

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52204; File No. SR-PCX-2005-63]

### Self-Regulatory Organizations; Pacific Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto Relating to the Adoption of Generic Listing Standards for Index-Linked Securities

August 3, 2005.

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> notice is hereby given that on April 28, 2005, the Pacific Exchange, Inc. (“PCX” or “Exchange”), through its wholly owned subsidiary PCX Equities, Inc. (“PCXE” or “Corporation”), filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in items I and II below, which items have been prepared by the Exchange. On July 26, 2005, PCX submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> On August 3, 2005, PCX submitted Amendment No. 2 to the proposed rule change.<sup>4</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons and is approving the proposal on an accelerated basis.

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

Through PCXE, the Exchange proposes to amend its rules governing the Archipelago Exchange (“ArcaEx”), the equities trading facility of PCXE, to adopt PCXE Rule 5.2(j)(6). With this filing, the Exchange proposes to adopt generic listing standards pursuant to Rule 19b-4(e)<sup>5</sup> of the Act in connection with index-linked securities (“Index Securities”). The text of the proposed rule change is set forth below. Proposed new language is in *italics*.

\* \* \* \* \*

#### Rule 5

##### Listings

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Rule 5.2(a)-(i)—No change.

Rule 5.2(j)(1)-(5)—No Change.

#### Index-Linked Securities

Rule 5.2(j)(6). *Index-linked securities are securities that provide for the payment at maturity of a cash amount based on the performance of an underlying index or indexes. Such securities may or may not provide for the repayment of the original principal investment amount. The Corporation may submit a rule filing pursuant to Section 19(b)(2) of the Securities Exchange Act of 1934 (“Act”) to permit the listing and trading of index-linked securities that do not otherwise meet the standards set forth below in paragraphs (a) through (k). The Corporation will consider for listing and trading pursuant to Rule 19b-4(e) under the Act, index-linked securities provided:*

(a) *Both the issue and the issuer of such security meet the criteria set forth above in “General Criteria,” except that the minimum public distribution shall be 1,000,000 units with a minimum of 400 public holders, except, if traded in thousand dollar denominations, then no minimum number of holders.*

(b) *The issue has a minimum term of one (1) year but not greater than ten (10) years.*

(c) *The issue must be the non-convertible debt of the issuer.*

(d) *The payment at maturity may or may not provide for a multiple of the positive performance of an underlying index or indexes; however, in no event will payment at maturity be based on a multiple of the negative performance of an underlying index or indexes.*

(e) *The issuer will be expected to have a minimum tangible net worth in excess of \$250,000,000, and to otherwise substantially exceed the earnings requirements set forth in PCXE Rule 5.2(c). In the alternative, the issuer will be expected: (i) To have a minimum tangible net worth of \$150,000,000 and to otherwise substantially exceed the earnings requirement set forth in PCXE Rule 5.2(c), and (ii) not to have issued securities where the original issue price of all the issuer’s other index-linked note offerings (combined with index-linked note offerings of the issuer’s affiliates) listed on a national securities exchange or traded through the facilities of Nasdaq exceeds 25% of the issuer’s net worth.*

(f) *The issuer is in compliance with Rule 10A-3 under the Act.*

(g) *Initial Listing Criteria—Each underlying index is required to have at least ten (10) component securities. In addition, the index or indexes to which the security is linked shall either (1) have been reviewed and approved for the trading of options or other*

*derivatives by the Commission under Section 19(b)(2) of the Act and rules thereunder and the conditions set forth in the Commission’s approval order, including comprehensive surveillance sharing agreements for non-U.S. stocks, continue to be satisfied, or (2) the index or indexes meet the following criteria:*

(i) *Each component security has a minimum market value of at least \$75 million, 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, the market value can be at least \$50 million;*

(ii) *Each component security shall have trading volume in each of the last six months of not less than 1,000,000 shares, 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, the trading volume shall be at least 500,000 shares in each of the last six months;*

(iii) *In the case of a capitalization weighted index or 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 an average monthly trading volume of at least 2,000,000 shares over the previous six months;*

(iv) *No underlying component security will represent more than 25% 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% of the weight of the index (60% for an index consisting of fewer than 25 component securities);*

(v) *90% of the index’s numerical value and at least 80% of the total number of component securities will meet the then current criteria for standardized option trading set forth in PCX Rule 5.3;*

(vi) *Each component security shall be an Act reporting company which is listed on a national securities exchange or is traded through the facilities of Nasdaq and reported national market system securities; and*

(vii) *Foreign country securities or American Depositary Receipts (“ADRs”) that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index.*

(h) *Continued Listing Criteria— (1) The Corporation will commence delisting or removal proceedings (unless the Commission has approved the*

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

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

<sup>3</sup> In Amendment No. 1, the Exchange made clarifying and technical changes to the original rule filing. Amendment No. 1 replaced PCX’s original submission in its entirety.

