

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54397; File No. SR-BSE-2005-11)

August 31, 2006

Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto Relating to Rules to Allow the Listing and Trading of Options on Indices on the Boston Options Exchange

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 May 5, 2005, the Boston Stock Exchange, Inc. (“BSE” 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. On July 12, 2006, BSE filed Amendment No. 1 to the proposed rule change.³ On August 29, 2006, BSE filed Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice and order to solicit comments on the proposal from interested persons and to approve the proposed rule change, as amended, on an accelerated basis.

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

BSE proposes to adopt rules which would allow the Boston Options Exchange (“BOX”) to list and trade options on indices, including rules pursuant to Rule 19b-4(e)

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaced and superseded the original rule filing in its entirety.

⁴ In Amendment No. 2, BSE removed its proposal to have generic listing standards for narrow-based options and added its proposal to list and trade options and long term index options on the full value of the Nasdaq 100 index, the one tenth value of the Nasdaq 100 index and the Russell 2000 index. Amendment No. 2 replaced and superseded the original rule filing in its entirety.

for the listing and trading of broad-based index options.⁵ BSE also seeks approval herein for BOX to list and trade index options and long term index options (“LEAPs”) on the full value of the Nasdaq 100 index (“NDX”), the one tenth value of the Nasdaq 100 index (“MNX”), and the Russell 2000 Index (“RUT”). The text of the proposed rule change, as amended is available on BSE’s Web site (<http://www.bostonstock.com>), at BSE’s principal office, 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 Exchange included statements concerning the purpose of, and basis for, the proposed rule change, as amended, and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

According to BSE, the purpose of the proposed rule change is to adopt rules necessary to allow BOX to list and trade options on indices. The proposed rules include, among other items, listing and maintenance criteria for options on underlying indices, rules on dissemination of index values, positions and exercise limits for index options, strike price intervals, and exemptions from the limits and terms of index options contracts. All of the proposed rules and changes to existing BOX Rules are based on the

⁵ 17 CFR 240.19b-4(e).

existing rules of the other five options exchanges.⁶

Because the rules related to trading options on indices are product specific in many areas, BSE, on behalf of BOX, will need to file additional proposed rule changes with the Commission when BOX identifies specific products (with the exception of those products that satisfy the “generic” broad-based listing standards pursuant to Rule 19b-4(e)). For purposes of this proposed rule change, certain rules indicate that they apply to “specified” indices. Proposed Sections 2(l), 5(a), 7(a), 8(a), 10, and 12 of proposed Chapter XIV of the BOX Rules all contain provisions that are dependant upon the BSE identifying specific index products in the rule. Accordingly, proposed Section 1 of proposed Chapter XIV of the BOX Rules states that where the rules in Chapter XIV indicate that particular indices or requirements with respect to particular indices will be

⁶ See rules of the American Stock Exchange LLC (“Amex”), the Chicago Board Options Exchange, Incorporated (“CBOE”), the Philadelphia Stock Exchange, Inc. (“Phlx”), NYSE Arca, Inc. (“NYSE Arca”) and the International Stock Exchange, Inc. (“ISE”). See, e.g., Amex Rules 900C through 905C; CBOE Rules 4.11, 4.16, 6.2, 6.7, 8.7, 11.1, and 23.1 through 24.20; ISE Rules 413, 418, 803, 1100, and 2000 through 2012; NYSE Arca Rules 5.10 through 5.26; and Phlx Rules 1000A through 1104A. The proposed new rules and changes to existing BOX Rules are primarily based on the ISE Rules previously referenced. Any differences are due to the following: (i) Section 11 of Chapter VI of the BOX Rules, unlike ISE Rule 1407, currently incorporates the NASD’s “hedging exception” and therefore does not need to be amended to accommodate the listing and trading of options on indices; (ii) the different terminology and defined terms in the BOX Rules; (iii) different cross-references; (iv) the regulatory role of the Boston Options Exchange Regulation LLC (BOXR); (v) that BOX does not have “trading rotations” as that term is used in ISE’s Rules; and (vi) other minor differences in current rules. BOX does not have “trading rotations” as that term is used in ISE’s Rules because BOX is not a specialist driven system. On BOX, there are no designated specialists, primary market makers, or lead market makers with authority to control trading in a particular options class. Instead, BOX has multiple and competing market makers trading in each options class. On a specialist driven system, the specialist maintains control over the open and the close, whereas on BOX, the electronic trading system maintains control over the open and the close.

