

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52923; File No. SR-PCX-2005-79)

December 7, 2005

Self-Regulatory Organizations; Pacific Exchange, Inc., Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 2 and 3 Relating to Generic Listing Standards for Options on Narrow-Based and Micro Narrow-Based Indexes

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 June 27, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”) filed with the Securities and Exchange Commission (“Commission” or “SEC”) the proposed rule change as described in Items I and II below, which Items have been substantially prepared by the Exchange. The PCX filed Amendment Nos. 1³ and 2⁴ on November 3, 2005. On December 6, 2005, the PCX filed Amendment No. 3.⁵ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and is approving the proposed rule change, as amended, on an accelerated basis.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange withdrew Amendment No. 1 on November 3, 2005.

⁴ Amendment No. 2 supplemented the PCX’s original filing and made certain technical corrections to the purpose section and to the proposed rule text.

⁵ Amendment No. 3 makes certain technical corrections to the proposed rule text and purpose section, but did not materially impact the filing.

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

The Exchange proposes to amend its index options rules in order to provide for the listing and trading of narrow-based index options pursuant to Rule 19b-4(e) under the Act.⁶ The Exchange is also proposing to amend the position and exercise limits with respect to narrow-based index options, as well as a number of conforming changes in order to bring the PCX narrow-based index option rules up to date with those of other Self-Regulatory Organizations (“SROs”).⁷ In addition, the Exchange proposes to adopt new generic listing standards for options on micro narrow-based indexes. The proposed rule changes are based on the rules of the International Securities Exchange, Inc. (“ISE”)⁸ and the Chicago Board Options Exchange, Incorporated (“CBOE”),⁹ which were approved by the Commission. The text of the proposed rule change appears below. Additions are underlined; deletions are [bracketed].

⁶ 17 CFR 240.19b-4(e).

⁷ The Exchange states that, on October 28, 2003, it filed a proposed rule change to update its broad-based and narrow-based index options rules. The Exchange further states that due to the time-sensitive circumstances at that time, the Exchange amended its filing to address only the updates to the broad-based index options rules and deleted all references to modifications to the narrow-based index options rules. At this time, the Exchange is proposing to update its narrow-based index options rules in order to bring its rules in line with other SROs. See Securities Exchange Act Release No. 49455 (March 22, 2004), 69 FR 16316 (March 29, 2004) (Order approving SR-PCX-2003-60). The Commission notes, however, that Rule 19b-4(e), with which the Exchange now proposes to bring its listing standards into compliance, has been in effect since December 8, 1998. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998).

⁸ See Securities Exchange Act Release No. 48405 (August 25, 2003), 68 FR 52257 (September 2, 2003) (SR-ISE-2003-05) (Order approving the ISE’s generic listing standards for options on narrow-based indexes).

⁹ See Securities Exchange Act Release No. 49932 (June 28, 2004), 69 FR 40994 (July 7, 2004) (SR-CBOE-2002-24) (Order approving generic listing standards for options on micro narrow-based security indexes) and Securities Exchange Act Release No. 51346 (March 9, 2005), 70 FR 12916 (March 16, 2005) (SR-CBOE-2005-08) (Order approving CBOE’s proposed modified capitalization-weighted methodology as an acceptable generic listing standard for options on narrow-based index).

Rule 5

Options Contracts Traded on the Exchange

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Definitions

Rule 5.10(b)(1) – (24) – No Change.

(25) The term "Micro Narrow-Based Index" means an industry or narrow-based index that meets the specific criteria provided under Rule 5.13(d).

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Designation of the Index Narrow-Based Index Options

Rule 5.13(a) The component securities of an index underlying an index option contract need not meet the requirements of Rule 5.3. Except as set forth in subsection (b) below, the listing of a class of index options on a narrow-based index requires the filing of a proposed rule change to be approved by the SEC under Section 19(b) of the Securities Exchange Act of 1934 ("1934 Act"). [The listing of a class of index options on a new narrow-based index will be treated by the Exchange as a proposed rule change subject to filing with and approval by the Securities and Exchange Commission ("Commission") under Section 19(b) of the Act. A rule change proposing the listing of a class of index options on a new underlying index may be designated by the Exchange as constituting a stated policy, practice or interpretation with respect to the administration of this Rule 5.13(a) within the meaning of subparagraph (3)(A) of subsection 19(b) of the Act, thereby qualifying the rule change for effectiveness upon filing with the Commission if the Exchange prefiles with the Commission a draft copy of the rule change not less than one week before it is filed, and if the Exchange proposes to commence trading in the

subject class of index options not earlier than 30 days after the date of filing, and if each of the following conditions is satisfied:]

(b) Narrow-Based Index. The Exchange may trade options on a narrow-based index pursuant to Rule 19b-4(e) of the 1934 Act, if each of the following conditions is satisfied:

(1) – No Change.

(2) The index is capitalization-weighted, price weighted, [or] or equal dollar-weighted, or modified capitalization-weighted, and consists of ten or more component securities;

(3) – (4) – No Change.

(5) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average monthly trading volume of at least 2,000,000 shares over the past six months;

(6) No single component security represents more than [25] 30% of the weight of the index, and the five highest weighted component securities in the index do not in the aggregate account for more than 50% ([60] 65% for an index consisting of fewer than 25 component securities) of the weight of the index.

(7) – No Change.

(8) [All Component securities are “reported securities” as defined in Rule 11Aa3-1 under the Exchange Act.] Each component security must be an “NMS Stock”

as defined in Rule 600 of Regulation NMS of the Securities Exchange Act of 1934.

(9) – (12) – No Change.

[Maintenance Requirements Narrow-Based Index Options]

[5.13(b)](c) Maintenance Criteria. The following maintenance listing standards shall apply to each class of index options originally listed pursuant to subsection [paragraph] [(a)] (b) above:

(1) The requirements [conditions] stated in subsections [subparagraphs] [(a)](b)(1), (3), (6), (7), (8), (9), (10), (11) and (12) must continue to be satisfied, provided that the requirements [conditions] stated in subparagraph [(a)](b)(6) must be satisfied only as of the first day of January and July in each year;

(2) – (3) – No change.

(4) In a capitalization-weighted index or a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index each have had an average monthly trading volume of at least 1,000,000 shares over the past six months.

