

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-51682; File No. SR-ISE-2004-27)**

**May 11, 2005**

**Self-Regulatory Organizations; International Securities Exchange, Inc.; Order Approving Proposed Rule Change and Amendments No. 1 and No. 2 Relating to Trading Options on Reduced Values of the NYSE U.S. 100 Index, the NYSE International 100 Index, the NYSE World Leaders Index, and the NYSE TMT Index, Including Long-Term Options**

**I. Introduction**

On July 23, 2004, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to trade options on three broad-based indexes and one narrow-based index, whose components currently trade on the New York Stock Exchange, Inc. ("NYSE"). The ISE submitted Amendments No. 1 and No. 2 to the proposal on January 5, 2005,<sup>3</sup> and March 1, 2005,<sup>4</sup> respectively. The proposed rule change and Amendments No. 1 and No. 2 were published for comment in the Federal Register on March 27, 2005.<sup>5</sup> The Commission received no comment letters regarding the proposal. This order approves the proposed rule change, as amended.

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

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

<sup>3</sup> Amendment No. 1 set forth a list of the underlying components of the NYSE Indexes.

<sup>4</sup> Amendment No. 2 replaced the original filing in its entirety, proposed a reduced number of contracts for position and exercise limits, addressed one of the events that the Exchange will monitor on an annual basis, and made other technical corrections to the filing.

<sup>5</sup> See Securities Exchange Act Release No. 51410 (March 22, 2005), 70 FR 15962 ("March Release").

## II. Description of the Proposal

The ISE proposes to list and trade cash-settled, European-style, index options on the NYSE U.S. 100 Index, the NYSE International 100 Index, and the NYSE World Leaders Index (the “Broad Based NYSE Indexes”) and the NYSE Technology, Media, and Telecommunication Index (“NYSE TMT Index”) (collectively, the “NYSE Indexes”).<sup>6</sup> Specifically, the Exchange proposes to list options based upon (i) one-tenth of the value of the NYSE Indexes (“Mini Index Options”) and (ii) one one-hundredth of the value of the NYSE Indexes (“Micro Index Options”).

A brief description of the proposal appears below; the March Release<sup>7</sup> provides a more detailed description of the proposal.

### Index Design and Composition

The NYSE Indexes are designed to be a comprehensive representation of the investable United States equity market. Each NYSE Index is a float-adjusted capitalization-weighted index,<sup>8</sup> whose components are all traded on the NYSE.

### NYSE U.S. 100 Index

The NYSE U.S. 100 Index tracks the top 100 U.S. stocks trading on the NYSE. The companies represented have a market capitalization of \$5.95 trillion, which covers 47% of the entire market capitalization of U.S. companies and over 62% of U.S. companies listed on the

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<sup>6</sup> A description of each of the NYSE Indexes can be found on the NYSE’s Web site at <http://www.nyseindexes.com>.

<sup>7</sup> See supra note 5.

<sup>8</sup> The calculation of a float-adjusted, market-weighted index involves taking the summation of the product of the price of each stock in the index and the number of shares available to the public for trading, rather than the total shares outstanding for each issue. In contrast, a price-weighted index involves taking the summation of the prices of the stocks in the index.

NYSE. This index is designed to assist investors looking to track the U.S. market across 10 industry sectors, as defined by Dow Jones & Company (“Dow Jones”).<sup>9</sup>

The NYSE U.S. 100 Index is calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all U.S. stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

#### NYSE International 100 Index

The NYSE International 100 Index is designed to assist investors seeking to track international markets. This index tracks the 100 largest non-U.S. stocks trading on the NYSE. It covers 27.1% of the international stock market and has a total market capitalization of \$3.8

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<sup>9</sup> As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (1.9%); Consumer, Cyclical (13.4%); Consumer, Non-Cyclical (11.4%); Energy (7.5%); Financial (23.3%); Healthcare (18.7%); Industrial (10.7%); Technology (5.9%); Telecommunication (6.7%); and Utilities (0.5%).

trillion. Currently, the components of the NYSE International 100 Index represent 18 countries.<sup>10</sup>

All of the components of this index are priced on the NYSE during U.S. trading hours.<sup>11</sup> The NYSE International 100 Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all non-U.S. stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, *i.e.*, average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically

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<sup>10</sup> According to the ISE, 98 of the 100 underlying components in the NYSE International 100 Index meet ISE's listing criteria for equity options as set forth in ISE Rule 502. This represents 97.93% of the index by market capitalization weight and 98% by number. Two American Depositary Receipts ("ADRs") underlying the NYSE International 100 Index, Allianz AG ("AZ") and Telefonica Moviles SA ("TEM"), do not meet the requirements of ISE Rule 502, because the NYSE does not have in place an effective surveillance sharing agreement with the primary exchange in the home country where AZ and TEM are traded. However, the U.S. market for the underlying ADRs is at least 50% or more of the worldwide trading volume. Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (March 21, 2005). The listing of options on an ADR without the existence of a comprehensive surveillance agreement with the foreign market where the underlying component trades is appropriate, as long as the U.S. market for the underlying ADR is at least 50% or more of the worldwide trading volume. See ISE Rule 502(f)(2).