<sup>4</sup> In Amendment No. 2, the Exchange corrected a reference in the proposed rule text.

<sup>5</sup> 17 CFR 240.19b-4(e).

continued trading of the subject index-linked security), if any of the standards set forth above in paragraph (g)(2) are not continuously maintained, except that:

(i) the criteria that no single component represent more than 25% of the weight of the index and the five highest weighted components in the index can not represent more than 50% (or 60% for indexes with less than 25 components) of the weight of the Index, need only be satisfied for capitalization weighted, modified capitalization weighted and price weighted indexes as of the first day of January and July in each year;

(ii) the total number of components in the index may not increase or decrease by more than 33⅓% from the number of components in the index at the time of its initial listing, and in no event may be less than ten (10) components;

(iii) the 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 components 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; and

(iv) in a capitalization-weighted index or 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 have had an average monthly trading volume of at least 1,000,000 shares over the previous six months.

(2) In connection with an index-linked security that is listed pursuant to paragraph (g)(1) above, the Corporation will commence delisting or removal proceedings (unless the Commission has approved the continued trading of the subject index-linked security) if an underlying index or indexes fails to satisfy the maintenance standards or conditions for such index or indexes as set forth by the Commission in its order under Section 19(b)(2) of the Act approving the index or indexes for the trading of options or other derivatives.

(3) The Corporation will also commence delisting or removal proceedings (unless the Commission has approved the continued trading of the subject index-linked security), under any of the following circumstances:

(i) if the aggregate market value or the principal amount of the securities publicly held is less than \$400,000;

(ii) if the value of the index or composite value of the indexes is no

longer calculated or widely disseminated on at least a 15-second basis; or

(iii) if such other event shall occur or condition exists which in the opinion of the Corporation makes further dealings on the Corporation inadvisable.

(i) Index Methodology and Calculation—(i) Each index will be calculated based on either a capitalization, modified capitalization, price, equal-dollar or modified equal-dollar weighting methodology. (ii) Indexes based upon the equal-dollar or modified equal-dollar weighting method will be rebalanced at least quarterly. (iii) If the index is maintained by a broker-dealer, the broker-dealer shall erect a “firewall” around the personnel who have access to information concerning changes and adjustments to the index and the index shall be calculated by a third party who is not a broker-dealer. (iv) The current value of an index will be widely disseminated at least every 15 seconds. (v) If the value of an index-linked security is based on more than one (1) index, then the composite value of such indexes must be widely disseminated at least every 15 seconds.

(j) Surveillance Procedures. The Corporation will implement written surveillance procedures for index-linked securities, including adequate comprehensive surveillance sharing agreements for non-U.S. securities, as applicable.

(k) Index-linked securities will be treated as equity instruments.

Rule 5.2(k)–(n)—No change.

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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 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 Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

#### 1. Purpose

Under PCXE Rule 5.2(j)(1), the Exchange may approve, for listing and trading, securities that cannot be readily categorized under the listing criteria for

common and preferred securities, bonds, debentures, or warrants.<sup>6</sup> The Exchange proposes to adopt PCXE Rule 5.2(j)(6) to provide generic listing standards to permit the trading of, either by listing or pursuant to unlisted trading privileges (“UTP”), Index Securities pursuant to Rule 19b–4(e) under the Act.<sup>7</sup> This filing is based on the American Stock Exchange LLC’s (“AMEX”) proposed rule filing, which the Commission recently approved.<sup>8</sup>