In the event of a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the Commission concurs in

that determination, or unless the continued listing of that class of index options has been approved by the Commission under Section 19(b)(2) of the Act.

(d) Notwithstanding subsection (a) above, the Exchange may trade options on a Micro Narrow-Based security index pursuant to Rule 19b-4(e) of the 1934 Act, if each of the following condition is satisfied:

(1) The Index is a security index:

(i) that has 9 or fewer component securities; or

(ii) in which a component security comprises more than 30 percent of the index's weighting; or

(iii) in which the 5 highest weighted component securities in the aggregate comprise more than 60 percent of the index's weighting; or

(iv) in which the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting have an aggregate dollar value of average daily trading volume of less than \$50,000,000 (or in the case of an index with 15 or more component securities, \$30,000,000) except that if there are two or more securities with equal weighting that could be included in the calculation of the lowest weighted component securities comprising, in the aggregate, 25 percent of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security;

(2) The index is capitalization-weighted, modified capitalization-weighted, price-weighted, share weighted, equal dollar-weighted, approximate equal-dollar weighted, or modified equal-dollar weighted;

(i) For the purposes of this Rule 5.13(d), an approximate equal-dollar weighted index is composed of one or more securities in which each component security will be weighted equally based on its market price on the index's selection date and the index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision the "notional value" is the market price of the component times the number of shares of the underlying component in the index. Reconstitution and rebalancing are also mandatory if the number of components in the index is greater than five at the time of rebalancing. The Exchange reserves the right to rebalance quarterly at its discretion.

(ii) For the purposes of this Rule 5.13(d), a modified equal-dollar weighted index is an index in which each underlying component represents a pre-determined weighting percentage of the entire index. Each component is assigned a weight that takes into account the relative market capitalization of the securities comprising the index. A modified equal-dollar weighted index will be balanced quarterly.

(iii) For the purposes of this Rule 5.13(d), a share-weighted index is calculated by multiplying the price of the component security by an adjustment factor. Adjustment factors are chosen to reflect the investment objective deemed appropriate by the designer of the index and will be published by the Exchange as part of the contract specifications. The value of the index is calculated by adding the weight of each component security and dividing the total by an index divisor, calculated to yield a benchmark index level as of a particular date. A share-weighted index is not adjusted to reflect changes in the number of outstanding shares of its components. A share-weighted Micro Narrow-Based index will not be re-balanced. If a share-weighted Micro Narrow-Based Index fails to meet the maintenance listing standards under Rule 5.13(e), the Exchange will restrict trading in existing option series to closing transactions and will not issue additional series for that index.

(iv) The Exchange may rebalance any Micro Narrow-Based index on an interim basis if warranted as a result of extraordinary changes in the relative values of the component securities. To the extent investors with open positions must rely upon the continuity of the options contract on the index, outstanding contracts are unaffected by rebalancings.

(3) Each component security in the index has a minimum market capitalization of at least \$75 million, except that each of the lowest weighted securities in the index that in the aggregate account for no more than 10% of the weight of the index may have a minimum market capitalization of only \$50 million;

(4) The average daily trading volume in each of the preceding six months for each component security in the index is at least 45,500 shares, except that each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index may have an average daily trading volume of only 22,750 shares for each of the last six months;

(5) In a capitalization-weighted index, the lesser of: (1) the five highest weighted component securities in the index each have had an average daily trading volume of at least 90,000 shares over the past six months; or (2) the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of component securities in the index each have had an average daily trading volume of at least 90,000 shares over the past six months;

(6) Subject to subparagraphs (4) and (5) above, the component securities that account for at least 90% of the total index weight and at least 80% of the total number of component securities in the index must meet the requirements of Rule 5.3 applicable to individual underlying securities;

(7) (i) Each component security must be an “NMS Stock” as defined in Rule 600 of Regulation NMS of the Securities Exchange Act of 1934; and

(ii) Foreign securities or ADRs that are not subject to comprehensive surveillance sharing agreements do not represent more than 20% of the weight of the index;

(8) The current underlying index value will be reported at least once every fifteen seconds during the time the index options are traded on the Exchange;

(9) An equal dollar-weighted index will be rebalanced at least once every quarter;

(10) If the underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has in place an information barrier around its personnel who have access to information concerning changes in and adjustments to the index;

(11) Each component security in the index is registered pursuant to Section 12 of the Exchange Act; and

(12) Cash settled index options are designated as A.M.-settled options.

(e) The following maintenance listing standards shall apply to each class of index options originally listed pursuant to paragraph (d) above:

(1) The index meets the criteria of paragraph (d)(1) of this Rule;

(2) Subject to subparagraphs (9) and (10) below, the component securities that account for at least 90% of the total index weight and at least 80% of the total number of component securities in the index must meet the requirements of Rule 5.3;

(3) Each component security in the index has a market capitalization of at least \$75 million, except that each of the lowest weighted component securities that in the aggregate account for no more than 10% of the weight of the index may have a market capitalization of only \$50 million;

(4) Each component security must be an “NMS stock” as defined in Rule 600 of Regulation NMS of the Securities and Exchange Act of 1934; and

(5) Foreign securities or ADRs thereon that are not subject to comprehensive surveillance sharing agreements do not represent more than 20% of the

weight of the index;

(6) The current underlying index value will be reported at least once every fifteen seconds during the time the index options are traded on the Exchange;

(7) If the underlying index is maintained by a broker-dealer, the index is calculated by a third party who is not a broker-dealer, and the broker-dealer has in place an information barrier around its personnel who have access to information concerning changes in and adjustments to the index;

(8) The total number of component securities in the index may not increase or decrease by more than 33 1/3% from the number of component securities in the index at the time of its initial listing;

(9) Trading volume of each component security in the index must be at least 500,000 shares for each of the last six months, except that for each of the lowest weighted component securities in the index that in the aggregate account for no more than 10% of the weight of the index, trading volume must be at least 400,000 shares for each of the last six months;

(10) In a capitalization-weighted index and a modified capitalization-weighted index, the lesser of the five highest weighted component securities in the index or the highest weighted component securities in the index that in the aggregate represent at least 30% of the total number of stocks in the index each have had an average monthly trading volume of at least 1,000,000 shares over the past six months;