"Specified," the BSE shall file a proposed rule change with the Commission pursuant to Section 19 of the Act⁷ and Rule 19b-4 thereunder⁸ to specify such indices or requirements.

New Chapter XIV to BOX Rules

The Exchange proposes to add a new Chapter XIV to the BOX Rules, as well as conforming changes to certain existing BOX rules. The following are the specific rule changes:

Proposed Section 1 of Chapter XIV: This proposed rule specifies that Chapter XIV is applicable only to index options, and that the rules in Chapters I through XIII also apply to index options, unless they are replaced by the new rules or the context otherwise requires.

Proposed Section 2 of Chapter XIV: This proposed rule contains the necessary definitions for index options trading.

Proposed Section 3 of Chapter XIV: This proposed rule contains the general listing standards for broad-based index options. Under proposed Section 3(a) of Chapter XIV the Exchange would be able to list broad-based index options pursuant to Rule 19b-4(e) under the Act, if each of the conditions set forth in proposed Section 3(b) of Chapter XIV are satisfied. Pursuant to proposed Section 3(b) of Chapter XIV, the proposed rule change would provide ongoing maintenance standards for broad-based index options listed pursuant to proposed Section 3(a) of Chapter XIV. These options would, in all other respects, be traded pursuant to the Exchange's trading rules and procedures applicable to index options.

⁷ 15 U.S.C. 78s.

⁸ 17 CFR 240.19b-4.

The Exchange notes that other options exchanges currently have rules that contain generic listing standards pursuant to Rule 19b-4(e) of the Act⁹ for broad-based index options.¹⁰ Other exchanges also have rules that contain generic listing standards for narrow-based indexes and micro-based index options.¹¹ The Exchange states that the standards contained in these proposed generic listing standards for broad-based index options are based on the standards contained in the generic listing standards for narrow-based index options and micro-based index options that were previously approved by the Commission, but have been modified to reflect the characteristics of broad-based index options. The proposed Section 3 of Chapter XIV is based on the broad-based index option rules of the ISE.¹² At this time, the Exchange is only proposing generic listing standards for broad-based index options.

In order to list broad-based index options pursuant to the generic Rule 19b-4(e) listing standards, the underlying index must satisfy all the conditions contained in proposed Section 3(b). If the underlying index does not satisfy all of the conditions, the Exchange would be required to file a proposed rule change with the Commission on Form 19b-4 pursuant to Section 19(b)(2) of the Act and obtain Commission approval in

⁹ 17 CFR 240.19b-4(e).

¹⁰ The ISE, CBOE, Amex, and Phlx have broad-based index generic listing standard rules. See Securities Exchange Act Release Nos. 52578 (October 7, 2005), 70 FR 60590 (October 18, 2005)(SR-ISE-2005-27); 52781 (November 16, 2005), 70 FR 70898 (November 23, 2005)(SR-Amex-2005-069); 53266 (February 9, 2006), 71 FR 8321 (February 16, 2006)(SR-CBOE-2005-59); 54158 (July 17, 2006), 70 FR 41853 (July 24, 2006)(SR-Phlx-2006-17).

¹¹ Examples of narrow-based rules are NYSE Arca Rule 5.13 and ISE Rule 2002. Examples of micro-based rules are NYSE Arca Rule 5.13 and CBOE Rules 24.2(d), 24.2(e) and 24.4B.

¹² See ISE Rules 2002(d) and 2002(e).

order to list options on that index. Following are the conditions contained in proposed Section 3(b) of Chapter XIV.

Under proposed Section 3(b) of Chapter XIV, the index must be broad-based as defined in Section 2 of Chapter XIV as an index designed to be representative of a stock market as a whole or for a range of companies in unrelated industries. The index must be designated as A.M. settled and must be either: (i) capitalization-weighted; (ii) price-weighted; (iii) equal-dollar weighted; or (iv) modified-capitalization weighted. Broad-based indexes must consist of 50 or more component securities. The Exchange believes that a 50 component minimum is reasonable for broad-based indexes, and, when applied in conjunction with the other listing requirements, would result in indexes that are sufficiently broad-based in scope and not readily subject to manipulation.¹³ Component securities comprising at least 95% of the index by weight must have a minimum market capitalization of \$75 million. Component securities comprising at least 65% of the index by weight must have a minimum market capitalization of \$100 million.