<sup>11</sup> The NYSE International 100 Index components are classified in ten market sectors. As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (3.1%); Consumer, Cyclical (11.1%); Consumer, Non-Cyclical (5.2%); Energy (17.7%); Financial (27.7%); Healthcare (12.0%); Industrial (1.1%); Technology (8.3%); Telecommunication (10.6%); and Utilities (3.2%).

included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

#### NYSE World Leaders Index

The NYSE World Leaders is designed to serve as a benchmark to track, as a single asset class, the performance of 200 world leaders across 10 industry sectors and all regions of the world. This index is constructed by combining the NYSE U.S. 100 Index and NYSE International 100 Indexes. The components of the NYSE World Leaders Index have a total market capitalization of \$9.7 trillion and cover 36.7% of the market capitalization of the world markets. It is well diversified across 10 industry sectors, as defined by Dow Jones, and currently represents 19 countries, including the United States. All of the components of this index are priced on the NYSE during U.S. trading hours.<sup>12</sup>

The NYSE World Leaders Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all stocks listed on the NYSE. The index universes for the NYSE U.S. 100 and NYSE International 100 are each ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100

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<sup>12</sup> The NYSE World Leaders Index components are classified in ten market sectors. As of March 18, 2004, these sectors and their respective weightings were: Basic Materials (2.3%); Consumer, Cyclical (12.6%); Consumer, Non-Cyclical (9.2%); Energy (11.2%); Financial (24.1%); Healthcare (16.3%); Industrial (7.2%); Technology (6.8%); Telecommunication (8.1%); and Utilities (1.5%).

companies are then selected from the remaining stocks in each universe, and the index is weighted by float-adjusted market capitalization.

The NYSE U.S. 100 and the NYSE International 100 Indexes are reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universes are ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. In addition to the scheduled quarterly review, the index is reviewed on an ongoing basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

#### NYSE TMT Index

The NYSE TMT Index is a narrow-based index. For narrow-based indexes that meet the standards of an exchange's rules, an SRO need only complete Form 19b-4(e) at least five business days after commencement of trading the new product. Since the listing of this product does not meet all of the requirements of ISE Rule 2002(b), Form 19b-4(e) is not available for the listing of this product.

The NYSE TMT Index is designed to track the top 100 technology, media and telecommunications stocks listed on the NYSE. The companies represented have a market capitalization of \$2.3 trillion, which covers 45.7% of the entire market capitalization of technology, media and telecommunication companies globally and is approximately the same

size as the nearly 4,000 companies in the Nasdaq Composite Index. All of the components of this index are priced on the NYSE during U.S. trading hours.<sup>13</sup>

The NYSE TMT Index is also calculated using a rules-based methodology that is fully transparent. Its original selection pool includes all technology, media and telecommunication stocks listed on the NYSE. The entire index universe is ranked in descending order by unadjusted market capitalization. If a component has multiple share classes, the most liquid issue for that company is included. Companies that fail a liquidity test, i.e., average trading volume of 100,000 shares for the preceding three months, are removed. The top 100 companies are then selected from the remaining universe, and the index is weighted by float-adjusted market capitalization.

The index is reviewed quarterly, with an 80-120 buffer applied to limit turnover. When the universe is ranked by market capitalization, all stocks in the top 80 are automatically included in the index, while all stocks ranked below 120 are automatically excluded. The remaining components are selected from stocks falling between 80 and 120, starting with the highest ranked component. At the quarterly rebalancing, market sector weights for technology, media and telecommunications are capped at no more than 40% and the sub-group weights are capped at no more than 20%. This ensures that one sector or sub-group does not dominate the index. In addition to the scheduled quarterly review, the index is also reviewed on an ongoing

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<sup>13</sup> The NYSE TMT Index components are classified in 14 industry sub-groups within the technology, media and telecommunication sectors. As of March 18, 2004, the sub-groups and their respective weightings were: Advertising (1.9%); Broadcasting (18.9%); Communications Technology (11.8%); Computers (13.0%); Diversified Technology Services (2.4%); Entertainment (0.3%); Fixed-line Communications (20.9%); Internet Services (0.0%); Office Equipment (1.2%); Publishing (6.1%); Semiconductors (10.8%); Technology, Software (2.8%); Wireless Communications (9.9%); and Other: Non-Technology, Media and Telecommunication (0.0%).

basis to accommodate extraordinary events, such as delistings, bankruptcies, mergers or acquisitions involving index components.

#### Index Calculation and Index Maintenance

The Mini Index Options level and the Micro Index Options level will each be calculated continuously, using the last sale price for each component stock in the NYSE Indexes, and will be disseminated every 15 seconds throughout the trading day.<sup>14</sup> The settlement value for purposes of settling Mini Index Options (“Mini Settlement Value”) and Micro Index Options (“Micro Settlement Value”) will be calculated on the basis of opening market prices on the business day prior to the expiration date of such options (“Settlement Day”).<sup>15</sup> The Settlement Day is normally the Friday preceding “Expiration Saturday.”<sup>16</sup> In the event that a component security in the Index does not trade on Settlement Day, the closing price from the previous trading day is used to calculate the Settlement Value. Accordingly, trading in Mini Index Options and Micro Index Options will normally cease on the Thursday preceding an Expiration Saturday. Dow Jones shall calculate, and the Exchange shall disseminate, both the Mini Settlement Value and the Micro Settlement Value in the same manner as the Dow Jones shall calculate, and the Exchange shall disseminate, the Mini Index Options level and the Micro Index Options level.