(11) Each component security in the index is registered pursuant to Section 12 of the Exchange Act;

(12) In an approximate equal-dollar weighted index, the index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision the "notional value" is the market price of the component times the number of shares of the underlying component in the index. Reconstitution and rebalancing are also mandatory if the number of components in the index is greater than five at the time of rebalancing. The Exchange reserves the right to rebalance quarterly at its discretion;

(13) In a modified equal-dollar weighted index the Exchange will re-balance the index quarterly;

(14) In a share-weighted index, if a share-weighted Micro Narrow-Based Index fails to meet the maintenance listing standards under Rule 5.13(e), the Exchange will not re-balance the index, will restrict trading in existing option series to closing transactions, and will not issue additional series for that index; and

(15) In the event a class of index options listed on the Exchange fails to satisfy the maintenance listing standards set forth herein, the Exchange shall not open for trading any additional series of options of that class unless such failure is determined by the Exchange not to be significant and the Commission concurs in that determination, or unless the continued listing of that class of index options has been approved by the Commission under Section 19(b)(2) of the 1934 Act.

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Position Limits for Industry (Narrow-Based) Index Options

[Narrow-Based Index Options]

Rule 5.16(a). Rule 6.8 generally shall govern position limits for industry index options, as modified by this Rule 5.16. Option contracts on an industry index shall, subject to the procedures specified in subsection (c) of this rule, be subject to the following position limits: [In determining compliance with Rule 6.8, narrow based (industry) index option contracts shall be subject to position limits determined as follows:]

(1) 18,000 [— 9,000] contracts if the Exchange determines, at the time of a review conducted pursuant to subsection [paragraph] (b) below, that any single underlying stock [in the group] accounted, on average, for 30% or more of the index value during the 30-day period immediately preceding the review; or

(2) 24,000 [— 12,000] contracts if the Exchange determines, at the time of a review conducted pursuant to subsection [paragraph] (b) below, that any single underlying stock [in the group] accounted, on average, for 20% or more of the index value or that any five underlying stocks [in the group] together accounted, on average, for more than 50% of the index value, but that no single stock in the group accounted, on average, for 30% or more of the index value, during the 30-day period immediately preceding the review; or

(3) 31,500 [— 15,000] contracts if the Exchange determines that the conditions specified above, which would require the establishment of a lower limit, have not occurred.

(b) The Exchange shall make the determinations required by subsection (a) above with respect to options on each industry index at the commencement of trading of such options on the Exchange and thereafter review the determination semi-annually on January 1 and

July 1. [determine the appropriate position limit at the time options on an index are initially opened for trading and shall review its determination semi-annually, at the same time it reviews position and exercise limits for stock options, pursuant to Rule 6.8 and Rule 6.9. If the Exchange determines after conducting its review that a higher position limit is appropriate for an index the Exchange shall increase the limit as soon as practicable. If the Exchange determines that a lower limit is appropriate for an index, the lower limit shall take effect after the expiration of the farthest term series open for trading at the time of the Exchange's review.]

(c) If the Exchange determines, at the time of a semi-annual review, that the position limit in effect with respect to options on a particular industry index is lower than the maximum position limit permitted by the criteria set forth in subsection (a), the Exchange may effect an appropriate position limit increase immediately. If the Exchange determines, at the time of a semi-annual review, that the position limit in effect with respect to options on a particular industry index exceeds the maximum position limit permitted by the criteria set forth in subsection (a), the Exchange shall reduce the position limit applicable to such options to a level consistent with such criteria; provided, however, that such a reduction shall not become effective until after the expiration date of the most distantly expiring options series relating to the industry index that is open for trading on the date of the review; and provided further that such a reduction shall not become effective if the Exchange determines, at the next semi-annual review, that the existing position limit applicable to such options is consistent with the criteria set forth in subsection (a).

(d) - No Change.

~~[(c)]~~ (e) Index [O]option contracts [on an index] shall not be aggregated with option contracts on any stocks whose prices are the basis for the calculation of the index.

(f) Positions in reduced-value index options shall be aggregated with positions in full-value index options. For such purposes, ten (10) reduced-reduced value options shall equal one (1) full-value contract.

Position Limits for Options on Cash Settled Micro Narrow-Based Indexes

Rule 5.16(f) Methodology for Establishing Position Limits on Cash-Settled Options on Micro Narrow-Based Indexes as defined under Rule 5.10(b)(25). The position limit for a cash-settled option on a Micro Narrow-Based Index that meets the criteria under Rule 5.13(d) shall be calculated in accordance with the following methodology:

(1) Determine the Market Capitalization of the S&P 500 Index.

(2) Calculate the Notional Value of a position at the limit in the Chicago Mercantile Exchange's ("CME") S&P 500 futures contract. The position limit for that contract is 20,000 (in all months combined) and the Index Multiplier is \$250.

Notional Value for the purposes of this rule = Index Level * Index Multiplier. Therefore, Notional Value of 20,000 S&P 500 futures contracts = 20,000 * S&P 500 Index Level * 250.

(3) Calculate the Market Capitalization Ratio of the S&P 500 Index Market Capitalization to the Notional Value of a position limit at the limit.

Market Capitalization Ratio = Market Capitalization of the S&P 500 / Notional Value of 20,000 S&P 500 futures contract positions.

(4) Determine the Market Capitalization of the Micro Narrow-Based Index by adding together the market capitalization of each underlying security component.

(5) Determine the Notional Value of the Micro Narrow-Based Index Option (Index Level * Contract Multiplier).

(6) Calculate the Position Limit of the Micro Narrow-Based Index using the following formula:

$$\text{Contract Position Limit on the Micro Narrow-Based Index} = \frac{\text{Market Capitalization of Micro Narrow-Based Index}}{(\text{Notional Value of Micro Narrow-Based Index Option} * \text{Market Capitalization Ratio})}$$

(7) Establishing the Position Limit. After the applicable position limit has been determined pursuant to Rule 5.16(f)(1)-(6), round the calculated position limit to the nearest 1,000 contracts using standard rounding procedures. For position limits that are 400 or greater, but less than 1000 contracts, round up to 1,000 contracts.