#### a. Generic Listing Standards

Rule 19b–4(e) provides that the listing and trading of a new derivative securities product by a self-regulatory organization (“SRO”) shall not be deemed a proposed rule change, pursuant to paragraph (c)(1) of Rule 19b–4,<sup>9</sup> if the Commission has approved, pursuant to section 19(b) of the Act,<sup>10</sup> the SRO’s trading rules, procedures, and listing standards for the product class that would include the new derivatives securities product, and the SRO has a surveillance program for the product class.<sup>11</sup> Hence, the Exchange is proposing this rule filing to adopt generic listing standards under new PCXE Rule 5.2(j)(6) for this product class, pursuant to which it will be able to trade, whether by listing or pursuant to UTP, Index Securities without individual Commission approval of each product pursuant to section 19(b)(2) of the Act.<sup>12</sup> Instead, the Exchange represents that any securities it lists and/or trades pursuant to PCXE Rule 5.2(j)(6) will satisfy the standards set forth therein. The Exchange states that within five (5) business days after commencement of trading of an Index Security in reliance on PCXE Rule 5.2(j)(6), the Exchange will file a Form 19b–4(e).<sup>13</sup>

#### b. Index Securities

Index Securities are designed for investors who desire to participate in a specific market segment through index products by providing investors with exposure to an identifiable underlying market index or combination of market indexes (the “Underlying Index” or “Underlying Indexes”).<sup>14</sup> Index

<sup>6</sup> See PCXE Rule 5.2(j)(1).

<sup>7</sup> 17 CFR 240.19b–4(e).

<sup>8</sup> See Securities Exchange Act Release No. 51563 (April 15, 2005), 70 FR 21257 (April 25, 2005) (SR-AMEX–2005–001).

<sup>9</sup> 17 CFR 240.19b–4(c)(1).

<sup>10</sup> 17 U.S.C. 78s(b).

<sup>11</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (the “19b–4(e) Order”).

<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 17 CFR 240.19b–4(e)(2)(ii); 17 CFR 249.820.

<sup>14</sup> The Exchange understands that the holder of an Index Security may or may not be fully exposed to

Securities are the non-convertible debt of an issuer that have a term of at least one (1) year but not greater than ten years. Index Securities may or may not make interest payments based on dividends or other cash distributions paid on the securities comprising the Underlying Index or Indexes to the holder during their term. Despite the fact that Index Securities are linked to an underlying index, each will trade as a single, exchange-listed security.

A typical Index Security traded, whether by listing or pursuant to UTP, on the Exchange provides for a payment amount in a multiple greater than one (1) times the positive index return or performance, subject to a maximum gain or cap. More generally, Index Securities may or may not be structured with accelerated returns, upside or downside, based on the performance of the Underlying Index. The Exchange represents that the proposed generic listing standards will not be applicable to Index Securities where the payment at maturity may be based on a multiple of negative performance of an underlying index or indexes. An Index Security may or may not provide "principal protection," *i.e.*, a minimum guaranteed amount to be repaid.<sup>15</sup> The Exchange believes that the flexibility to list a variety of Index Securities will offer investors the opportunity to more precisely focus their specific investment strategies.

The Exchange understands that the original public offering price of Index Securities may vary, with the most common offering price expected to be \$10 or \$1,000 per unit. As discussed above, Index Securities entitle the owner at maturity to receive a cash amount based upon the performance of a particular market index or combination of indexes. The Index Securities do not give the holder any right to receive a portfolio security, dividend payments, or any other ownership right or interest in the portfolio or index of securities comprising the Underlying Index. Pursuant to PCXE Rule 5.2(j)(6), the current value of an Underlying Index or composite value of the Underlying Index will be widely disseminated every 15 seconds during the trading day.

the appreciation and/or depreciation of the underlying component securities. For example, an Index Security may be subject to a "cap" on the maximum principal amount to be repaid to holders or a "floor" on the minimum principal amount to be repaid to holders at maturity.

<sup>15</sup> Some Index Securities may provide for "contingent" protection of the principal amount, whereby the principal protection may disappear if the Underlying Index at any point in time during the life of such security reaches a certain predetermined level.

Index Securities are expected to trade at a lower cost than the cost of trading each of the underlying component securities separately (because of reduced commission and custody costs) and are also expected to give investors the ability to maintain index exposure without the corresponding management or administrative fees and ongoing expenses. The initial offering price for an Index Security will be established on the date the security is priced for sale to the public. The final value of an Index Security will be determined on the valuation date at or near maturity consistent with the mechanics detailed in the prospectus for such Index Security.