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<sup>14</sup> The Mini Index Options level and the Micro Index Options level shall each be calculated by Dow Jones on behalf of the NYSE and disseminated to the Consolidated Quote System (“CQS”). The Exchange shall receive those values from CQS and disseminate them to its members. Each of the NYSE Indexes is published daily in real-time on the NYSE’s public website and through, among other places, major quotation vendors such as Reuters and Thomson’s ILX.

<sup>15</sup> The aggregate exercise value of the option contract is calculated by multiplying the Index value by the Index multiplier, which is 100.

<sup>16</sup> For any given expiration month, options on the NYSE Indexes will expire on the third Saturday of the month.

Dow Jones will monitor and maintain each of the NYSE Indexes. Although the Exchange is not involved in the maintenance of the NYSE Indexes, the Exchange represents that it will monitor the NYSE Indexes on a quarterly basis,<sup>17</sup> at which point the Exchange will notify the Commission's Division of Market Regulation ("Division"), and will cease trading options on the NYSE Indexes if and when: (i) the number of securities in each of the NYSE Indexes drops by 1/3<sup>rd</sup> or more; (ii) 10% or more of the weight of each of the NYSE Indexes is represented by component securities having a market value of less than \$75 million; (iii) less than 80% of the weight of each of the NYSE Indexes is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (iv) 10% or more of the weight of each of the NYSE Indexes is represented by component securities trading less than 20,000 shares per day; or (v) the largest component security accounts for more than 15% of the weight of each of the NYSE Indexes or the largest five components in the aggregate account for more than 40% of the weight of each of the NYSE Indexes.<sup>18</sup>

The Exchange will notify the Division immediately in the event Dow Jones determines to cease maintaining or calculating the NYSE Indexes. In the event any of the NYSE Indexes ceases to be maintained or calculated, the Exchange will determine not to list any additional series for trading or limit all transactions in such options to closing transactions only for the purpose of maintaining a fair and orderly market and protecting investors.<sup>19</sup>

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<sup>17</sup> Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (March 21, 2005).

<sup>18</sup> Telephone conversation between Samir Patel, Assistant General Counsel, ISE, and A. Michael Pierson, Attorney, Division, Commission (May 10, 2005). The Exchange understands that it may file a proposal pursuant to Section 19(b) of the Act and Rule 19b-4 if it wishes to trade options on the NYSE Indexes that would not otherwise meet the eligibility requirements listed above.

<sup>19</sup> Id.

### Contract Specifications

The NYSE U.S. 100, the NYSE International 100 and the NYSE World Leaders Indexes are each broad-based, as defined in Exchange Rule 2001(j).<sup>20</sup> The NYSE TMT Index is a narrow-based index, as defined in Exchange Rule 2001(i).<sup>21</sup> Options on the NYSE Indexes are European-style and A.M. cash-settled. The Exchange's standard trading hours for index options (9:30 a.m. to 4:15 p.m., New York time), as set forth in Rule 2008(a), will apply to the NYSE Indexes. Exchange rules that are applicable to the trading of options on broad-based indexes will apply to the trading of Mini Index Options and Micro Index Options on the Broad-Based Indexes. Exchange rules that are applicable to the trading of options on narrow-based indexes will apply to the trading of Mini Index Options and Micro Index Options on the TMT Index.<sup>22</sup> Specifically, the trading of Mini Index Options and Micro Index Options on the NYSE Indexes will be subject to, among others, Exchange rules governing sales practice rules, margin requirements, trading rules, and position and exercise limits.

For each of the Broad-Based NYSE Indexes, the Exchange proposes to establish aggregate position and exercise limits for Mini Index Options at 50,000 contracts on the same side of the market, provided no more than 30,000 of such contracts are in the nearest expiration month series. The Mini Index Options contracts shall be aggregated with Micro Index Options contracts, where ten (10) Micro Index Options contracts equal one (1) Mini Index Options contract. For the narrow-based NYSE TMT Index, the aggregate position and exercise limits

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<sup>20</sup> ISE Rule 2001(j) defines a "market index" or a "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.

<sup>21</sup> ISE Rule 2001(i) defines an "industry index" or a "narrow-based index" to mean an index designed to be representative of a particular industry or a group of related industries.

<sup>22</sup> See ISE Rules 2000 through 2012.

shall be as set forth in ISE Rule 2005(a)(3). Currently, that rule would set position exercise limits for the Mini Index Options on the NYSE TMT Index at 31,500 contracts on the same side of the market. Similar to the aggregation of the position and exercise limits on the Broad-Based NYSE Indexes, the Mini Index Options contracts on the NYSE TMT Index shall be aggregated with Micro Index Options contracts on the NYSE TMT Index, where ten (10) Micro Index Options contracts equal one (1) Mini Index Options contract.