Component securities comprising at least 80% of the index by weight must satisfy the requirements of Section 3 of Chapter IV of BOX Rules which sets forth the criteria for underlying securities. Accordingly, those securities must be “options eligible,” meaning they must have, for example, at least a \$7 million share float, 2000 holders, total annual trading volume of 2,400,000 shares, a minimum price of \$3 per share, and the issuer

¹³ The Exchange notes that there are currently a number of broad-based indexes that consist of fewer than 50 components, such as, the Dow Jones Industrial Average Index (30 components) and the Amex Major Market Index (20 components), which would require specific approval for listing and trading by the Commission. Telephone conference between Bill Meehan, General Counsel, BSE, and Florence Harmon, Senior Special Counsel, Division of Market Regulation, Commission on August 31, 2006 (“August 31 Telephone Conference”).

must be in compliance with its obligations under the Act. The Exchange believes that an 80% weighting is reasonable for broad-based indexes, and, when applied in conjunction with the other listing requirements, will result in indexes that contain components that are sufficiently liquid and not readily subject to manipulation. The Exchange notes that broad-based indexes may consist of thousands of components (for example, the Russell 3000 Index), and the components comprising the bottom 10% to 20% of the weight of the index generally are the smallest capitalized stocks and tend not to meet the requirements of Section 3 of Chapter IV of BOX Rules.¹⁴

Each component security that accounts for at least 1% of the weight of the index must have an average daily trading volume (“ADTV”) of at least 90,000 shares over the prior six-month period. The Exchange believes that 90,000 ADTV is reasonable for broad-based indexes, and, when applied in conjunction with the other listing requirements, will result in indexes in which the more heavily-weighted components are sufficiently liquid and not readily subject to manipulation.

No single component security may account for more than 10% of the weight of an index, and the five highest weighted components securities in the index may not, in the aggregate, account for more than 33% of the weight for an index. The Exchange notes that the 10% and 33% weighting concentration caps are reasonable for broad-based

¹⁴ The Exchange further notes that the generic listing standards pursuant to Rule 19b-4(e) for narrow-based index options are less liberal, requiring a 90% weighting. August 31 Telephone Conference.

indexes, and, when applied in conjunction with the other listing requirements, will result in indexes that are not unreasonably dominated by a few heavily-weighted components.¹⁵

All component securities must be NMS Stocks as defined in Rule 600 of Regulation NMS. No more than 20% of the securities in the index, by weight, may be comprised of foreign securities or American Depositary Receipts overlying foreign securities that are not subject to comprehensive surveillance sharing agreements. Section 3(b) of Chapter XIV also requires the current index value to be widely disseminated at least once every fifteen seconds by one or more major market data vendors during the time options on the index are traded on the Exchange.

The Exchange must reasonably believe it has adequate system capacity to support the trading of options on the index. That belief must be based on the performance of a calculation by the Exchange that takes into account the Exchange's current Independent System Capacity Advisor ("ISCA") allocation and the number of new peak messages per second expected to be generated by options on such index.

An equal dollar-weighted index must be rebalanced at least once every calendar quarter.

Broker-dealer maintained indexes must be calculated by a third party who is not a broker-dealer. Further, the broker-dealer must establish procedures including informational barriers, to ensure that the broker-dealer will not possess or be able to misuse any informational advantages with respect to changes in, and adjustments to, an index.

¹⁵ The Exchange notes that the generic listing standards for narrow-based index options require 30% and 50% weighting concentration caps. August 31 Telephone Conference.

The Exchange must also have written surveillance procedures in place for broad-based index options.¹⁶

Following the listing of a broad-based index option pursuant to proposed Section 3(b) the underlying index must continue to satisfy the maintenance standards contained in proposed Section 3(c) of Chapter XIV, which are based on the criteria set forth in proposed Section 3(b) of Chapter XIV. If the underlying index fails to satisfy the maintenance standards, the Exchange may not open for trading any additional series of options on that class of index options unless the continued listing of that class of options has been approved by the Commission pursuant to Section 19(b)(2) of the Act.

Proposed Section 4 of Chapter XIV: This proposed rule requires the dissemination of index values as a condition to the trading of options on an index.

