

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50414; File No. SR-Amex-2004-68)

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change by the American Stock Exchange LLC Relating to the Listing and Trading of Contingent Principal Protection Notes Linked to the Performance of the Standard and Poor's 500 Index

September 20, 2004

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on August 16, 2004, 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 to grant accelerated approval of the proposal rule change.

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

The Exchange proposes to list and trade under Section 107A of the Amex Company Guide ("Company Guide") notes linked to the performance of the Standard and Poor's 500 Index ("S&P 500" or "Index").

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 proposed rule change. The text of these statements may be examined at

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 Company Guide, the Exchange may approve for listing and trading securities which cannot be readily categorized under the listing criteria for common and preferred stocks, bonds, debentures, or warrants.³ The Amex proposes to list for trading under Section 107A of the Company Guide notes linked to the performance of the Index that provide for contingent principal protection ("Contingent Principal Protected Notes" or "Notes").⁴ The Exchange represents that the Index value will be disseminated at least once every fifteen seconds throughout the trading day. The Index is determined, calculated, and maintained solely by S&P.⁵ The Notes will provide

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

⁴ Lehman Brothers Holdings Inc. ("Lehman") and Standard & Poor's, a division of The McGraw-Hill Companies, Inc. ("S&P") have entered into a non-exclusive license agreement providing for the use of the S&P 500 by Lehman and certain affiliates and subsidiaries in connection with certain securities including these Notes. S&P is not responsible and will not participate in the issuance and creation of the Notes.

⁵ Amex represents that the Index is a broad-based stock index which provides an indication of the performance of the U.S. equity market. The Index is a capitalization-weighted index reflecting the total market value of 500 widely-held component stocks relative to a particular base period. The Index is computed by dividing the total market value of the 500 stocks by an Index divisor. The Index Divisor keeps the Index comparable over time to its base period of 1941-1943 and is the reference point for all maintenance adjustments. The securities included in the Index are listed on the Amex, New York Stock Exchange, Inc. ("NYSE") or traded through Nasdaq Stock Market, Inc. ("Nasdaq"). The Index reflects the price of the common stocks of 500 companies without taking into account the value of the dividend paid on such stocks.

for an uncapped participation in the positive performance of the Index during their term while also reducing the risk exposure to the principal investment amount, as long as the Index does not at any time decline to a pre-established level to be determined at the time of issuance (“Contingent Level”). This Contingent Level will be a pre-determined percentage decline from the level of the Index at the close of the market on the date the Notes are prices for initial sale to the public (“Initial Level”). The Issuer expects that the Contingent Level will be approximately 60 percent of the initial value of the Index.

The Contingent Principal Protection Notes will initially conform to the listing guidelines under Section 107A⁶ and continued listing guidelines under Sections 1001-

The Exchange notes that S&P has announced a change to its methodology so that Index weightings are based on the “public float” of a component stocks and not those shares of stock that are not publicly traded.

On March 1, 2004, S&P announced that it intends to shift its major indexes, such as the S&P 500, to a “float-adjusted” market capitalization index. In the “float adjusted” market capitalization index, the value of the index will be calculated by multiplying the public float of each component by the price per share of the component. The result is then divided by the divisor. Accordingly, a “float-adjusted” market capitalization index will exclude those blocks of stocks that do not publicly trade from determining the weight for a stock in the index. The transition from a market capitalization weighted index to a “float-adjusted” capitalization weighted index will be implemented over an 18-month period. In September 2004, S&P will publish procedures and float adjustment factors, and begin calculation of provisional float adjusted indexes. At that time, S&P will start calculating a provisional index alongside the regular index, although there will still be only one official set of index values. In March 2005, the non-provisional index values will then shift to partial float adjustment, using float adjustment factors that represent half of the total adjustment, based on the information published in September 2004. In September 2005, the shift to float adjustment will be completed so that official index values will be fully float-adjusted, and the provisional indexes will be discontinued.