The Exchange proposes to set strike price intervals at 2 1/2 points for certain near-the-money series in near-term expiration months when each of the NYSE Indexes is at a level below 200, and 5 point strike price intervals for other options series with expirations up to one year, and 25 to 50 point strike price intervals for longer-term options. Accordingly, since the current Mini Index Options level for each of the NYSE Indexes is 576.38, 450.57, 527.34 and 506.09, the Exchange shall set strike price intervals at 5 points for the Mini Index Options. Since the current Micro Index Options level for each of the NYSE Indexes is 57.64, 45.06, 52.73 and 50.61, the Exchange shall set strike price intervals at 2 1/2 points for the Micro Index Options. The minimum tick size for series trading below \$3 shall be 0.05, and for series trading at or above \$3 shall be 0.10.

The Exchange proposes to list Mini Index Options and Micro Index Options in the three consecutive near-term expiration months plus up to three successive expiration months in the March cycle. For example, consecutive expirations of January, February, March, plus June, September, and December expirations would be listed.<sup>23</sup> In addition, long-term option series (“LEAPS”) having up to 36 months to expiration may be traded.<sup>24</sup> The interval between

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<sup>23</sup> See ISE Rule 2009(a)(3).

<sup>24</sup> See ISE Rule 2009(b)(1). The Exchange is not listing reduced value LEAPS on either of the Mini Index or Micro Index Options. Telephone conversation between Samir Patel,

expiration months on the Mini Index Options or Micro Index Options shall not be less than six months. The trading of any LEAPS on Micro Index Options and Mini Index Options shall be subject to the same rules that govern the trading of all the Exchange's index options, including sales practice rules, margin requirements, trading rules, and position and exercise limits.

#### Surveillance and Capacity

The ISE represents that it has an adequate surveillance program for options traded on the NYSE Indexes, and intends to apply to the trading of Mini Index or Micro Index Options the same program procedures that it applies to the Exchange's other index options. Additionally, the Exchange is a member of the Intermarket Surveillance Group ("ISG") under the ISG Agreement, dated June 20, 1994. The members of the ISG include all of the U.S. registered stock and options markets: the American Stock Exchange, the Boston Stock Exchange, the Chicago Board Options Exchange, the Chicago Stock Exchange, the National Stock Exchange, the National Association of Securities Dealers, the New York Stock Exchange, the Pacific Stock Exchange and the Philadelphia Stock Exchange. The ISG members work together to coordinate surveillance and investigative information sharing in the stock and options markets. In addition, the major futures exchanges and non-U.S. Exchanges are affiliated members of the ISG, which allows for the sharing of surveillance information for potential intermarket trading abuses. The ISE notes that members of the ISG work together to coordinate surveillance and investigative information sharing in the stock and options markets.

In a confidential submission to the Commission, the Exchange provided an analysis supporting its representation that it has the system capacity to adequately handle all options

series that could be listed pursuant to this proposal, including long-term Reduced Value Index Options and long-term Micro Index Options.

### **III. Discussion**

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 and, in particular, the requirements of Section 6(b)(5) of the Act.<sup>25</sup> The Commission finds that the trading of options on reduced values of the NYSE Indexes will permit investors to participate in the price movements of the securities that comprise the NYSE Indexes. The Commission also believes that the trading of options on the NYSE Indexes will allow investors holding positions in some or all of the securities underlying the Index to hedge the risks associated with their portfolios. Accordingly, the Commission believes that options on the NYSE Indexes will provide investors with an important trading and hedging mechanism. By broadening the hedging and investment opportunities of investors, the Commission believes that the trading of options on the NYSE Indexes will serve to protect investors, promote the public interest, and contribute to the maintenance of fair and orderly markets.<sup>26</sup>

The trading of options on the NYSE Indexes, however, raises several issues, including

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<sup>25</sup> 15 U.S.C. 78f(b)(5). In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>26</sup> Pursuant to Section 6(b)(5) of the Act, the Commission must predicate approval of any new option or warrant proposal upon a finding that the introduction of such new derivative instrument is in the public interest. Such a finding would be difficult for a derivative instrument that served no hedging or other economic function, because any benefits that might be derived by market participants likely would be outweighed by the potential for manipulation, diminished public confidence in the integrity of the markets, and other valid regulatory concerns. In this regard, the Commission believes that options on the NYSE Indexes will provide investors with a hedging and investment vehicle that should reflect the overall movement of a substantial segment of the capital markets.

issues related to index design, customer protection, surveillance, and market impact. For the reasons discussed below, the Commission believes that the ISE has adequately addressed these issues.

