (SPX) listed on the CBOE. Dividends paid on the component stocks underlying the S&P 500 and the dollar value of option premium deemed received from the sold call options are functionally “re-invested” in the covered S&P 500 portfolio.

The value of the BXM Index on any given date will equal: the value of the BXM Index on the previous day, multiplied by the daily rate of return<sup>21</sup> on the covered S&P 500 portfolio on that date. Thus, the daily change in the BXM Index reflects the daily changes in value of the covered S&P 500 portfolio, which consists of the S&P 500 (including dividends) and the component S&P 500 option (SPX). The daily closing price of the BXM Index is calculated and disseminated by the CBOE on its Web site at <http://www.cboe.com> and via the Options Pricing

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<sup>21</sup> The daily rate of return on the covered S&P 500 portfolio is based on (a) the change in the closing value of the stocks in the S&P 500 portfolio, (b) the value of ordinary cash dividends on the stocks underlying the S&P 500, and (c) the change in the market price of the call option. The daily rate of return will also include the value of ordinary cash dividends distributed on the stocks underlying the S&P 500 that are trading “ex-dividend” on that date (that is, when transactions in the stock on an organized securities exchange or trading system no longer carry the right to receive that dividend or distribution) as measured from the close in trading on the previous day.

and Reporting Authority (“OPRA”) at the end of each trading day.<sup>22</sup> The value of the S&P 500 Index is widely disseminated at least once every fifteen (15) seconds throughout the trading day. The Exchange believes that the intraday dissemination of the S&P 500, along with the ability of investors to obtain real time, intraday S&P 500 call option pricing, provides sufficient transparency regarding the BXM Index.<sup>23</sup> In addition, as indicated above, the value of the BXM Index is calculated once every trading day, thereby providing investors with a daily value of such “hypothetical” buy-write options strategy on the S&P 500.

The CBOE has represented that the BXM Index value will be calculated and disseminated by the CBOE once every trading day after the close. The daily change in the BXM Index reflects the daily changes in the S&P 500 and related options positions. The Exchange

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<sup>22</sup> The Commission, in connection with the Strategic Total Return Securities, the Bond Index Term Notes, and the Merrill Lynch EuroFund Market Index Target Term Securities, has previously approved the listing and trading of products where the dissemination of the value of the underlying index occurred once per trading day. See Securities Exchange Act Release Nos. 50719 (Nov. 22, 2004), 69 FR 69644 (Nov. 30, 2004) (approving the listing and trading of non-principal protected notes linked to the BXM Index) (File No. SR-Amex-2004-55); 41334 (Apr. 27, 1999), 64 FR 23883 (May 4, 1999) (approving the listing and trading of Bond Indexed Term Notes) (File No. SR-Amex-99-03); and 40367 (Aug. 26, 1998), 63 FR 47052 (Sept. 3, 1998) (approving the listing and trading of Merrill Lynch EuroFund Market Index Target Term Securities) (File No. SR-Amex-98-24).

<sup>23</sup> Call options on the S&P 500 (SPX) are traded on the CBOE, and both last sale and quotation information for the call options are disseminated in real time through OPRA. The value of the BXM can be readily approximated as a function of observable market prices throughout the trading day. In particular, such a calculation would require information on the current price of the S&P 500 index and specific nearest-to-expiration call and put options on that index. These components trade in highly liquid markets, and real-time prices are available continuously throughout the trading day from a number of sources including Bloomberg and CBOE. The “Indicative Value” (as discussed below) may be a more accurate indicator of the valuation of the Notes because it reflects the fees associated with the Notes (e.g., on the initial principal amount and the Adjustment Amount); however, the “Indicative Value” is also not adjusted intraday. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division, Commission, on February 18, 2005.

states that Morgan Stanley has represented that it will seek to arrange to have the BXM Index calculated and disseminated on a daily basis through a third party if the CBOE ceases to calculate and disseminate the Index.<sup>24</sup> If, however, Morgan Stanley is unable to arrange the calculation and dissemination of the BXM Index as indicated above, the Exchange will delist the Notes.<sup>25</sup>