⁶ Pursuant to Section 107A of the Company Guide, the initial listing standards for the Notes require: (1) a market value of at least \$4 million; and (2) a term of at least one year. Because the Notes will be issued in \$1,000 denominations, the minimum public distribution requirement of one million units and the minimum

1003⁷ of the Company Guide. The Notes are senior non-convertible debt securities of Lehman. The Notes will have a term of at least one (1) but no more than ten (10) years. Lehman will issue the Notes in denominations of whole units (a “Unit”), with each Unit representing a single Note. The original public offering price will be \$1,000 per Unit with a required minimum initial investment of \$10,000. The Notes will entitle the owner at maturity to receive at least 100% of the principal investment amount as long as the Index never experiences a Contingent Event. In this case, the holder of the Notes would receive the full principal investment amount of the Note plus the product of \$1,000, the percentage change of the Index during the term and the participation rate (expected to be between 105-115 percent). Accordingly, even if the Index declines substantially but never reaches the Contingent Level, the holder will receive the principal investment

holder requirement of 400 holders do not apply. 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.

⁷ 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 or the issuer is not able to meet its obligations on the Notes.

amount of the Notes at maturity. However, if the Index declines at any time during the term of the Notes, to a level expected to be 60% of the Initial Level (the exact percentage amount will be specified in the prospectus supplement), this is a Contingent Event and the holder's principal will be reduced accordingly at maturity. Thus, if the Notes experience a Contingent Event during the term, the holder loses the "principal protection" and will be entitled to receive a payment based on the percentage change of the Index, positive or negative. In this case, the Notes will not have a minimum principal investment 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. Accordingly, if the Index experiences a negative return and a Contingent Event, the Notes would be fully exposed to any decline in the level of the Index.⁸ The Notes are also not callable by the Issuer.

The payment that a holder or investor of a Note will be entitled to receive at the stated maturity date⁹ ("Redemption Amount") will depend on the relation of the level of the Index at the close of the market on the third business day ("Valuation Date") before maturity of the Notes ("Final Level") and the closing level of the Index on the date the Notes are priced for initial sale to the public Initial Level. In addition, whether the Notes retain "principal protection" or are fully exposed to the performance of the Index is

⁸ A negative return of the Index, together with a Contingent Event, will reduce the redemption amount at maturity with the potential that the holder of the Note could lose his entire investment amount.

⁹ The Commission notes that the expected maturity date of the Note agrees to be September 2009. See prospectus supplement dated September, 2004.

determined by whether the Index ever experiences a Contingent Event during the term of the Notes.

If the percentage change of the Index is positive, the Redemption Amount per Unit will equal:

$$\$1000 + [\$1000 \times \left(\frac{\text{Final Level} - \text{Initial Level}}{\text{Initial Level}} \right) \times \text{Participation Rate}]$$

If the percentage change of the Index is zero or negative and the Index never experience a Contingent Event, the redemption amount per unit will equal the principal investment amount of \$1000.

If the Index experiences a Contingent Event, the Redemption Amount per Unit will equal:

$$\$1000 + [\$1000 \times \left(\frac{\text{Final Level} - \text{Initial Level}}{\text{Initial Level}} \right)]$$

The Notes are cash-settled in U.S. dollars and do not give the holder any right to receive a portfolio security, dividend payments or any other ownership right or interest in the portfolio or index of securities comprising the Index. The Notes are designed for investors who want to participate or gain exposure to the Index, while partially limiting their investment risk and who are willing to forego market interest payments on the Notes during such term. The Commission has previously approved the listing of securities and options, the performance of which have been linked to or are based on the Index.¹⁰

¹⁰ See e.g., Securities Exchange Act Release Nos. 19907 (June 24, 1983), 48 FR 30814 (July 5, 1983) (approving the listing and trading of options on the S&P 500 Index); 31591 (December 18, 1992), 57 FR 60253 (December 18, 1992) (approving the listing and trading of Portfolio Depositary Receipts based on the

As of August 11, 2004, the market capitalization of the securities included in the S&P 500 ranged from a high of approximately \$339.9 billion to a low of approximately \$464.7 million. The average daily trading volume for these same securities for the last six (6) months ranged from a high of approximately 25.9 million shares to a low of approximately 117,071 shares.