**A. Index Design and Structure**

The Commission finds that it is appropriate and consistent with the Act to classify the NYSE U.S. 100 Index, the NYSE International 100 Index, and the NYSE World Leaders Index as broad-based and the NYSE TMT Index as narrow-based for purposes of index options trading, and therefore appropriate to permit ISE rules applicable to the trading of broad-based and narrow-based index options to apply to the NYSE Index options, as applicable. Specifically, the Commission believes that the Broad Based NYSE Indexes are broad-based, because they reflect a substantial segment of the U.S. equity markets. The NYSE U.S. 100 Index is comprised of 100 component stocks, and is designed to track the U.S. market by including the top 100 stocks trading on the NYSE; the NYSE International 100 Index is comprised of 100 component stocks, and is designed to track the international markets by including the 100 largest non-U.S. stocks trading on the NYSE; and the NYSE World Leaders Index is comprised of 200 component stocks by combining the NYSE U.S. 100 Index and the NYSE International 100 Index. The ISE believes it is intended to track the performance of 200 “world leader” stocks trading on the NYSE. The NYSE World Leaders Index includes stocks across 10 industry sectors and all regions of the world. The TMT Index is narrow-based, because it is representative of a particular industry or a group of related industries. The NYSE TMT Index is designed to track the top 100 technology, media, and telecommunications stocks listed on the NYSE.

NYSE U.S. 100 Index

According to the ISE, as of March 18, 2004, 100% of the components were options eligible.<sup>27</sup> Second, as of March 18, 2004, the NYSE U.S. 100 Index's components were classified in ten industry sectors, which were weighted in the Index as follows: Basic Materials (1.9%); Consumer, Cyclical (13.4%); Consumer, Non-Cyclical (11.4%); Energy (7.5%); Financial (23.3%); Healthcare (18.7%); Industrial (10.7%); Technology (5.9%); Telecommunication (6.7%); and Utilities (0.5%). Third, as of March 18, 2004, the total capitalization of the Index was approximately \$6.166 trillion, the capitalization of the Index's components ranged from approximately \$17.13 billion to approximately \$310.02 billion, and the mean capitalization of the Index's components was approximately \$61.665 billion. As of March 18, 2004, the largest Index component accounted for 5.03% of the weight of the Index, and the five highest weighted securities accounted for 22.2% of the weight of the Index.

The Commission also believes that the general broad diversification, capitalizations, liquidity, and relative weighting of the Index's component securities minimize the potential for manipulation of the Index. First, the Index is comprised of 100 components listed and actively traded on the NYSE, and no single security dominates the Index. Second, the capitalizations of the stocks in the Index are very large. As of March 18, 2004, the total Index capitalization was approximately \$6.166 trillion, the median and mean capitalizations of the Index's components were approximately \$40.673 billion and \$61.665 billion, respectively and the capitalizations of the Index's components ranged from a high of approximately \$310.02 billion for the highest-weighted component (which represented 5.03% of the weight of the Index) to a low of approximately \$18.59 billion for the lowest-weighted Index component (which represented .30%

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<sup>27</sup> See ISE Rule 502.

of the weight of the Index). As of March 18, 2004, the capitalizations of the Index's five most heavily weighted components, which represented 22.2% of the weight of the Index, ranged from approximately \$255 billion to approximately \$310.02 billion. Third, as of March 18, 2004, mean and median six-month average daily trading volume of the Index's components was 5.376 million shares and 4.082 million shares, respectively, and 100% of the Index's components had six-month average daily trading volume of at least 50,000 shares. Fourth, as of March 18, 2004, components representing over 100% of the weight of the Index were options eligible. Fifth, the ISE has represented that it will monitor the Index on a quarterly basis at which point the Exchange will notify the Division, and will cease trading options on the Index if and when: (1) the number of securities in the Index drops by 1/3<sup>rd</sup> or more; (2) 10% or more of the weight of the Index is represented by component securities having a market value of less than \$75 million; (3) less than 80% of the weight of the Index is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (4) 10% or more of the weight of the Index is represented by component securities trading less than 20,000 shares per day; or (5) the largest component security accounts for more than 15% of the weight of the Index or the largest five components in the aggregate account for more than 40% of the weight of the Index.<sup>28</sup>

The Commission believes that these factors minimize the potential for manipulation because it is unlikely that attempted manipulations of the prices of the Index's components would affect significantly the Index's value. Moreover, the surveillance procedures discussed below should detect as well as deter potential manipulations and other trading abuses.

Finally, the Commission believes that the position and exercise limits for the Mini Index Options and Micro Index Options are designed to minimize the potential for manipulation and

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<sup>28</sup> See supra note 18.

other market impact concerns. The position and exercise limits for the Mini Index Options and Micro Index Options are comparable to the position and exercise limits approved for other index options.<sup>29</sup>

#### NYSE International 100 Index

According to the ISE, as of March 18, 2004, 88.15% of the components were options eligible, as measured by weighting, and 79% of the components were options eligible, as measured by number.<sup>30</sup> Second, as of March 18, 2004, the NYSE International 100 Index's components were classified in ten market sectors, which were weighted in the Index as follows: Basic Materials (3.1%); Consumer, Cyclical (11.1%); Consumer, Non-Cyclical (5.2%); Energy (17.7%); Financial (27.7%); Healthcare (12.0%); Industrial (1.1%); Technology (8.3%); Telecommunication (10.6%); and Utilities (3.2%). Third, as of March 18, 2004, the total capitalization of the Index was approximately \$4.308 trillion, the capitalization of the Index's components ranged from approximately \$4.99 billion to approximately \$182.444 billion, and the mean capitalization of the Index's components was approximately \$43.086 billion. As of March 18, 2004, the largest Index component accounted for 4.23% of the weight of the Index, and the five highest weighted securities accounted for 16.96% of the weight of the Index.