#### c. Proposed Listing Criteria

The Exchange proposes the following for each issuer of Index Securities:

(A) *Assets/Equity*—Pursuant to PCXE Rule 5.2(j)(1), the issuer shall have assets in excess of \$100 million and stockholders' equity of at least \$10 million. In the case of an issuer that is unable to satisfy the earnings criteria set forth in PCXE Rule 5.2(c), the Exchange generally will require the issuer to have the following: (i) assets in excess of \$200 million and stockholders' equity of at least \$10 million; or (ii) assets in excess of \$100 million and stockholders' equity of at least \$20 million.

(B) *Distribution*—Minimum public distribution of 1,000,000 notes with a minimum of 400 public shareholders, except, if traded in thousand dollar denominations, then no minimum number of holders.

(C) *Principal Amount/Aggregate Market Value*—Not less than \$4 million.

(D) *Term*—The issue has a minimum of one (1) year but not greater than ten (10) years.

(E) *Tangible Net Worth*—The issuer will be expected to have a minimum tangible net worth<sup>16</sup> in excess of \$250,000,000 and to otherwise substantially exceed the earnings requirements set forth in PCXE Rule 5.2(c). In the alternative, the issuer will be expected: (i) To have a minimum tangible net worth of \$150,000,000 and to otherwise substantially exceed the earnings requirement set forth in PCXE Rule 5.2(c), and (ii) not to have issued securities where the original issue price of all the issuer's other index-linked note offerings (combined with index-linked note offerings of the issuer's affiliates) listed on a national securities exchange or traded through the facilities

<sup>16</sup> "Tangible net worth" is defined as total assets less intangible assets and total liabilities. Intangibles include non-material benefits such as goodwill, patents, copyrights and trademarks.

of Nasdaq exceeds 25% of the issuer's net worth.

#### Criteria for Underlying Indexes

Under the Exchange's proposal, each Underlying Index must satisfy the specific criteria set forth in proposed PCXE Rule 5.2(j)(6)(g) or be an index previously approved for the trading of options or other derivative securities by the Commission under Section 19(b)(2) of the Act<sup>17</sup> and rules thereunder. In general, the criteria for the underlying component securities of the Underlying Index are substantially similar to the requirements for index options set forth in PCX Rule 5.13(a). In all cases, an Underlying Index must contain at least ten (10) component securities (each, an "Underlying Security").

Examples of Underlying Indexes intended to be covered under the proposed generic listing standards include the Standard & Poor's 500 Index ("S&P 500"), Nasdaq-100 Index ("Nasdaq 100"), the Dow Jones Industrial Average ("DJIA"), Nikkei 225 Index ("Nikkei 225"), the Dow Jones STOXX 50 Index ("DJ STOXX 50"), the Global Titans 50 Index ("Global Titans 50"), Amex Biotechnology Index ("Amex Biotech"), and certain other indexes that represent various industry and/or market segments.

In order to satisfy the proposed generic listing standards, the Underlying Index will be calculated based on either a market capitalization,<sup>18</sup> modified market capitalization,<sup>19</sup> price,<sup>20</sup> equal-dollar<sup>21</sup> or modified equal-dollar<sup>22</sup> weighting

<sup>17</sup> 15 U.S.C. 78s(b)(2).

<sup>18</sup> A "market capitalization" index is the most common type of stock index. The components are weighted according to the total market value of the outstanding shares, *i.e.*, share price times the number of shares outstanding. This type of index will fluctuate in line with the price moves of the component stocks.

<sup>19</sup> A "modified market capitalization" index is similar to the market capitalization index, except that an adjustment to the weights of one or more of the components occurs. This is typically done to avoid having an index that has one or a few stocks representing a disproportionate amount of the index value.

<sup>20</sup> A "price weighted" index is an index in which the component stocks are weighted by their share price. The most common example is the DJIA.

<sup>21</sup> An "equal dollar weighted" index is an index structured so that share quantities for each of the component stocks in the index are determined as if one were buying an equal dollar amount of cash stock in the index. Equal dollar weighted indexes are usually rebalanced to equal weightings either quarterly, semi-annually, or annually.