Rule 5.13(d) shall not apply to any Micro Narrow-Based Index in which the applicable position limit, as calculated using Rule 5.16(f)(1)-(6), for that Micro Narrow-Based Index is less than 400 contracts.

Exemptions from Position Limits

Rule 5.17(a). Broad-based Index Hedge Exemptions – No Change.

(b) Industry (Narrow-Based) Index Hedge Exemptions. The industry (narrow-based) index hedge exemption is in addition to the other exemptions available under Exchange Rules, interpretations and policies, and may not exceed twice the standard limit established under Rule 5.16. Industry [Narrow-based (industry)] index option positions may be exempt from established position limits for each option contract “hedged” by an

equivalent dollar amount of the underlying component securities or securities convertible into such components; provided that, in applying such hedge, each option position to be exempted is hedged by a position in at least 75% of the number of component securities underlying the index. In addition, the underlying value of the option position may not exceed the value of the underlying portfolio. The value of the underlying portfolio is:

(1)[(a)] the total market value of the net stock position; and [, less]

(2)[(b)] for positions in excess of the standard limit, subtract the underlying market value of:

(A)[(1)] any offsetting calls and puts in the respective index option; and

(B)[(2)] any offsetting positions in related stock index futures or options;

and

(C)[(3)] any economically equivalent positions (assuming no other hedges for these contracts exist).

The following procedures and criteria must be satisfied to qualify for an industry index hedge exemption:

[Prior Exchange approval on the appropriate form designated by the Exchange is required. This exemption requires that both the option and stock positions be initiated and liquidated in an orderly manner. Specifically, a reduction of the option position must occur at or before the corresponding reduction in the stock portfolio position. The position in a narrow-based index option may not exceed the total of: (a) the limit established under Rule 5.16, plus (b) two times that limit (for hedged positions). The Exchange may determine, in its discretion, to grant a hedge exemption for a number of contracts that is less than the maximum number permitted under this Commentary. The

Exchange may also grant other position limit exemptions under Exchange rules, and such exemptions shall be applied in addition to any exemption provided under this

Commentary.]

(1) The hedge exemption account must have received prior Exchange approval for the hedge exemption specifying the maximum number of contracts that may be exempt under this Rule. The hedge exemption account must have provided all information required on Exchange-approved forms and must have kept such information current. Exchange approval may be granted on the basis of verbal representations, in which event the hedge exemption account shall within two business days, or such other time period designated by the Exchange, furnish the Exchange with appropriate forms and documentation substantiating the basis for the exemption. The hedge exemption account may apply from time to time for an increase in the maximum number of contracts exempt from the position limits.

(2) A hedge exemption account that is not carried by an OTP Holder or OTP Firm must be carried by a member of a self-regulatory organization participating in the Intermarket Surveillance Group.

(3) The hedge exemption account shall:

(A) liquidate and establish options, stock positions, or economically equivalent positions in an orderly fashion; not initiate or liquidate positions in a manner calculated to cause unreasonable price fluctuations or unwarranted price changes; and not initiate or liquidate a stock position or its equivalent with an equivalent index option position with a view

toward taking advantage of any differential in price between a group of securities and an overlying stock index option;

(B) liquidate any options prior to or contemporaneously with a decrease in the hedged value of the portfolio which options would thereby be rendered excessive.

(C) promptly notify the Exchange of any change in the portfolio that materially affects the unhedged value of the portfolio.

(4) If an exemption is granted, it will be effective at the time the decision is communicated. Retroactive exemptions will not be granted.

(5) The hedge exemption account shall promptly provide to the Exchange any information requested concerning the portfolio.

(6) Positions included in a portfolio that serve to secure an index hedge exemption may not also be used to secure any other position limit exemption granted by the Exchange or any other self regulatory organization or futures contract market.

(7) Any OTP Holder or OTP Firm that maintains an industry index option position in such OTP Holder or OTP Firm's own account or in a customer account, and has reason to believe that such position is in excess of the applicable limit, shall promptly take the action necessary to bring the position into compliance. Failure to abide by this provision shall be deemed to be a violation of Rules 6.8 and this Rule 5.16 by the OTP Holder or OTP Firm.

(8) Violation of any of the provisions of this Rule, absent reasonable justification or excuse, shall result in withdrawal of the index hedge exemption and may form

the basis for subsequent denial of an application for an index hedge exemption hereunder.

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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 the basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. The PCX has prepared summaries, set forth in sections A, B and C below, of the most significant aspects of such statements.

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

Purpose

1. Designation of Narrow-Based Index Options

The Exchange is proposing to amend PCX's index option rules to provide for the listing and trading of narrow-based stock index options pursuant to Rule 19b-4(e) under the Act.¹⁰ The purpose of the proposal is to allow the PCX to list and trade narrow-based index options immediately without filing a proposed rule change with the Commission under Section

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Rule 19b-4(e)(1) provides that "the listing and trading of a new derivative securities product by a self-regulatory organization shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of [Rule 19b-4], if the Commission has approved, pursuant to Section 19(b) of the Exchange Act, the self-regulatory organization's trading rules, procedures and listing standards for the product class that would include the new derivative securities product and the self-regulatory organization has a surveillance program for the product class." 17 CFR 240.19b-4(e)(1). When relying on Rule 19b-4(e), the SRO must submit Form 19b-4(e) to the Commission within five business days after the exchange begins trading the new derivative securities products. See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File S7-13-98) ("19b-4(e) Adopting Release").

19(b)(3)(A) of the Act prior to trading the product, as PCX Rule 5.13(a) currently requires.¹¹

Current PCX Rule 5.13(a) states that the Exchange may list and trade options on a narrow-based index 30 days after the Exchange files a formal rule filing under Section 19(b)(3)(A) describing the index option, provided that the index meets the generic listing criteria set forth in PCX Rule 5.13(a)(1)-(12). However, the 19b-4(e) Adopting Release no longer requires a Section 19(b)(3)(A) filing and subsequent waiting period so long as the exchange, relying on Rule 19b-4(e) under the Act, has generic listing criteria which have been approved by the Commission. The 19b-4(e) Adopting Release indicated that products meeting the listing criteria approved by the Commission qualified for filing under Rule 19b-4(e), so long as the exchange eliminated that requirement from its existing rules.¹²

Therefore, the PCX is proposing to eliminate the Section 19(b)(3)(A) rule filing requirement from PCX Rule 5.13(a) and, instead, incorporate the provisions of Rule 19b-4(e) into the new proposed PCX Rule 5.13(b). The Exchange believes that this proposal will allow the PCX to list and trade narrow-based index options that comply with the PCX Rule 5.13(b) criteria, immediately, thereby providing a more expeditious method of offering these products in the marketplace. The Exchange represents that PCX's surveillance procedures are adequate to monitor the trading in options on narrow-based indexes as defined under Rule 5.13(b).