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<sup>29</sup> See, e.g., Securities Exchange Act Release Nos. 48884 (December 5, 2003), 68 FR 69753 (December 15, 2003) (File No. SR-PHLX-2003-66) (order approving the listing and trading of Nasdaq 1000 Index options, with position limits of 50,000 contracts on either side of the market and no more than 30,000 contracts in series in the nearest expiration month); 31382 (October 30, 1992), 57 FR 52802 (November 5, 1992) (File No. SR-CBOE-92-02) (order approving the listing and trading of options on the Russell 2000 Index, with position limits of 50,000 contracts on either side of the market and no more than 30,000 contracts in series in the nearest expiration month); and 50937 (December 27, 2004), 70 FR 416 (January 4, 2005) (File No. SR-ISE-2004-09) (order approving the listing and trading of options on the S&P 1000 Index).

<sup>30</sup> See supra note 27.

The Commission also believes that the general broad diversification, capitalizations, liquidity, and relative weighting of the Index's component securities minimize the potential for manipulation of the Index. First, the Index is comprised of 100 components listed and actively traded on the NYSE, and no single security dominates the Index. Second, the capitalizations of the stocks in the Index are very large. As of March 18, 2004, the total Index capitalization was approximately \$4.308 trillion, the median and mean capitalizations of the Index's components were approximately \$30.612 billion and \$43.086 billion, respectively, and the capitalizations of the Index's components ranged from a high of approximately \$182.444 billion for the highest-weighted component (which represented 4.23% of the weight of the Index) to a low of approximately \$5.02 billion for the lowest-weighted Index component (which represented .05% of the weight of the Index). As of March 18, 2004, the capitalizations of the Index's five most heavily weighted components, which represented 16.96% of the weight of the Index, ranged from approximately \$117.7 billion to approximately \$182.444 billion. Third, as of March 18, 2004, mean and median six-month average daily trading volume of the Index's components was 1.054 million shares and 197,450 shares, respectively, and 79% of the Index's components had six-month average daily trading volume of at least 50,000 shares. Fourth, as of March 18, 2004, 88.15% of the components were options eligible, as measured by weighting, and 79% of the components were options eligible, as measured by number. Fifth, the ISE has represented that it will monitor the Index on a quarterly basis at which point the Exchange will notify the Division, and will cease trading options on the Index if and when: (1) the number of securities in the Index drops by 1/3<sup>rd</sup> or more; (2) 10% or more of the weight of the Index is represented by component securities having a market value of less than \$75 million; (3) less than 80% of the weight of the Index is represented by component securities that are eligible for options trading pursuant to ISE

Rule 502; (4) 10% or more of the weight of the Index is represented by component securities trading less than 20,000 shares per day; or (5) the largest component security accounts for more than 15% of the weight of the Index or the largest five components in the aggregate account for more than 40% of the weight of the Index.<sup>31</sup>

The Commission believes that these factors minimize the potential for manipulation because it is unlikely that attempted manipulations of the prices of the Index's components would affect significantly the Index's value. Moreover, the surveillance procedures discussed below should detect as well as deter potential manipulations and other trading abuses.

Finally, the Commission believes that the position and exercise limits for the Mini Index Options and Micro Index Options are designed to minimize the potential for manipulation and other market impact concerns. The position and exercise limits for the Mini Index Options and Micro Index Options are comparable to the position and exercise limits approved for other index options.<sup>32</sup>

#### NYSE World Leaders Index

According to the ISE, as of March 18, 2004, 95.1% of the components were options eligible, as measured by weighting, and 89.5% of the components were options eligible, as measured by number.<sup>33</sup> Second, the capitalizations of the stocks in the Index are very large. As of March 18, 2004, the NYSE World Leaders Index's components were classified in ten industry sectors, which were weighted in the Index as follows: Basic Materials (2.3%); Consumer, Cyclical (12.6%); Consumer, Non-Cyclical (9.2%); Energy (11.2%); Financial (24.1%); Healthcare (16.3%); Industrial (7.2%); Technology (6.8%); Telecommunication (8.1%); and

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<sup>31</sup> See supra note 18.

<sup>32</sup> See supra note 29.

<sup>33</sup> See supra note 27.

Utilities (1.5%). Third, as of March 18, 2004, the total capitalization of the Index was approximately \$9.7 trillion, the capitalization of the Index's components ranged from approximately \$4.99 billion to approximately \$310.02 billion, and the mean capitalization of the Index's components was approximately \$52.668 billion. As of March 18, 2004, the largest Index component accounted for 2.94% of the weight of the Index, and the five highest weighted securities accounted for 12.99% of the weight of the Index. Fourth, because the Index is a combination of two broad-based indexes, the NYSE U.S. 100 Index and the NYSE International 100 Index, and the selection and maintenance criteria for the NYSE U.S. 100 Index and the NYSE International 100 Index determine the components of the NYSE World Leaders Index, the selection and maintenance criteria for the NYSE U.S. 100 Index and the NYSE International 100 Index should serve to ensure that the Index maintains its broad representative sample of stocks.