Proposed Sections 5 through 8 of Chapter XIV: These proposed rules contain the standard position limit and exercise limits for index options, as well as exemption standards and the procedures for requesting exemptions from those proposed rules. Proposed Section 5 of Chapter XIV sets the standard position limit for broad-based index options listed pursuant to Rule 19b-4(e) in proposed Section 3 of Chapter XIV at 25,000 contracts unless “specified” as defined in Proposed Section 1 of Chapter XIV. The Exchange has specified limits on the three broad-based index options it intends to trade upon Commission approval of these proposed rule changes. The Exchange proposes to have no position limits for the NDX, a 750,000 contract position for the MNX, and to have a 50,000 contact position limit for the RUT. Section 7(a)(5) of this Chapter XIV specifies that the broad-based hedge exemption for the MNX index options is 1,500,000

¹⁶ See infra Index Surveillance Letter, dated August 29, 2006.

contracts and for all other broad-based index options 75,000 in addition to the standard limit.

Proposed Section 9 of Chapter XIV: This proposed rule provides that index options will trade until 4:15 p.m. Eastern Time, the same as on other exchanges. The proposed rule also contains procedures for openings, as well as trading halts and suspensions.

Proposed Sections 10 and 11 of Chapter XIV: Proposed Section 10 outlines the terms of index options contracts, while proposed Section 11 applies to debit put spreads. Proposed Section 10 incorporates a rule change proposed by the ISE that was effective upon filing.¹⁷ In the proposal, ISE clarified that the “reporting authority” (or index calculator) for any securities index on which options are traded on the ISE may determine to use the reported sales prices for one or more underlying securities from a market that may not necessarily be the primary market for that security in calculating the appropriate index value. Proposed Section 10 also states that the NDX, MNX and RUT, and LEAPS on those index options will be A.M. settled and European Style exercised with strike prices intervals of no less than \$2.50 if the strike price is less than \$200.

Proposed Section 12 of Chapter XIV: This proposed rule disclaims liability for index reporting authorities.

Proposed Section 13 of Chapter XIV: This proposed rule contains standards for exercising American-style index options.

Amendments to Current Rules:

Amendment to Section 8 of Chapter III: This proposed amendment adds broad-

¹⁷ See Securities Exchange Act Release No. 51176 (February 9, 2005), 70 FR 7985 (February 16, 2005)(SR-ISE-2005-03).

based index options to the market maker exemption from position limits.

Amendments to Section 12 of Chapter III and Section 1 of Chapter VII: In conjunction with proposed Section 13 of Chapter XIV, these proposed rules will govern the exercise of American-style, cash settled index options.

Amendment to Section 6 of Chapter IV: This Section currently provides that at the commencement of trading on BOX of a particular class of options, BOXR usually will open three (3) series of options for each expiration month in that class in the case of individual equity options, or four (4) series of options for each expiration month in that class in the case of index options. The proposal would amend this section to replace BOXR with BOX because BOX, as the options trading facility, is the entity responsible for opening all series of options. In order to conform this Section to the corresponding rule of other options exchanges, the proposal would also amend this section to eliminate the separate reference to index options. However, the Exchange also proposes to clarify this section to reflect actual market practice by specifying that at the commencement of trading on BOX of a particular class of options, BOX usually will open a “minimum” of three (3) series of options for each expiration month in that class.

Amendment to Section 26 of Chapter V: In conjunction with proposed Section 12 of Chapter XIV, this proposed rule would limit liability regarding the dissemination of index information.

Amendment to Section 5 of Chapter VI: This proposed amendment discusses bid/ask differentials for indices.

Amendment to Section 4 of Chapter XII: In conjunction with proposed Section 7 of Chapter XIV (specifically subsection (a)(14) of Section 7 of Chapter XIV), this

proposed rule would permit BOXR to impose additional margin upon an account if it determines that additional margin is warranted in light of the risk associated with an under-hedged options position in certain broad-based indices.

NDX, MNX and RUT Index Options

The Exchange proposes to amend its rules to provide for the listing and trading of NDX and MNX (one tenth value of the NDX)¹⁸ including long term index options based upon the full value of the Nasdaq 100 Index (“NDX Leaps”) and one tenth value (“MNX Leaps”). These indexes are cash settled, European style options based on the full and one tenth value of the Nasdaq 100, a stock index calculated and maintained by the Nasdaq Stock Market, Inc. (“Nasdaq”).¹⁹

The Nasdaq 100 includes 100 of the largest domestic and international non-financial securities listed on Nasdaq, based on market capitalization. The Nasdaq 100 reflects companies across major industry groups including computer hardware and software, telecommunications, retail/wholesale trade and biotechnology. The Nasdaq 100 is calculated using a modified capitalization-weighted methodology. To be eligible for initial inclusion in the Nasdaq 100, a security must be listed on Nasdaq’s Global or Global Select markets, unless it was dually-listed on another exchange prior to January 1, 2004 and has maintained such listing. The security must have an ADTV of at least 200,000 shares, and the issuer must not currently be in bankruptcy proceedings. If a