Because the Notes are issued in \$1,000 denominations, the Amex's existing debt 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.¹¹ Second, even though the Exchange's debt trading rules apply, the Notes will be subject to the equity margin rules of the Exchange.¹² Third, the Exchange will, prior to trading the Notes, distribute a circular to the membership providing guidance with regard to member

S&P 500 Index); 27382 (October 26, 1989), 54 FR 45834 (October 31, 1989) (approving the listing and trading of Exchange Stock Portfolios based on the value of the S&P 500 Index); 30394 (February 21, 1992), 57 FR 7409 (March 2, 1992) (approving the listing and trading of a unit investment trust linked to the S&P 500 Index ("SPDR's")); 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); 47983 (June 4, 2003), 68 FR 35032 (June 11, 2003) (approving the listing and trading of a CSFB Accelerated Return Notes linked to S&P 500); 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of UBS Partial Protection Notes linked to the S&P 500); 48486 (September 11, 2003), 68 FR 54758 (September 18, 2003) (approving the listing and trading of CSFB Contingent Principal Protection Notes linked to the S&P 500); and 50019 (July 14, 2004), 69 FR 43635 (July 21, 2004) (approving the listing and trading of Morgan Stanley PLUS Notes linked to the S&P 500).

¹¹ 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.

¹² See Amex Rule 462 and Section 107B of the Company Guide.

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. In addition, Lehman will deliver a prospectus in connection with the initial 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, 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(b) of the Act¹³ in general, and furthers the objectives of Section 6(b)(5),¹⁴ in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and, in general, to protect investors and the public interest.

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

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 has not solicited and 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. Please include SR-Amex-2004-68 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 SR-Amex-2004-68. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site <http://www.sec.gov/rules/sro.shtml>.

Copies of the submission, all subsequent amendments, all written statements with respect

to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Amex. 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 SR-Amex-2004-68 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 Proposed Rule Change

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.¹⁵ The Commission believes that the proposal is similar to several approved instruments currently listed and traded on the Amex.¹⁶ Accordingly, the

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ See Securities Exchange Act Release Nos. 48152 (July 10, 2003), 68 FR 42435 (July 17, 2003) (approving the listing and trading of a UBS Partial Protection Note linked to the S&P 500); 48486 (September 11, 2003), 68 FR 54758 (September 18, 2003) (approving the listing and trading of CSFB Contingent Principal Protection Notes); 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); 47983 (June 4, 2003), 68 FR 35032 (June 11, 2003) (approving the listing and trading of a CSFB Accelerated Return Notes linked to S&P 500); and 50019

Commission finds that the listing and trading of the Notes based on the 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 securities, and, in general, protect investors and the public interest consistent with Section 6(b)(5) of the Act.¹⁷

As described more fully above, at maturity, the holder of the Note will receive at least 100% of the principal investment amount as long as the Final Level of the Index exceeds the Initial Level of the Index and the Index never experiences a Contingent Event. Specifically, at maturity, the holder would receive a full principal investment amount of the Notes plus the percentage change of the Index at the maturity date. Also, if the Index declines substantially but never reaches the Contingent Level, the holder will receive the principal investment amount of the Notes at maturity. However, if the Index declines at any time during the term of the Notes, to a level expected to be 60% of the Initial Level (the exact percentage amount will be specified in the prospectus), this is a Contingent Event and the holder's principal will be reduced accordingly at maturity. The Notes will provide investors who are willing to forego market interest payments during the term of the Notes with a means to participate or gain exposure to the Index, subject to a minimum payment amount.

(July 14, 2004), 69 FR 43635 (July 21, 2004) (approving the listing and trading of Morgan Stanley PLUS Notes).