The Commission also believes that the general broad diversification, capitalizations, liquidity, and relative weighting of the Index's component securities minimize the potential for manipulation of the Index. First, the Index is comprised of 200 components listed and actively traded on the NYSE, and no single security dominates the Index. Second, the capitalizations of the stocks in the Index are very large. As of March 18, 2004, the total Index capitalization was approximately \$10.533 trillion, the median and mean capitalizations of the Index's components were approximately \$37.291 billion and \$52.668 billion, respectively, and the capitalizations of the Index's components ranged from a high of approximately \$310.02 billion for the highest-weighted component (which represented 2.94% of the weight of the Index) to a low of approximately \$4.99 billion for the lowest-weighted Index component (which represented .05% of the weight of the Index). As of March 18, 2004, the capitalizations of the Index's five most heavily weighted components, which represented 12.99% of the weight of the Index, ranged

from approximately \$255.08 billion to approximately \$310.02 billion. Third, as of March 18, 2004, mean and median six-month average daily trading volume of the Index's components was 3.218 million shares and 1.73 million shares, respectively, and 89.5% of the Index's components had six-month average daily trading volume of at least 50,000 shares. Fourth, as of March 18, 2004, 95.1% of the components were options eligible, as measured by weighting, and 89.5% of the components were options eligible, as measured by number. Fifth, the ISE has represented that it will monitor the Index on a quarterly basis at which point the Exchange will notify the Division, and will cease trading options on the Index if and when: (1) the number of securities in the Index drops by 1/3<sup>rd</sup> or more; (2) 10% or more of the weight of the Index is represented by component securities having a market value of less than \$75 million; (3) less than 80% of the weight of the Index is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (4) 10% or more of the weight of the Index is represented by component securities trading less than 20,000 shares per day; or (5) the largest component security accounts for more than 15% of the weight of the Index or the largest five components in the aggregate account for more than 40% of the weight of the Index.<sup>34</sup>

The Commission believes that these factors minimize the potential for manipulation because it is unlikely that attempted manipulations of the prices of the Index's components would affect significantly the Index's value. Moreover, the surveillance procedures discussed below should detect as well as deter potential manipulations and other trading abuses.

Finally, the Commission believes that the position and exercise limits for the Mini Index Options and Micro Index Options are designed to minimize the potential for manipulation and other market impact concerns. The position and exercise limits for the Mini Index Options and

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<sup>34</sup> See supra note 18.

Micro Index Options are comparable to the position and exercise limits approved for other index options.<sup>35</sup>

#### NYSE TMT Index

According to the ISE, as of March 18, 2004, 100% of the components were options eligible.<sup>36</sup> Second, as of March 18, 2004, the NYSE TMT Index's components were classified in 14 industry sub-groups, which were weighted in the Index as follows: Advertising (1.9%); Broadcasting (18.9%); Communications Technology (11.8%); Computers (13.0%); Diversified Technology Services (2.4%); Entertainment (0.3%); Fixed-line Communications (20.9%); Internet Services (0.0%); Office Equipment (1.2%); Publishing (6.1%); Semiconductors (10.8%); Technology, Software (2.8%); Wireless Communications (9.9%); and Other: Non-Technology, Media and Telecommunication (0.0%). Third, as of March 18, 2004, the total capitalization of the Index was approximately \$2.701 trillion, the capitalization of the Index's components ranged from approximately \$2.89 billion to approximately \$165.12 billion, and the mean capitalization of the Index's components was approximately \$27.01 billion. As of March 18, 2004, the largest Index component accounted for 6.11% of the weight of the Index, and the five highest weighted securities accounted for 23.62% of the weight of the Index.

The Commission also believes that the large capitalizations, liquidity, and relative weighting of the Index's component securities minimize the potential for manipulation of the Index. First, the Index is comprised of 100 components listed and actively traded on the NYSE, and no single security dominates the Index. Second, the capitalizations of the stocks in the Index are very large. As of March 18, 2004, the total Index capitalization was approximately \$2.701

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<sup>35</sup> See supra note 29.