In addition, the Exchange proposes to amend its Rules to include the modified capitalization-weighted methodology as an acceptable generic listing criteria for options on a

¹¹ The Commission notes that this procedure for listing and trading of narrow-based stock index options has been obsolete since the Commission approved the Rule 19b-4(e) Adopting Release in 1998.

¹² See id. at note 89.

narrow-based index.¹³ Current PCX Rule 5.13(a)(2) requires that the subject index be capitalization-weighted, price-weighted, or equal-dollar weighted and consist of ten or more component securities. The Exchange proposes to include the modified capitalization-weighted methodology as an acceptable generic listing criteria. The Exchange believes that such methodology is a widely established method of weighting securities indexes and is already in place at other SROs.¹⁴ The Exchange represents that PCX's surveillance procedures are adequate to monitor the trading in options on narrow-based index options that meet the specified criteria in PCX Rule 5.13(b).

2. Position and Exercise Limits

The Exchange is proposing to amend PCX Rule 5.16 in order to increase the position and exercise limits for narrow-based index options to the levels currently in place at the ISE,¹⁵ the CBOE,¹⁶ the Philadelphia Stock Exchange, Inc. ("Phlx"),¹⁷ and the American Stock Exchange LLC ("Amex").¹⁸ The three-tier position and exercise limit determination will remain unchanged. Specifically, the PCX proposes to increase the position and exercise limits for

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A modified capitalization weighted index is similar to a capitalization weighted index, where the components are weighted according to the total market value compared to the market value of the outstanding shares, except that an adjustment to the weighting of one or more of the components occurs. The general purposes for using this methodology are to: (1) retain the economic attributes of capitalization weighting; (2) promote portfolio weight diversification; (3) reduce index performance distortion by preserving the capitalization ranking of companies; and (4) reduce market impact on the smallest underlying components from necessary weight rebalancings. For example, indexes such as the Nasdaq-100 Index, KBW Bank Index, KBW Capital Markets Index, and the Goldman Sachs Technology Indexes are calculated using the Modified Capitalization-Weighted Methodology.

14

See supra note 9.

15

See ISE Rules 2004 and 2005.

16

See CBOE Rules 24.4, 24.4A, and 24.5.

17

See Phlx Rule 1001A and 1002A.

18

See Amex Rules 904C and 905C.

narrow-based index options from 9,000, 12,000 and 15,000 contracts to 18,000, 24,000 and 31,500 contracts, respectively.

In addition to providing regulatory equality, the PCX believes that an increase in the position and exercise limits for narrow-based index options is appropriate for a number of reasons. First, the Exchange believes that increased position and exercise limits for narrow-based index options may bring additional depth and liquidity, in terms of both volume and open interest, to these index options classes without significantly increasing concerns regarding inter-market manipulations or disruptions of the index options or the underlying component securities.

Second, the Exchange notes that the proposal, while increasing the position limits for narrow-based index options, continues to reflect the unique characteristics of each index option and to maintain the structure of the current three-tiered system. Specifically, under the proposal, the lowest proposed limit, 18,000 contracts, will apply to narrow-based index options in which a single underlying stock accounted on average for 30% or more of the index value during the 30-day period immediately preceding the Exchange's semi-annual review of industry index option position limits. A position limit of 24,000 contracts will apply if: (1) any single underlying stock accounted, on average, for 20% or more of the index value, or (2) any five underlying stocks together accounted, on average, for more than 50% of the index value, but no single stock in the group accounted, on average, for more than 30% or more of the index value, during the 30-day period immediately preceding the Exchange's semi-annual review of industry index option position limits. The 31,500 contract limit will apply only if the Exchange determines that the above-specified conditions requiring either the 18,000 contract limit or the 24,000 contract limit have not occurred.

3. Narrow-Based Index Hedge Exemptions

The Exchange proposes to amend PCX Rule 5.17(b) in order to update the Exchange's exemptions from position limits for narrow-based index options and the procedures for requesting such exemptions. The Exchange represents that the proposed exemptions are substantially identical to those of other SROs.

4. Micro Narrow-Based Index Options

The Exchange proposes to adopt new PCX Rules 5.13(d) and 5.16(f) in order to adopt the criteria for a new classification of narrow-based indexes, classified as “micro narrow-based” indexes and adopt initial listing standards, maintenance standards, and position and exercise limits for options on micro narrow-based security indexes.¹⁹

a. Listing and Maintenance Standards

The Exchange proposes to use the term “micro narrow-based” to distinguish this classification of narrow-based indexes from the existing “narrow-based” security indexes. Specifically, the Exchange proposes to list and trade options on a micro narrow-based security index, pursuant to Rule 19b-4(e) under the Act, if the index is a micro narrow-based security index: (1) that has 9 or fewer component securities; or (2) in which a component security comprises more than 30% of the index's weighting; or (3) in which the 5 highest weighted component securities in the aggregate comprise more than 60% of the index's weightings; or (4) in which the lowest weighted component securities comprising, in the aggregate, 25% of the index's weighting, have an aggregate dollar value of average daily trading volume of less than \$50 million (or in the case of an index with 15 or more component securities, \$30 million), except that if there are 2 or more securities with equal weighting that could be included in the

¹⁹

See supra note 9.

calculation of the lowest weighted securities comprising, in the aggregate, 25% of the index's weighting, such securities shall be ranked from lowest to highest dollar value of average daily trading volume and shall be included in the calculation based on their ranking starting with the lowest ranked security. The proposed rule change also makes other modifications that are consistent with the standards for futures on narrow-based indices, including a requirement that all component securities of a narrow-based security index be registered pursuant to Section 12 of the Act.