¹⁸ MNX and NDX index options are currently listed and trading on the Amex, the CBOE, and the ISE. See Securities Exchange Act Release Nos. 51884 (June 20, 2005), 70 FR 36973 (June 27, 2005)(SR-Amex-2005-038); 33166 (November 8, 1993), 58 FR 60710 (November 17, 1993)(SR-CBOE-93-42); and 51121 (February 1, 2005), 70 FR 6476 (February 7, 2005)(SR-ISE-2005-01).

¹⁹ A description of the Nasdaq 100 Index is available on Nasdaq’s Web site at http://dynamic.nasdaq.com/dynamic/nasdaq100_activity.stm.

component security is of a foreign issuer, based on its country of incorporation, it must have listed options or be eligible for listed options trading. In addition, the issuer of a component security must not have entered into any definitive agreement or other arrangement that would result in the security no longer being eligible for inclusion in the index within the next six months. In addition, the issuer of a component security must not have annual financial statements with an audit opinion, where the auditor or the issuer indicated that the audit opinion cannot be currently relied upon.

As of July 31, 2006, the following were characteristics of the Nasdaq 100:

- Total capitalization of all components of the Index was approximately \$2.4 trillion;
- Component capitalization: (a) the highest capitalization of a component was \$158.4 billion; (b) the lowest capitalization of a component was \$4.5 billion; (c) the mean capitalization was \$24.1 billion; and (d) the median capitalization of the components was \$14.5 billion.
- Component price per share: (a) the highest price per share of a component was \$386.60; (b) the lowest price per share of a component was \$2.13; (c) the mean price per share of the components was \$39.98; and (d) the median price per share of the components was \$32.31.
- Component weightings: (a) the highest weighting of a component was 6.57%; (b) the lowest weighting of a component was .19%; (c) the mean weighting of the components was 1.00%; and (d) the median weighting of a component was .605%.

Since the full value NDX options trade at a level that may be uncomfortably high for retail investors, the Exchange believes that listing index options on a reduced one-

tenth value of the full value of the NDX, such as the MNX, attracts a greater source of customer business and provides an opportunity for investors to hedge or speculate on the market risk associated with the component stocks with a smaller outlay of capital, thereby creating a more active and liquid trading environment.

The Nasdaq maintains and monitors the Nasdaq 100 and is responsible for any adjustments, component deletions and component additions. The NDX component securities are evaluated on an annual basis. The NDX and MNX are calculated continuously, using the last sale price for each component stock in the Index, and are disseminated every 15 seconds throughout the trading day.

The Exchange is also amending its rules to provide for the listing of index options on the Russell 2000 Index (“RUT”)²⁰ and long-term index options on the Russell 2000 Index (“RUT LEAPS”).²¹ The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set. The Russell 2000 includes the smallest of the Russell 3000 stocks representing approximately 8% of the investable U.S. equity market. Component stocks must be trading at or above \$1.00 on May 31st of every year to be eligible for inclusion.

The Russell 2000 is capitalization-weighted and includes only common stocks belonging to corporations domiciled in the United States that are traded on the NYSE, AMEX or Nasdaq exchanges. Stocks are weighted by their available market

²⁰ For more detailed description of the Russell 2000 Index, [see](http://russell.com/indexes) <http://russell.com/indexes>.

²¹ Options on the Russell 2000 Index trade on the CBOE and ISE. See Securities Exchange Act Release Nos. 51619 (April 27, 2005), 70 FR 22947 (May 3, 2005)(SR-ISE-2005-09) and 31382 (October 30, 1992), 57 FR 52802 (November 5, 1992)(SR-CBOE-92-02).

capitalization, which is calculated by multiplying the primary market price by the available shares. As of June 30, 2006, the average market capitalization was \$1.07 billion, the median market capitalization was \$604 million, the largest company by market capitalization had a \$2.335 billion market capitalization, and the smallest company had a market capitalization of \$83 million.

The Russell 2000 is monitored and maintained by the Frank Russell Company. The Frank Russell Company is responsible for making any adjustments, component deletions and component additions. The value of the Russell 2000 is calculated by Reuters on behalf of the Frank Russell Company and is disseminated every 15 seconds throughout the trading day.