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

The Commission notes that the Notes are non-convertible debt securities whose price will be derived and based upon the Initial Level. In addition, if the level of the Index experiences a Contingent Event during the term, the holder of the Notes will lose the principal protection and will be entitled to receive a payment on the Notes based on the percentage change of the Index. Thus, the Commission notes that the Notes will not have a minimum principal investment amount that will be repaid, and payment on the Notes prior to or at maturity may be less than the original issue price of the Notes. The level of risk involved in the purchase or sale of the Notes is similar to the risk involved in the purchase or sale of traditional common stock, but the Note holder's principal is permanently reduced if there is a Contingent Event at any time during the term of the Note. Because the final level of return of the Notes is derivatively priced and based upon the performance of an index of securities because the Notes are debt instruments that do not guarantee a return of principal, and because investors' potential return is limited by minimum payment amount, if the value of the Index has increased over the term of such Note, there are several issues regarding the trading of this type of product. However, for the reasons discussed below, the Commission believes the Exchange's proposal adequately addresses the concerns raised by this type of product.

In approving the product, the Commission recognizes that the Index is a capitalization-weighted index of 500 companies listed on Nasdaq, the NYSE, and the Amex. The Exchange represents that the Index will be determined, calculated, and maintained by S&P.

As of August 11, 2004, the market capitalization of the securities included in the S&P 500 ranged from a high of approximately \$339.9 billion to a low of approximately

\$464.7 million. The average daily trading volume for these same securities for the last six (6) months ranged from a high of approximately 25.9 million shares to a low of approximately 117,071 shares.

Given the large trading volume and capitalization of the compositions of the stocks underlying the Index, the Commission believes that the listing and trading of the Notes that are linked to the Index should not unduly impact the market for the underlying securities comprising the Index or raise manipulative concerns.¹⁸ As discussed more fully above, the underlying stocks comprising the Index are well-capitalized, highly liquid stocks. Moreover, the issuers of the underlying securities comprising the 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. Additionally, the Amex's surveillance procedures will serve to deter as well as detect any potential manipulation.

Furthermore, the Commission notes that the Notes are depending upon the individual credit of the issuer, Lehman. To some extent this credit risk is minimized by the Exchange's listing standards in Section 107A of the Company Guide, which provide that the only issuers satisfying substantial asset and equity requirements may issue securities such as the Notes. In addition, the Exchange's "Other Securities" listing

¹⁸ The issuer Lehman 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 Lehman'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. The Commission expects such hedging activity to be conducted in accordance with applicable regulatory requirements.

standards further require that the Notes have a market value of at least \$4 million.¹⁹ In any event, financial information regarding Lehman in addition to the information on the 500 common stocks comprising the Index will be publicly available.²⁰

The Commission also has a systemic concern, however, that a broker-dealer such as Lehman, or a subsidiary providing a hedge for the issuer will incur position exposure. However, as the Commission has concluded in previous approval orders for other hybrid instruments issued by broker-dealers,²¹ the Commission believes that this concern is minimal given the size of the Notes issuance in relation to the net worth of Lehman.

Finally, the Commission notes that the value of the Index will be disseminated at least once every fifteen seconds throughout the trading day. The Commission believes that providing access to the value of the Index at least once every fifteen seconds throughout the trading day is extremely important and will provide benefits to investors in the product.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of the notice of filing thereof in the

¹⁹ See Company Guide Section 107A.

²⁰ The Commission notes that the 500 component stocks that comprise the Index are reporting companies under the Act, and the Notes will be registered under Section 12 of the Act.

²¹ See Securities Exchange Act Release Nos. 44913 (October 9, 2001), 66 FR 52469 (October 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 (September 27, 1996), 61 FR 52480 (October 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).

Federal Register. The Exchange has requested accelerated approval because this product is similar to several other instruments currently listed and traded on the Amex.²² 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. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,²³ to approve the proposal on an accelerated basis.

²² See supra note 16.

²³ 15 U.S.C. 78f(b)(5) and 78s(b)(2).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-Amex-2004-68) is hereby approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.²⁵

Margaret H. McFarland
Deputy Secretary

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).