The Exchange proposes to permit a micro narrow-based index to be a modified capitalization-weighted index²⁰ and proposes three additional index weighting methodologies for micro narrow-based indexes – modified equal-dollar weighted, approximate equal-dollar weighted, and share weighted. A modified equal-dollar weighted methodology is designed to be a fair measurement of the particular industry or sector represented by the index, but without assigning an excessive weight to one or more index components that have a larger market capitalization relative to other index components. Under this methodology, each component is assigned a weight that takes into account the relative market capitalization of the securities comprising the index. The index is subsequently rebalanced to maintain these pre-established weighting levels. In the case of an index with 9 components or less, the weight assigned to the largest component will not exceed 50% of the entire index weight. Like equal-dollar weighted indexes, the value of a modified equal-dollar weighted index will equal the current combined market value (based on U.S. primary market prices) of the assigned number of shares of each of

²⁰

See Securities Exchange Act Release No. 49932 (June 28, 2004), 69 FR 40994 (July 7, 2004) (SR-CBOE-2002-24). The Exchange states that these listing and maintenance standards are consistent with the Commission's Staff Legal Bulletin No. 15: Listing Standards for Trading Security Futures Products (September 5, 2001).

the underlying components divided by the appropriate index divisor. A modified equal-dollar weighted will be balanced quarterly.

An approximate equal-dollar weighted index is composed of one or more securities in which each component security will be weighted equally based on its market price on the index's selection date. The index must be reconstituted and rebalanced if the notional value of the largest component is at least twice the notional volume of the smallest component for fifty percent or more of the trading days in the three months prior to December 31 of each year. For purposes of this provision, the Exchange defines "notional value" as the market price of the component times the number of shares of the underlying component in the index. The Exchange also states that the reconstitution and rebalancing are also mandatory if the number of components in the index changes. The Exchange also states that it will reserve the right to rebalance quarterly at its discretion.

A share-weighted index is designed to mimic the value of a portfolio consisting of two or more securities. The weight of each component security is calculated by multiplying the price of the component security by an adjustment factor. Adjustment factors are chosen to reflect the investment objective deemed appropriate by the designer of the index and will be published by the Exchange as part of the contract specifications.²¹ The value of the index is calculated by adding the weight of each component security and dividing the total by an index divisor.²² If a share-weighted micro narrow-based index fails to meet the maintenance listing standards under PCX Rule 5.13(e), the index would not be rebalanced by the Exchange. Instead, the Exchange

²¹ For example, an index designer might want to apply an adjustment factor in order to prevent one or a few components from dominating the weight of the index. This is similar to an adjustment factor in other types of weighting methods, such as modified capitalization weighted indexes.

²² The index "divisor" is calculated to yield a benchmark index level (50, 100, 200, etc.) as of a particular date.

would restrict options transactions to “closing-only” transactions and would not issue any additional series for that index.²³ Upon the expiration of the last series on that index, the Exchange will no longer calculate that index and no additional series would be listed.

Regardless of the weighting methodology, the Exchange represents that it will also reserve the right to rebalance any micro narrow-based index on an interim basis if warranted as a result of extraordinary changes in the relative values of the component securities. Proposed PCX Rule 5.13(d)(2)(iv) shall provide that, to the extent investors with open positions must rely upon the continuity of the options contracts on the index, outstanding contracts are unaffected by rebalancings. The Exchange believes that these provisions are consistent with previous rule changes approved by the Commission.²⁴

Proposed PCX Rule 5.13(e) contains the maintenance standards that will apply to micro narrow-based security indexes.²⁵ The Exchange believes that the maintenance standards generally adhere to the Commission’s Division of Market Regulation’s Bulletin²⁶ and those standards applicable to futures in a narrow-based security index. The Exchange represents that

²³ When option series are restricted to “closing-only” status, the only opening transactions allowed in such a series are (i) opening transactions by market-makers executed to accommodate closing transactions of other market participants and (ii) opening transactions by an OTP Holder to facilitate the closing transactions of public customers executed as crosses pursuant to and in accordance with PCX Rule 6.47. PCX will issue a bulletin to notify OTP Holders and OTP Firms of such a situation.

²⁴ See Securities Exchange Act Release No. 42787 (May 24, 2000), 65 FR 33598 (May 24, 2000) (Commentary .03 to Amex Rule 1000 and Commentary .02 to Amex Rule 1000A).

²⁵ Exhibit A summarizes how the Exchange generally expects to handle certain corporate actions upon listing Micro Narrow-Based Index Options based on approximate equal-dollar weighted or share-weighted indexes.

²⁶ Commission Staff Legal Bulletin No. 15: Listing Standards for Trading Security Futures Products (September 5, 2001).

PCX's surveillance procedures are adequate to monitor the trading in options on micro narrow-based indexes as defined under PCX Rule 5.10(b)(25).

b. Position and Exercise Limits

The Exchange also proposes to establish a new method for determining the applicable position limits for options on any micro narrow-based index that meets the generic listing standards under proposed PCX Rule 5.13(d). The Exchange represents that it will utilize a formulaic approach as provided in proposed PCX Rule 5.16(f), "Position Limits for Options on Cash Settled Micro Narrow-Based Indexes" as defined under PCX Rule 5.10(b)(25).

This new methodology is a departure from the manner in which position limits are assigned for index options under existing PCX rules. The current position limits for narrow-based index options are assigned from pre-determined tiers based on an analysis of the respective index's underlying components. Under the proposed methodology, position limits would be determined in accordance with a formula that considers a cash settled micro narrow-based index's market capitalization and contract size in relation to the market capitalization of the S&P 500 index and the contract size and position limit of a futures contract on the S&P 500 index.

In determining compliance with PCX Rule 5.18 (Exercise Limits), the applicable exercise limit for option contracts on any micro narrow-based index, as defined under proposed PCX Rule 5.10(b)(25), shall be a limit equivalent to the applicable position limits for options on that micro narrow-based index, as calculated under proposed PCX Rule 5.16(f)(1)-(7).

c. Margin and Strikes Prices

PCX Rule 4.16 governs the determination of the applicable margin treatment for options traded on the Exchange, including options that overlie narrow-based indexes. The existing applicable margin for options on narrow-based indexes, as provided under PCX Rule 4.16, also

shall apply to micro narrow-based indexes. The interval between strike prices for options on indexes that meet the criteria under PCX Rule 5.13(d) will be no less than \$2.50.