The Exchange believes the NDX, NDX LEAPS, MNX, MNX LEAPS, RUT, and RUT LEAPS are not readily subject to manipulation because of the broad-based characteristics of the underlying indexes, including the component security criteria, index weighting methodologies, maintenance, evaluation, calculation and dissemination. The trading of NDX, NDX LEAPS, MNX, MNX LEAPS, RUT, and RUT LEAPS would be subject to the same rules proposed in Chapter XIV that would govern the trading of all index options.

The Exchange represents that it will not list any options on indices without first determining that BOX has sufficient capacity to accommodate the anticipated order flow. The Exchange will also not commence the trading of any options on indices without having the appropriate surveillance procedures for such index options trading in operation as set forth to the Commission in the Exchange's Index Surveillance Letter dated August 29, 2006 submitted confidentially under a FOIA request ("Index

Surveillance Letter”). Pursuant to the Index Surveillance Letter the Exchange will incorporate new index option products into the Exchange’s surveillance reports and procedures prior to trading these products.

2. Statutory Basis

BSE believes that the proposed rule change, as amended, is consistent with the requirements of Section 6(b) of the Act,²² in general, and Section 6(b)(5) of the Act,²³ in particular, in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, to remove impediments to and perfect the mechanism for 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

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

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

No written comments were solicited or received with respect to the proposed rule change, as amended.

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. Comments may be submitted by any of the following methods:

²² 15 U.S.C. 78(f)(b).

²³ 15 U.S.C. 78(f)(b)(5).

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 File Number SR-BSE-2005-11 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-BSE-2005-11. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BSE-2005-11 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

After careful review, 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.²⁴ In particular, the Commission finds that the proposed rule change, as amended, is consistent with Section 6(b)(5) of the Act,²⁵ which requires, among other things, that the rules of a national securities exchange be 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 for a free and open market and a national market system, and, in general, to protect investors and the public interest.

To list options on a particular broad-based index, BSE currently must file a proposed rule change with the Commission pursuant to Section 19(b)(1) of the Act and Rule 19b-4 thereunder. However, Rule 19b-4(e) provides that the listing and trading of a new derivative security product by a self-regulatory organization ("SRO") will not be deemed a proposed rule change pursuant to Rule 19b-4(c)(1) if the Commission has approved, pursuant to Section 19(b) of the Act, the SRO's trading rules, procedures, and listing standards for the product class that would include the new derivative securities product, and the SRO has a surveillance program for the product class.

As described more fully above, the BSE proposes to establish listing standards for

²⁴ In approving this rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

²⁵ 15 U.S.C. 78f(b)(5).

broad-based index options. The Commission's approval of the BSE's listing standards for broad-based index options will allow options that satisfy the listing standards to begin trading pursuant to Rule 19b-4(e), without constituting a proposed rule change within the meaning of Section 19(b) of the Act and Rule 19b-4, for which notice and comment and Commission approval is necessary.²⁶ The Exchange's ability to rely on Rule 19b-4(e) to list broad-based index options that meet the requirements of proposed Section 3 of Chapter XIV of BOX Rules potentially reduces the time frame for bringing these securities to the market, thereby promoting competition and making new broad-based index options available to investors more quickly.

With regard to the NDX, MDX, and RUT index options and LEAPs, the Commission finds the current characteristics of these indexes are such that the indexes that contain components that are sufficiently liquid and not readily subject to manipulation; and thus, the Exchange's trading rules and surveillance procedures for these products address the current characteristics of these products.

The Commission notes that the Exchange has represented that it has adequate trading rules, procedures, listing standards and a surveillance program for broad-based index options, including the NDX, MDX, and RUT. BSE's existing index option trading rules and procedures will apply to broad-based index options listed pursuant to proposed Chapter XIV. Other existing BOX rules, including provisions addressing sales practices and margin requirements, also will apply to these options. In addition, BSE proposes to

²⁶ When relying on Rule 19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the SRO begins trading the new derivative securities product. See Securities Exchange Act Release No. 40761 (December 8, 1998), 65 FR 70952 (December 22, 1998)(File No. S7-13-98).

establish position and exercise limits of 25,000 contracts on the same side of the market for broad-based index options listed pursuant to Section 5 of Chapter XIV.²⁷ The Commission believes that the proposed position and exercise limits should serve to minimize potential manipulation concerns.