In order to provide an updated value of the Net Entitlement Value for use by investors, the Exchange will disseminate over the Consolidated Tape Association's Network B, a daily indicative Net Entitlement Value equal to the Net Entitlement Value on the previous trading day multiplied by the percentage change in the BXM Index, adjusted on a monthly basis on each Roll Date by the Adjustment Amount (the "Indicative Value"). The Indicative Value will be calculated by the Amex after the close of trading and after the CBOE calculates the BXM Index for use by investors the next trading day. It is designed to provide investors with a daily reference value of the adjusted Index. The Indicative Value may not reflect the precise value of the current Net Entitlement Value or amount payable upon repurchase or maturity. Therefore, the Indicative Value disseminated by the Amex during trading hours should not be viewed as a real-time update of the BXM Index, which is calculated only once a day. While the Indicative Value that will be disseminated by the Amex is expected to be close to the current BXM Index

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<sup>24</sup> Prior to such change in the manner in which the BXM Index is calculated, the Exchange will file a proposed rule change pursuant to Rule 19b-4, which must be approved by the Commission prior to continued listing and trading in the Notes. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Richard Holley III, Attorney, Division, Commission, on February 18, 2005.

<sup>25</sup> See supra note 4 (regarding discontinuation of the calculation and dissemination of the Notes).

value, the values of the Indicative Value and the BXM Index will diverge due to the application of the Adjustment Amount.<sup>26</sup>

From June 30, 1988 through January 31, 2005, the annualized returns for the BXM Index and the S&P 500 were 11.94% and 11.71%, respectively, with a total deviation of the returns during the same time period of 21.33%. As the chart in Exhibit A to the Exchange's Form 19b-4 indicates, the BXM Index will closely track the S&P 500 except in those cases where the market is significantly rising or decreasing. In the case of a fast rising market, the BXM Index will trail the S&P 500 due to the limited upside potential of the Index because of the "buy-write" strategy. Due to the cushioning effect of the "buy-write" strategy, the BXM Index has in the past exhibited negative returns that are less than the S&P 500 during a down market. The Exchange expects the BXM Index to continue to display these characteristics.

The call options included in the value of the BXM Index have successive terms of approximately one month. Each day that an option expires, which day is referred to as a "roll" date, that option's value at expiration is taken into account in the value of the BXM Index. At expiration, the call option is settled against the "Special Opening Quotation," a special calculation of the S&P 500. The final settlement price of the call option at expiration is equal to the difference between the Special Opening Quotation and the strike price of the expired call option, or zero, whichever is greater, and is removed from the value of the BXM Index. Subsequent to the settlement of the expired call option, a new "short" or sold at-the-money call

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<sup>26</sup> The Indicative Value will not reflect the interest payments on the Notes. Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

option is included in the value of the BXM Index.<sup>27</sup> The initial value of the new call option is calculated by the CBOE and is based on the volume-weighted average of all the transaction prices of the new call option during a designated time period on the day the strike price is determined.<sup>28</sup>

As of February 9, 2005, the market capitalization of the securities included in the S&P 500 Index ranged from a high of \$382 billion to a low of \$566 million. The average daily trading volume for these same securities for the last six (6) months ranged from a high of 16.9 million shares to a low of 350,830 shares.

The Exchange represents that it prohibits the initial and/or continued listing of any security that is not in compliance with Rule 10A-3 under the Act.<sup>29</sup>

Because the Notes are expected to be issued in \$10 denominations, the Amex's existing equity floor trading rules will apply to the trading of the Notes. First, pursuant to Amex Rule 411, the Exchange will impose a duty of due diligence on its members and member firms to learn the essential facts relating to every customer prior to trading the Notes.<sup>30</sup> Second, the Notes will be subject to the equity margin rules of the Exchange.<sup>31</sup> Third, the Exchange will, prior to trading the Notes, distribute a circular to the membership providing guidance with regard to

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<sup>27</sup> Like the expired call option, the new call option will expire approximately one month after the date of sale.

<sup>28</sup> For this purpose, the CBOE excludes from the calculation those call options identified as having been executed as part of a spread (i.e., a position taken in two or more options in order to profit through changes in the relative prices of those options).

<sup>29</sup> 17 CFR 240.10A-3.

<sup>30</sup> Amex Rule 411 requires that every member, member firm or member corporation use due diligence to learn the essential facts, relative to every customer and to every order or account accepted.