5. System Capacity

Finally, the Exchange reasonably believes it has adequate system capacity to support the trading of options on narrow-based and micro narrow-based indexes, based on a calculation of the Exchange's current ISCA allocation and the number of new messages per second expected to be generated by options on such index.

Statutory Basis

The Exchange believes that the proposal is consistent with Section 6(b) of the Act,²⁷ in general, and furthers the objectives of Section 6(b)(5)²⁸ of the Act, in particular, in that it is designed to facilitate transactions in securities, to promote just and equitable principles of trade, to enhance competition, and to protect investors and the public interest.²⁹

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

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

Written comments on the proposed rule change were neither solicited nor received.

²⁷ 15 U.S.C. 78f(b).

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ PCX clarified that it believes the proposal is consistent with Section 6(b)(5) of the Act as opposed to Section 6(b)(4) as stated in Exhibit 1 to the original proposed rule change and requested that the statutory language relating to Section 6(b)(5) of the Act provided on page 13 of the original rule filing to be inserted in place of the language cited from Section 6(b)(4) in Exhibit 1. Telephone conversation between David Strandberg, Director, Issuer Services PCX and Johnna B. Dumler, Attorney, Division of Market Regulation, Commission, December 6, 2005.

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:

Electronic Comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rules-comments@sec.gov. Please include Filed No. SR-PCX-2005-79 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File No. SR-PCX-2005-79. 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 will also be available for inspection and copying at the principal office of the PCX. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available

publicly. All submissions should refer to File No. SR-PCX-2005-79 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

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

After careful 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. In particular, the Commission finds that the PCX's proposal is consistent with Section 6(b)(5) of the Act,³⁰ which requires that the rules of an 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.³¹ Specifically, the Commission notes that the proposed rule change would permit the Exchange to list and trade, pursuant to Rule 19b-4(e) under the Act,³² options on narrow-based and micro narrow-based security indexes that meet the listing criteria set forth in PCX Rule 5.13. The Commission finds that the proposal strikes a reasonable balance between the Commission's mandates under Section 6(b)(5)³³ of the Act to remove impediments to, and perfect the mechanism of a free and open market and a national market system, while protecting investors and the public interest.

³⁰ 15 U.S.C. 78f(b)(5).

³¹ In approving this proposed 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).

³² 17 CFR 240.19b-4(e).

³³ 15 U.S.C. 78f(b)(5).

The Commission believes that the proposed initial listing and maintenance standards for options on narrow-based and micro narrow-based security indexes are consistent with the standards previously established by other SROs.³⁴

The Commission also believes that the proposed generic listing standards for micro narrow-based index options covering, among other things, minimum capitalization, monthly trading volume, and relative weightings of component stocks are reasonably designed to ensure that the trading market for component stocks are adequately capitalized and sufficiently liquid. In addition, the Commission notes that position limits for options on any micro narrow-based index that meets the generic listing standards of proposed PCX Rule 5.13(d) would be determined in accordance with a proposed new formula that considers the index's market capitalization and contract size in relation to the market capitalization of the S&P 500 index and the contract size and position limit of a futures contract on the S&P 500 index. The Commission believes that the proposed formula for determining position limits for micro narrow-based index options is appropriate to deter manipulation of the index. In addition, the Commission finds that the weighting methodologies employed by the PCX, including the modified equal-dollar weighted, approximate equal-dollar weighted and share-weighted methodologies, are appropriate index construction standards. The Commission notes that the Exchange represents that it reasonably believes it has sufficient operational system capacity to accommodate the PCX's listing and trading of narrow-based and micro narrow-based security indexes.

³⁴

See CBOE Rule 24.2. See e.g. Securities Exchange Act Release No. 51346 (March 9, 2005), 70 FR 12916 (March 16, 2005) (SR-CBOE-2005-08) (Order approving CBOE's proposed modified capitalization-weighted methodology as an acceptable generic listing standard for options on narrow-based index); see also Securities Exchange Act Release No. 34157 (June 3, 1994), 59 FR 30062 (June 10, 1994) (SR-Amex-92-35) (SR-CBOE-93-59) (SR-NYSE-94-17) (SR-PSE-94-07) (SR-Phlx-94-10). The Commission findings in this approval order are prospective from the date of this order.

The Exchange is also charged with surveillance for the product classes, including options on narrow-based and micro narrow-based security indexes. The Exchange represents that it has developed and submitted surveillance procedures that it will use to monitor the general trading and settlement activity in narrow-based and micro narrow-based indexes to ensure full compliance with Exchange Rules and federal securities laws. The Exchange indicates that it will have complete access to information regarding trading activity in the underlying securities. The Exchange has developed new surveillance procedures specific to these products that the Commission finds adequate to monitor for manipulation in the narrow-based and micro narrow-based indexes.

The Commission's approval of the proposed generic listing standards for options on narrow-based and micro narrow-based security indexes will allow those options that satisfy these standards to start trading under Rule 19b-4(e), without constituting a proposed rule change within the meaning of Section 19(b) of the Act³⁵ and Rule 19b-4,³⁶ for which notice and comment and Commission approval is necessary. Rule 19b-4(e)³⁷ states that the listing and trading of a new derivative securities product by an SRO shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b-4, if the Commission has approved, pursuant to Section 19(b) of the Act, such 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.

³⁵ 15 U.S.C. 78s(b).

³⁶ 17 CFR 240.19b-4.

³⁷ 17 CFR 240.19b-4(e).

The Exchange's ability to rely on Rule 19b-4(e) for these products potentially reduces the time frame for bringing these securities to the market, promoting competition and providing investors with derivative securities products to meet their needs more quickly. As stated above, the Commission believes that the Exchange has adequate trading rules, procedures, listing standards, and a surveillance program for the narrow-based and micro narrow-based indexes, and thus, the Commission is approving the generic listing standards pursuant to 19b-4(e) for these product classes.