The BSE represents that its surveillance procedures are adequate to properly monitor the trading of broad-based index options and that it intends to apply its existing surveillance procedures for index options to monitor trading in broad-based index options listed pursuant to Section 3 of Chapter XIV of BOX Rules. In addition, because Section 3(b)(9) of Chapter XIV requires that each component of an index be an “NMS stock” as defined in Rule 600 of Regulation NMS under the Act, each index component must trade on a registered national securities exchange or through Nasdaq. Accordingly, the BSE will have access to information concerning trading activity in the component securities of an underlying index through the Intermarket Surveillance Group (“ISG”).²⁸ Section 3(b)(10) of Chapter XIV of BOX Rules also provides that non-U.S. index components that are not subject to a comprehensive surveillance sharing agreement between the BSE and the primary market(s) trading the index components may comprise no more than

²⁷ Under Section 10 of Chapter XIV of BOX Rules, the exercise limits for index options are equivalent to the position limits prescribed for option contracts with the nearest expiration in Section 5 or Section 6 of BOX Rules. Also, the position and exercise limits for the NDX, MDX, and RUT options and LEAPs are consistent with those rules approved by the Commission for other options exchanges.

²⁸ The ISG was formed on July 14, 1983, to, among other things, coordinate more effectively surveillance and investigative information sharing arrangements in the stock and options markets. All of the registered national securities exchanges and the National Association of Securities Dealers, Inc. are members of the ISG. In addition, futures exchanges and non-U.S. exchanges and associations are affiliate members of the ISG.

20% of the weight of the index.²⁹ The Commission believes that these requirements will help to ensure that the BSE has the ability to monitor trading in broad-based index options listed pursuant to Section 3 of Chapter XIV of BOX Rules and in the component securities of the underlying indexes.

The Commission believes that the requirements Section 3 of Chapter XIV of BOX Rules regarding, among other things, the minimum market capitalization, trading volume, and relative weightings of an underlying index's component stocks are designed to ensure that the markets for the index's component stocks are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. In addition, Section 3 of Chapter XIV of BOX Rules requires that the underlying index be "broad-based," as defined in Section 2 of Chapter XIV of BOX Rules.³⁰ The Commission believes that these requirements minimize the potential for manipulating the underlying index.

The Commission believes that the requirement in Section 3(b)(11) of Chapter XIV of BOX Rules that the current index value be widely disseminated at least once every 15 seconds by the Options Price Reporting Authority, the Consolidated Tape Association, the Nasdaq Index Dissemination Service or by one or more major market data vendors during the time an index option trades on the BOX should provide transparency with respect to current index values and contribute to the transparency of the market for broad-based index options. In addition, the Commission believes, as it has noted in other contexts, that the requirement in Section 10 of Chapter XIV of BOX Rules

²⁹ However, such non-U.S. index components, as "NMS stocks," would be registered under Section 12 of the Act and listed and traded on a national securities exchange or Nasdaq, where there is last sale reporting.

³⁰ Section 2(j) of Chapter XIV of BOX Rules defines "broad-based index" to mean "an index designed to be representative of a stock market as a whole or of a range of companies in unrelated industries."

that an index option be settled based on the opening prices of the index's component securities, rather than on closing prices, could help to reduce the potential impact of expiring index options on the market for the index's component securities.³¹

The proposed rule change will permit the Exchange and its members to trade options on indices on BOX and should allow BOX to remain competitive with the other options exchanges that already list and trade options on indices. The proposed rule change should also benefit investors by increasing competition among markets that trade options on indices.

The Commission finds good cause for approving the proposed rule change, as amended, prior to the 30th day after the date of publication of the notice of filing in the Federal Register. The Exchange has requested accelerated approval of the proposed rule change. The proposal implements listing and maintenance standards and position and exercise limits for broad-based index options substantially identical to those recently approved for the ISE, the Amex and CBOE.³² The Commission does not believe that the Exchange's proposal raises any novel regulatory issues. Therefore, the Commission finds good cause, consistent with Section 19(b)(2) of the Act,³³ to approve the proposed rule change, as amended, on an accelerated basis.

BSE also proposes to amend its rules to provide for the listing of the NDX and

³¹ See, e.g., Securities Exchange Act Release No. 30944 (July 21, 1992), 57 FR 33376 (July 28, 1992)(order approving CBOE proposal to establish open price settlement for S&P 500 Index options).