<sup>31</sup> See Amex Rule 462 and Section 107B of the Company Guide.

member firm compliance responsibilities (including suitability recommendations) when handling transactions in the Notes and highlighting the special risks and characteristics of the Notes. With respect to suitability recommendations and risks, the Exchange will require members, member organizations and employees thereof recommending a transaction in the Notes: (1) to determine that such transaction is suitable for the customer, and (2) to have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of such transaction.<sup>32</sup> In addition, Morgan Stanley will deliver a prospectus in connection with its sales of the Notes.

The Exchange represents that its surveillance procedures are adequate to properly monitor the trading of the Notes. Specifically, the Amex will rely on its existing surveillance procedures governing equities and options that include additional monitoring on key pricing dates,<sup>33</sup> which have been deemed adequate under the Act. In addition, the Exchange also has a general policy, which prohibits the distribution of material, non-public information by its employees.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6 of the Act<sup>34</sup> in general and furthers the objectives of Section 6(b)(5)<sup>35</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

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<sup>32</sup> See Amex Rule 411.

<sup>33</sup> Telephone conference between Jeffrey P. Burns, Associate General Counsel, Amex, and Florence Harmon, Senior Special Counsel, Division, Commission, on March 23, 2005.

<sup>34</sup> 15 U.S.C. 78f.

<sup>35</sup> 15 U.S.C. 78f(b)(5).

transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition.

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

The Exchange did not receive any written comments on the proposed rule change.

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 SR-Amex-2005-022 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 No. SR-Amex-2005-022. 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 at <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 on the Exchange's Web site at <http://www.amex.com> and 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 No. SR-Amex-2005-022 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

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

Amex has asked the Commission to approve the proposal on an accelerated basis to accommodate the timetable for listing the Notes. After careful consideration, 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 exchange, and, in particular, with the requirements of Section 6(b)(5) of the Act.<sup>36</sup> The Commission finds that this proposal is similar to several approved instruments currently listed and traded on the Amex.<sup>37</sup> Accordingly,

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<sup>36</sup> 15 U.S.C. 78f(b)(5).

<sup>37</sup> See, e.g., Securities Exchange Act Release Nos. 48486 (Sept. 11, 2003), 68 FR 54758 (Sept. 18, 2003) (approving the listing and trading of CSFB Contingent Principal Protected Notes on the S&P 500); 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of UBS Partial Principal Protected Notes linked to the S&P 500); 47983 (June 4, 2003), 68 FR 35032 (June 11, 2003) (approving the listing and trading of CSFB Accelerated Return Notes linked to S&P 500); 47911 (May 22, 2003), 68 FR 32558 (May 30, 2003) (approving the listing and trading of notes (Wachovia TEES) linked to the S&P 500); 45160 (Dec. 17, 2001), 66 FR 66485 (Dec. 26, 2001)

the Commission finds that the listing and trading of the Notes based on the BXM Index is consistent with the Act and will promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to and facilitating transactions in securities consistent with Section 6(b)(5) of the Act.<sup>38</sup>

The requirements of Section 107A of the Company Guide were designed to address the concerns attendant to the trading of hybrid securities, like the Notes. For example, Section 107A of the Company Guide provides that only issuers satisfying substantial asset and equity requirements may issue securities such as the Notes. In addition, the Exchange's "Other Securities" listing standards further require that the Notes have a market value of at least \$4 million.<sup>39</sup> In any event, financial information regarding Morgan Stanley, in addition to the information on the component stocks, which are reporting companies under the Act, and the Notes, which will be registered under Section 12 of the Act, will be available.

In approving the product, the Commission recognizes that the Index is a passive total return index based on (1) buying a portfolio consisting of the component stocks of the S&P 500,

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(approving the listing and trading of non-principal protected notes linked to the Balanced Strategy Index); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (approving the listing and trading of non-principal protected notes linked to the Institutional Holdings Index); 44437 (June 18, 2001), 66 FR 33585 (June 22, 2001) (approving the listing and trading of non-principal protected notes linked to the Industrial 15 Index); 44342 (May 23, 2001), 66 FR 29613 (May 31, 2001) (approving the listing and trading of non-principal protected notes linked to the Select Ten Index); and 36710 (Jan. 11, 1996), 61 FR 1791 (Jan. 23, 1996) (approving the listing and trading of BOUNDS).