The PCX has requested that the Commission find good cause for approving the proposed rule change, as amended, prior to the thirtieth day after the proposal is published for comment in the Federal Register. The Commission believes that the adoption of the proposal will enable the PCX to act expeditiously in listing options on narrow-based and micro narrow-based securities indexes in the same manner currently afforded to other options exchanges, such as the CBOE.³⁸ In addition, the Commission believes that the proposed rule change would remove impediments to a free and open market place by providing competition among exchanges for new products. Accordingly, the Commission finds good cause, pursuant to Section 19(b)(2) of the Act,³⁹ for approving the proposed rule change, as amended, prior to the thirtieth day after publication thereof in the Federal Register.

³⁸ See supra note 9.

³⁹ 15 U.S.C. 78s(b)(2).

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, Section 6(b)(5) of the Act.⁴⁰

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,⁴¹ that the proposed rule change (SR-PCX-2005-79), as amended by Amendment Nos. 2 and 3, is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁴²

Jonathan G. Katz
Secretary

⁴⁰ 15 U.S.C. 78f(b)(5).

⁴¹ 15 U.S.C. 78s(b)(2).

⁴² 17 CFR 200.30-3(a)(12).

EXHIBIT A

Corporate Action Summary A for Approximately Equal Dollar Weighted Indexes

Type		Adjustments		Notes
Action	Company	Close Price/ Action	Share Lot ⁽¹⁾	
Special Cash Dividend	Component of Index	Adj. Close = Prev. Close - Dividend	Adj. Share lot = Prev. Share lot + (Prev. Share lot * Div.)/Adj. Close	Companies contribution to index not affected by Special dividend
Stock Split or Dividend	Component of Index	Adj. Close = Prev. Close / Adjustment Factor	Adj. Round Lot = Prev. Share Lot * Adjustment Factor	Adjustment Factor = # of New Shares for 1 Old Share
Spin Off	Component of Index (A)	Adj. Close = Close - (Ratio * Spun off Company's Price)		Ratio = # of shares of spun off company received for every share of parent company owned. Spun off company will be added at a weight such that the index contribution of the two companies after the event is equal to the index contribution of the parent prior to the event.
	Spun Off Company (B)	ADDED	Share lot = ((Share lot A * Prev. Close A) - (Share lot A * Adj. Close A)) / Close B	
Two Components Merge in an All Stock, Cash or Combination Deal	Remaining Companies (A)		Adj. Share Lot = Share Lot + ((B's Close * B's Share Lot) / # of remaining components) / A's Close	All remaining companies will be adjusted using the formula to the left. Their shares will increase based on their price so as to distribute the weight of the acquired company evenly.
	Acquired Company (B)	DELETED		
A Non-Component Takes Over a Component	Acquirer (A)	ADDED	Share Lot = (B's Round Lot * B's Close) / A's Close	The acquiring company will replace the acquired company. Its share lot will be set to contribute the same amount to the index as the acquired company contributed prior to the acquisition.
	Acquired Component of Index (B)	DELETED		
Rights Issue	Component of Index	Adj. Close = (Close + (Ratio * Subscription Price)) / (1 + Ratio)	Adj. Share Lot = (Close * Share Lot) / Adj. Close	Ratio = # of rights received for 1 share of A.
Extraordinary Removal	(1) Remaining Securities (A) or (2) Replacement Company (A)	ADDED if (2)	If (1): Adj. Share Lot (A) = Prev. Share lot (A) + (B's share lot * B's Close) / (# of Remaining Components * A's Close) If (2): Share lot A = (B's Share lot * B's Close) / A's Close	Company B may be removed for any of the following reasons: Bankruptcy proceedings, Financial distress, Delisting from a primary exchange (NYSE, Nasdaq, Amex), or Illiquidity (10 consecutive no trade days). The Exchange would either: (1) Divide B's index contribution evenly between remaining components or (2) if Replacement Company A is added, Replacement A would be the highest ranked (as of the most recent selection date) of the remaining securities in the industry group which qualify for inclusion. The method to be utilized will be described in the index's contract specification.
	Component of Index (B)	DELETED		

(1) Share lots will be rounded to the nearest hundred at rebalance. Odd lots may exist between rebalances.

Corporate Action Summary B for Share-Weighted Indexes

Type		Adjustments		Notes
Action	Company	Component Price Change	Adjustment Factor Change	
Special Cash Dividend	Component of Index	New Close = Prev. Close - Dividend	New Adj. Factor = (Prev. Adj. Factor * Prev. Close)/New Close	
Stock Split or Dividend	Component of Index	New Close = Prev. Close / Split Ratio	New Adj. Factor = Prev. Adj. Factor * Split Ratio	For example, in the case of a 2-for-1 split, the Split Ratio would be 2. In the case of a 5% stock dividend, the split ratio would be 1.05
Spin Off	Component of Index (A)	New Close = Prev. Close - (Price Adjustment due value of spun-off company)	New Adj. Factor = (Prev. Adj. Factor * Prev. Close) / New Close	Price Adjustment due to value of spun-off company = (Market capitalization of parent company – market capitalization of spun-off company)/number of outstanding shares of the parent company. Spun-off Company is not added.
Two Components Merge in an All Stock, Cash or Combination Deal	Acquiring Company		New Adj. Factor = Prev. Adj. Factor + ((Acquired Company's Close * Acquired Company's Adj. Factor)/Acquiring Company's Close)	The weight of the Acquired Company is added to the weight of the Acquiring Company.
	Acquired Company	DELETED		
A Non-Component Takes Over a Component	Non-Component Acquiring Company	ADDED	New Adj. Factor = ((Acquired Company's Close * Acquired Company's Adj. Factor)/Acquiring Company's Close)	Non-Component Acquiring Company added to index at Acquired Company's weight.
	Acquired Component of Index	DELETED		
Rights Offering	Component of Index	New Close = Prev. Close – Price Adjustment due to value of offering	New Adj. Factor = (Prev. Adj. Factor * Prev. Close)/New Close	Price Adjustment due to value of rights offering = (market capitalization of parent company – market capitalization of rights)/number of outstanding shares of the parent company.
Extraordinary Removal	Index Component	DELETED	The Adjustment Factors for each remaining component will be increased to reflect an equal distribution of the weight of a deleted component	An Index Component will be removed for bankruptcy proceedings, financial distress, or delisting from a national market (NYSE, Nasdaq, Amex)