³² See Securities Exchange Act Release Nos. 52578 (October 7, 2005), 70 FR 60590 (October 18, 2005)(SR-ISE-2005-27); 52781 (November 16, 2005), 70 FR 70898 (November 23, 2005)(SR-Amex-2005-069); and 53266 (February 9, 2006), 71 FR 8321 (February 16, 2006)(SR-CBOE-2005-59).

³³ 15 U.S.C. 78s(b)(2).

MNX (one tenth value of the NDX), including long term index options based upon the full value of the Nasdaq 100 Index (“NDX Leaps”) and one-tenth value (“MNX Leaps”). These indexes are cash settled, European style options based on the full and one-tenth value of the Nasdaq 100, a stock calculated and maintained by the Nasdaq stock market. The BSE is also amending its rules to provide for the listing of the RUT and RUT LEAPS.

The Commission notes that it previously approved the listing and trading of options on the NDX and MNX on other exchanges.³⁴ The Commission also notes that it has previously approved the listing and trading of the RUT on other exchanges.³⁵ The Commission is presently not aware of any regulatory issues that should cause it to revisit that earlier finding or preclude the trading of such options on the BSE.

In approving the proposal, the Commission has specifically relied on the following representations made by the BSE:

1. The BSE will notify the Commission’s Division of Market Regulation immediately if Nasdaq ceases to maintain or calculate the Nasdaq 100 Index (or one-tenth Nasdaq 100 value), or if these Nasdaq 100 Index values are not disseminated every 15 seconds by a widely available source during the time the index options trade on BOX. The BSE will notify the Commission’s Division of Market Regulation immediately if the Frank Russell Company ceases to maintain or calculate the Russell 2000 Index, or if the

³⁴ Options on the MNX and NDX are currently listed and trading on the Amex, the CBOE and the ISE. See Securities Exchange Act Release Nos. 51884 (June 20, 2005), 70 FR 36973 (June 27, 2005)(SR-Amex-2005-038); 33166 (November 8, 1993), 58 FR 60710 (November 17, 1993)(SR-CBOE-93-42); and 51121 (February 1, 2005), 70 FR 6476 (February 7, 2005)(SR-ISE-2005-01).

³⁵ See Securities Exchange Act Release Nos. 51619 (April 27, 2005), 70 FR 22947 (May 3, 2005)(SR-ISE-2005-09) and 31382 (October 30, 1992), 57 FR 52802 (November 5, 1992)(SR-CBOE-92-02).

Russell 2000 Index value is not disseminated every 15 seconds by a widely available source during the time the index options trade on BOX. If such Indexes cease to be maintained or calculated, or if the Index values are not disseminated every 15 seconds by a widely available source, the BSE will not list any additional series for trading and will limit all transactions in such option to closing transactions for the purpose of maintaining a fair and orderly market and protecting investors.

2. The BSE has an adequate surveillance program in place for index options traded on the Nasdaq 100 Index and the Russell 2000 Index.

3. The additional quote and message traffic that will be generated by listing and trading the NDX, MNX, NDX LEAPS, MNX LEAPS, the RUT and the RUT LEAPS will not exceed the BSE's current message capacity allocated by the Independent System Capacity Advisor.

The Commission further notes that in approving this proposal, it relied on the BSE's discussion of how Nasdaq and the Frank Russell Company currently calculates the respective indexes. If the manner in which Nasdaq or the Frank Russell Company calculates the indexes were to change substantially, the approval might no longer be consistent with the Act and might no longer be effective.

With respect to the NDX, the MNX, and the RUT, the Commission believes that the position limits for these index options and the hedge exemption for such position limits are reasonable and consistent with the Act. The Commission previously has found identical provisions for NDX and MNX options to be consistent with the Act.³⁶

³⁶ See e.g., Securities Exchange Act Release No. 44156 (April 6, 2001), 66 FR19261 (April 13, 2001)(SR-CBOE-00-14)(order approving a proposed rule change by CBOE to increase position limits and exercise limits for Nasdaq 100

The Commission finds good cause for approving this proposal before the thirtieth day after the publication of the notice thereof in the Federal Register. Because options on the NDX, MNX, and the RUT already trade on other exchanges, accelerating approval of the BSE's proposal should benefit investors by creating, without due delay, additional competition in the market for these options.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,³⁷ that the proposed rule change (SR-BSE-2005-11), as amended, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁸

Nancy M. Morris
Secretary

Index options, expand the Index hedge exemption, and eliminate the near-term position limits).

³⁷ 15 U.S.C. 78s(b)(2).

³⁸ 17 CFR 200.30-3(a)(12).