<sup>22</sup> A "modified equal-dollar weighted" index is designed to be a fair measurement of the particular industry or sector represented by the index, without assigning an excessive weight to one or more index components that have a large market capitalization relative to the other index components. In this type of index, the cash component is assigned a weight

Continued

methodology. If a broker-dealer is responsible for maintaining (or has a role in maintaining) the Underlying Index, such broker-dealer is required to erect and maintain a "firewall," in a form satisfactory to the Exchange, to prevent the flow of information regarding the Underlying Index from the index production personnel to the sales and trading personnel.<sup>23</sup> In addition, an Underlying Index that is maintained by a broker-dealer is also required to be calculated by an independent third party who is not a broker-dealer.

#### Eligibility Standards for Underlying Securities

Index Securities will be subject to the criteria in proposed PCXE Rule 5.2(j)(6)(g) and (h) for initial and continued listing. For an Underlying Index to be appropriate for the initial listing of an Index Security, such Index must either be approved for the trading of options or other derivative securities by the Commission under section 19(b)(2) of the Act<sup>24</sup> and rules thereunder or meet the following requirements:

- Each Underlying Security must have a minimum market value of at least \$75 million, except that for each of the lowest weighted Underlying Securities in the index that in the aggregate account for no more than 10% of the weight of the index, the market value can be at least \$50 million;
- Each Underlying Security must have a trading volume in each of the last six months of not less than 1,000,000 shares, except that for each of the lowest weighted Underlying Securities in the index that in the aggregate account for no more than 10% of the weight of the index, the trading volume shall be at least 500,000 shares in each of the last six months;
- In the case of a capitalization-weighted or modified capitalization-

that takes into account the relative market capitalization of the securities comprising the index. The index is subsequently re-balanced to maintain these pre-established weighting levels. Like equal-dollar weighted indexes, the value of a modified equal-dollar weighted index will equal the current combined market value of the assigned number of shares of each of the underlying components divided by the appropriate index divisor. A modified equal-dollar weighted index will typically be re-balanced quarterly.

<sup>23</sup> For certain indexes, an index provider, such as Dow Jones, may select the components and calculate the index, but overseas broker-dealer affiliates of U.S. registered broker-dealers may sit on an "advisory" committee that recommends component selections to the index provider. In such case, the Exchange should ensure that appropriate information barriers and insider trading policies exist for this advisory committee. See Securities Exchange Act Release No. 51563 (April 15, 2005), 70 FR 21257 (April 25, 2005) (SR-AMEX-2005-001).

<sup>24</sup> 15 U.S.C. 78s(b)(2).

weighted index, the lesser of the five highest weighted Underlying Securities in the index or the highest weighted Underlying Securities in the index that in the aggregate represent at least 30% of the total number of Underlying Securities in the index, each have an average monthly trading volume of at least 2,000,000 shares over the previous six months;

- No component security will represent more than 25% of the weight of the index, and the five highest weighted component securities in the index will not in the aggregate account for more than 50% of the weight of the index (60% for an index consisting of fewer than 25 Underlying Securities);
- 90% of the index's numerical index value and at least 80% of the total number of component securities will meet the then current criteria for standardized options trading set forth in PCX Rule 5.3;
- Each component security shall be a reporting company under the Act, which is listed on a national securities exchange or is traded through the facilities of a national securities system and is subject to last sale reporting; and
- Foreign country securities or American Depositary Receipts ("ADRs") that are not subject to comprehensive surveillance agreements do not in the aggregate represent more than 20% of the weight of the index.

As described above in the Section entitled "Criteria for Underlying Indexes," all Underlying Indexes are required to have at least ten (10) component securities.

The proposed continued listing criteria set forth in proposed PCXE Rule 5.2(j)(6)(h) regarding the underlying components of an Underlying Index provides that the Exchange will commence delisting or removal proceedings of an Index Security (unless the Commission has approved the continued trading of the Index Security) if any of the standards set forth in the initial eligibility criteria of proposed PCXE Rule 5.2(j)(6)(g)(2) are not continuously maintained, except that:

- The criteria that no single component represent more than 25% of the weight of the index and the five highest weighted components in the index can not represent more than 50% (or 60% for indexes with less than 25 components) of the weight of the Index, need only be satisfied for capitalization weighted and price weighted indexes as of the first day of January and July in each year;
- The total number of components in the index may not increase or decrease by more than 33 $\frac{1}{3}$ % from the number of components in the index at the time

of its initial listing, and in no event may be less than ten (10) components;

- The 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 components 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; and
- In a capitalization-weighted or 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 have had an average monthly trading volume of at least 1,000,000 shares over the previous six months.