<sup>36</sup> See supra note 27.

trillion, the median and mean capitalizations of the Index's components were approximately \$15.38 billion and \$27.01 billion, respectively, and the capitalizations of the Index's components ranged from a high of approximately \$165.12 billion for the highest-weighted component (which represented 6.11% of the weight of the Index) to a low of approximately \$2.89 billion for the lowest-weighted Index component (which represented .11% of the weight of the Index). As of March 18, 2004, the capitalizations of the Index's five most heavily weighted components, which represented 23.62% of the weight of the Index, ranged from approximately \$99.62 billion to approximately \$165.12 billion. Third, as of March 18, 2004, mean and median six-month average daily trading volume of the Index's components was 4.138 million shares and 1.302 million shares, respectively, and 86% of the Index's components had six-month average daily trading volume of at least 50,000 shares. Fourth, as of March 18, 2004, components representing over 100% of the weight of the Index were options eligible. Fifth, the ISE has represented that it will monitor the Index on a quarterly basis at which point the Exchange will notify the Division, and will cease trading options on the Index if and when: (1) the number of securities in the Index drops by 1/3<sup>rd</sup> or more; (2) 10% or more of the weight of the Index is represented by component securities having a market value of less than \$75 million; (3) less than 80% of the weight of the Index is represented by component securities that are eligible for options trading pursuant to ISE Rule 502; (4) 10% or more of the weight of the Index is represented by component securities trading less than 20,000 shares per day; or (5) the largest component security accounts for more than 15% of the weight of the Index or the largest five components in the aggregate account for more than 40% of the weight of the Index.<sup>37</sup>

The Commission believes that these factors minimize the potential for manipulation

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See supra note 18.

because it is unlikely that attempted manipulations of the prices of the Index's components would affect significantly the Index's value. Moreover, the surveillance procedures discussed below should detect as well as deter potential manipulations and other trading abuses.

Finally, the Commission believes that the position and exercise limits for the Mini Index Options and Micro Index Options are designed to minimize the potential for manipulation and other market impact concerns. The position and exercise limits for the Mini Index Options and Micro Index Options are comparable to the position and exercise limits approved for other index options.<sup>38</sup>

### **B. Customer Protection**

The Commission believes that a regulatory system designed to protect public customers must be in place before the trading of sophisticated financial instruments, such as options on the NYSE Indexes, can commence on a national securities exchange. The Commission notes that the trading of standardized, exchange-traded options occurs in an environment that is designed to ensure, among other things, that: (1) the special risks of options are disclosed to public customers; (2) only investors capable of evaluating and bearing the risks of options trading are engaged in such trading; and (3) special compliance procedures are applicable to options accounts. Accordingly, because options on the NYSE Indexes will be subject to the same regulatory regime as the other standardized options traded currently on the ISE, the Commission believes that adequate safeguards are in place to ensure the protection of investors in Index Options.

### **C. Surveillance**

The Commission generally believes that a surveillance sharing agreement between an

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<sup>38</sup> See supra note 29.

exchange proposing to list a stock index derivative product and the market(s) trading the stocks underlying the derivative product is an important measure for the surveillance of the derivative product and the underlying securities markets. Such agreements ensure the availability of information necessary to detect and deter potential manipulations and other trading abuses, thereby making the stock index product less readily susceptible to manipulation. In this regard, the ISE and the NYSE, the NASD, and the Amex are members of the ISG and the ISG Agreement will apply to the trading of Index Options.<sup>39</sup> In addition, the ISE will apply to the options on the NYSE Indexes the same surveillance procedures it uses currently for existing index options trading on the ISE.

The NYSE International 100 Index and the NYSE World Leaders Index both contain foreign component ADRs that all trade on the NYSE. As mentioned above, 98 out of the 100 underlying components are subject to effective surveillance sharing agreements as set forth in ISE Rule 502. The remaining two components, representing only 0.86% of the Index, also meet surveillance requirements in ISE Rule 502(f)(2), because 50% of the volume for the underlying ADRs occurs on the NYSE. Accordingly, the Commission expects that there will be adequate surveillance mechanisms to detect and deter potential manipulation when trading Index options on the NYSE Indexes, which contain the foreign components.<sup>40</sup>

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<sup>39</sup> 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 NASD are members of the ISG. In addition, futures exchanges and non-U.S. exchanges and associations are affiliate members of ISG.

<sup>40</sup> Under the maintenance standards, 80% of the Indexes would have to meet the standards of ISE Rule 502, which would ensure that the Indexes with foreign components are adequately covered by effective surveillance mechanisms. See also supra note 18, and accompanying text.

**D. Market Impact**

The Commission believes that the listing and trading of options on the NYSE Indexes will not adversely impact the underlying securities markets.<sup>41</sup> First, as described above, the NYSE Indexes are highly capitalized and their underlying components are actively traded. Second, the position and exercise limits applicable to the options on the NYSE Indexes should serve to minimize potential manipulation and market impact concerns. Third, the risk to investors of contra-party non-performance will be minimized because the options on the NYSE Indexes, like other standardized options traded in the U.S., will be issued and guaranteed by the Options Clearing Corporation. Fourth, existing ISE index options rules and surveillance procedures will apply to the options on the NYSE Indexes.

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<sup>41</sup> As noted above, the ISE represented in a confidential submission to the Commission that it has the necessary systems capacity to support the introduction of options on the NYSE Indexes.

**IV. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>42</sup> that the proposed rule change (SR-ISE-2004-27), as amended, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>43</sup>

J. Lynn Taylor  
Assistant Secretary

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<sup>42</sup> 15 U.S.C. 78s(b)(2).

<sup>43</sup> 17 CFR 200.30-3(a)(12).