<sup>38</sup> 15 U.S.C. 78f(b)(5). In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>39</sup> See Company Guide Section 107A(c).

and (2) “writing” (or selling) near-term S&P 500 call options (SPX), generally on the third Friday of each month. Given the large trading volume and capitalization of the compositions of the stocks underlying the S&P 500 Index, the Commission believes that the listing and trading of the Notes that are linked to the BXM Index should not unduly impact the market for the underlying securities compromising the S&P 500 Index or raise manipulative concerns.<sup>40</sup> Moreover, the issuers of the underlying securities comprising the S&P 500 Index are subject to reporting requirements under the Act, and all of the component stocks are either listed or traded on, or traded through the facilities of, U.S. securities markets.

The Commission also believes that any concerns that a broker-dealer, such as Morgan Stanley, or a subsidiary providing a hedge for the issuer, will incur undue position exposure are minimized by the size of the Notes issuance in relation to the net worth of Morgan Stanley.<sup>41</sup>

Finally, the Commission notes that the value of the Index will be calculated and disseminated by CBOE once every trading day after the close of trading. However, the

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<sup>40</sup> The issuer, Morgan Stanley, disclosed in the prospectus that the original issue price of the Notes includes commissions (and the secondary market prices are likely to exclude commissions) and Morgan Stanley’s costs of hedging its obligations under the Notes. These costs could increase the initial value of the Notes, thus affecting the payment investors receive at maturity. Additionally, the issuer discloses in the prospectus that the hedging activities of its affiliates, including selling call options on the S&P 500, could affect the value of these call option during the half hour period in which their value is determined for purposes of inclusion in the BXM Index. Such hedging activity must, of course, be conducted in accordance with applicable regulatory requirements.

<sup>41</sup> See Securities Exchange Act Release Nos. 44913 (Oct. 9, 2001), 66 FR 52469 (Oct. 15, 2001) (order approving the listing and trading of notes whose return is based on the performance of the Nasdaq-100 Index) (File No. SR-NASD-2001-73); 44483 (June 27, 2001), 66 FR 35677 (July 6, 2001) (order approving the listing and trading of notes whose return is based on a portfolio of 20 securities selected from the Amex Institutional Index) (File No. SR-Amex-2001-40); and 37744 (Sept. 27, 1996), 61 FR 52480 (Oct. 7, 1996) (order approving the listing and trading of notes whose return is based on a weighted portfolio of healthcare/biotechnology industry securities) (File No. SR-Amex-96-27).

Commission notes that the value of the S&P 500 Index will be widely disseminated at least once every fifteen seconds throughout the trading day and that investors are able to obtain real-time call option pricing on the S&P 500 Index during the trading day. Further, the Indicative Value, which will be calculated by the Amex after the close of trading and after the CBOE calculates the BXM Index for use by investors the next trading day, is designed to provide investors with a daily reference value of the adjusted Index. The Commission notes that Morgan Stanley has agreed to arrange to have the BXM Index calculated and disseminated on a daily basis through a third party in the event that the CBOE discontinues calculating and disseminating the Index. In such event, the Exchange agrees to obtain Commission approval, pursuant to filing the appropriate Form 19b-4, prior to the substitution of CBOE. Further, the Commission notes that the Exchange has agreed to undertake to delist the Notes in the event that CBOE ceases to calculate and disseminate the Index, and Morgan Stanley is unable to arrange to have the BXM Index calculated and widely disseminated through a third party.

The Commission finds good cause for approving the proposed rule change prior to the 30th day after the date of publication of the notice of filing thereof in the Federal Register. The Exchange has requested accelerated approval because this product is similar to several other instruments currently listed and traded on the Amex.<sup>42</sup> The Commission believes that the Notes will provide investors with an additional investment choice and that accelerated approval of the proposal will allow investors to begin trading the Notes promptly. Additionally, the Notes will be listed pursuant to Amex's existing hybrid security listing standards as described above.

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<sup>42</sup> See supra notes 13 (citing previous approvals of securities with structures similar to that of the proposed Notes); and 15 (citing previous approvals of securities linked to the performance of the S&P 500 as well as options on the S&P 500).

Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,<sup>43</sup> to approve the proposal on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>44</sup> that the proposed rule change (SR-Amex-2005-022) is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>45</sup>

J. Lynn Taylor  
Assistant Secretary

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<sup>43</sup> 15 U.S.C. 78f(b)(5) and 78s(b)(2).

<sup>44</sup> 15 U.S.C. 78o-3(b)(6) and 78s(b)(2).

<sup>45</sup> 17 CFR 200.30-3(a)(12).