In connection with an Index Security that is listed pursuant to proposed PCXE Rule 5.2(j)(6)(g)(1), the Exchange will commence delisting or removal proceedings (unless the Commission has approved the continued trading of the Index Security) if an underlying index or indexes fails to satisfy the maintenance standards or conditions for such index or indexes as set forth by the Commission in its order under section 19(b)(2) of the Act<sup>25</sup> approving the index or indexes for the trading of options or other derivatives.

As set forth in proposed PCXE Rule 5.2(j)(6)(h)(3), the Exchange will also commence delisting or removal proceedings of an Index Security (unless the Commission has approved the continued trading of the Index Security), under any of the following circumstances:

- If the aggregate market value or the principal amount of the securities publicly held is less than \$400,000;
- If the value of the Underlying Index or composite value of the Underlying Index is no longer calculated and widely disseminated on at least a 15-second basis; or
- If such other event shall occur or condition exists which in the opinion of the Exchange makes further dealings on the Exchange inadvisable.

The Exchange represents that Index Securities traded, whether by listing or pursuant to UTP, on the Exchange will be required to be in compliance with Rule 10A-3 under the Act.<sup>26</sup>

<sup>25</sup> 15 U.S.C. 78s(b)(2).

<sup>26</sup> See 17 CFR 240.10A-3(c)(7).

### Exchange Rules Applicable to Index-Linked Securities

Index Securities will be treated as equity instruments and will be subject to all Exchange rules governing the trading of equity securities, including, among others, rules governing priority, parity and precedence of orders, market volatility related trading halt provisions pursuant to PCXE Rule 7.12. Exchange equity margin rules and the regular trading hours set forth in PCXE Rule 7.34 will apply to transactions in Index-Linked Securities.

### Information Circular

In addition, upon evaluating the nature and complexity of each Index Security, the Exchange represents that it will prepare and distribute, if appropriate, an Information Circular to Equities Trading Permit ("ETP") Holders describing the product. Accordingly, the particular structure and corresponding risk of an Index Security traded on the Exchange will be highlighted and disclosed.<sup>27</sup> In particular, the circular will set forth the Exchange's suitability rule that requires ETP Holders recommending a transaction in Index Securities: (1) To determine that such transaction is suitable for the customer (PCXE Rule 9.2) and (2) to have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of such transaction.

### Surveillance

The Exchange will closely monitor activity in Index Securities to identify and deter any potential improper trading activity in Index Securities. Additionally, the Exchange represents that its surveillance procedures are adequate to properly monitor the trading of Index Securities. Specifically, the Exchange will rely on its existing surveillance procedures governing

<sup>27</sup> The Exchange notes that ETP Holders conducting a public securities business are subject to the rules and regulations of the National Association of Securities Dealers, Inc. ("NASD"), including NASD Rule 2310(a) and (b). Accordingly, NASD Notice to Members 03-71 regarding non-conventional investments or "NCIs" applies to ETP Holders recommending/selling index-linked securities to public customers. This Notice specifically reminds members in connection with NCIs (such as index-linked securities) of their obligations to: (1) Conduct adequate due diligence to understand the features of the product; (2) perform a reasonable-basis suitability analysis; (3) perform customer-specific suitability analysis in connection with any recommended transactions; (4) provide a balanced disclosure of both the risks and rewards associated with the particular product, especially when selling to retail investors; (5) implement appropriate internal controls; and (6) train registered persons regarding the features, risk and suitability of these products.

equities, options and exchange-traded funds, which have been deemed adequate under the Act. The Exchange has developed procedures to closely monitor activity in the Index Security and related Underlying Securities to identify and deter potential improper trading activity. Proposed PCXE Rule 5.2(j)(6)(j) provides that the Exchange will implement written surveillance procedures for Index Securities.

The Exchange also has a general policy prohibiting the distribution of material, non-public information by its employees. As detailed above in the description of the generic standards, if the issuer or a broker-dealer is responsible for maintaining (or has a role in maintaining) the Underlying Index, such issuer or broker-dealer is required to erect and maintain a "firewall" in a form satisfactory to the Exchange, in order to prevent the flow of information regarding the Underlying Index from the index production personnel to sales and trading personnel. In addition, the Exchange will require that calculation of Underlying Indexes be performed by an independent third party who is not a broker-dealer.

### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act,<sup>28</sup> in general, and furthers the objectives of section 6(b)(5) of the Act,<sup>29</sup> in particular in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

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.

<sup>28</sup> 15 U.S.C. 78f(b).

<sup>29</sup> 15 U.S.C. 78f(b)(5).

### 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 [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-PCX-2005-63 on the subject line.

#### Paper Comments

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

All submissions should refer to File Number SR-PCX-2005-63. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal offices of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-PCX-2005-63 and should be submitted on or before August 31, 2005.

### IV. Commission's Findings

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with section 6(b) of the Act<sup>30</sup> and the

<sup>30</sup> 15 U.S.C. 78f(b).

rules and regulations thereunder applicable to a national securities exchange.<sup>31</sup> In particular, the Commission believes that the proposal furthers the objectives of section 6(b)(5) of the Act<sup>32</sup> in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments and perfect the mechanisms of a free and open market and to protect investors and the public interest.

The Commission has previously approved the listing and trading of several Index Securities based on a variety of debt structures and market indexes.<sup>33</sup> The Commission has also approved, pursuant to Rule 19b-4(e) under the Act,<sup>34</sup> generic listing standards for these securities proposed by the AMEX that, in all material respects, are identical to those proposed by PCX.<sup>35</sup>

Consistent with its previous orders, the Commission believes that generic listing standards proposed by PCX for Index Securities should fulfill the intended objective of Rule 19b-4(e) by allowing those Index Securities that satisfy the generic listing standards to commence trading without public comment and Commission approval.<sup>36</sup> This has the potential to reduce the time frame for bringing Index Securities to market and thereby reduce the burdens on issuers and other market participants. Further, the Exchange's ability to rely on Rule 19b-4(e) for Index Securities potentially reduces the time frame for listing and trading these securities, and thus enhances investors' opportunities. The Commission notes that it maintains regulatory oversight over any products listed pursuant to generic listing standards through regular inspection oversight.

#### A. Trading of Index Securities

Taken together, the Commission finds that the PCX proposal contains adequate

rules and procedures to govern the trading of Index Securities listed pursuant to Rule 19b-4(e) on the Exchange or traded pursuant to unlisted trading privileges. All Index Security products listed under the standards will be subject to the full panoply of PCX rules and procedures that now govern the trading of Index Securities and the trading of equity securities on the PCX, including among others, rules and procedures governing trading halts, disclosures to members, responsibilities of the specialist, account opening and customer suitability requirements, the election of a stop or limit order, and margin.

PCX has proposed asset/equity requirements and tangible net worth for each Index Security issuer, as well as minimum distribution, principal/market value, and term thresholds for each issuance of Index Securities. As set forth more fully above, PCX's proposed listing criteria include minimum market capitalization, monthly trading volume, and relative weighting requirements for the Index Securities. These requirements are designed to ensure that the trading markets for index components underlying Index Securities are adequately capitalized and sufficiently liquid, and that no one stock dominates the index. The Commission believes that these requirements should significantly minimize the potential for of manipulation. The Commission also finds that the requirement that each component security underlying an Index Security be listed on a national securities exchange or traded through the facilities of a national securities system and subject to last sale reporting will contribute significantly to the transparency of the market for Index Securities. Alternatively, if the index component securities are foreign securities that are not reporting companies, the generic listing standards permit listing of an Index Security if the Commission previously approved the underlying index for trading in connection with another derivative product and certain surveillance sharing arrangements exist with foreign markets. The Commission believes that if it has previously determined that such index and its components were sufficiently transparent, then the Exchange may rely on this finding, provided it has comparable surveillance sharing arrangements with the foreign market that the Commission relied on in approving the previous product.

The Commission believes that by requiring pricing information for both the relevant underlying index or indexes and the Index Security to be readily available and disseminated, the

proposed listing standards should help ensure a fair and orderly market for Index Securities approved pursuant to PCX Rule 5.2(j)(6).

The Commission also believes that the requirement that at least 90 percent of the component securities, by weight, and 80 percent of the total number of Underlying Securities, be eligible individually for options trading will prevent an Index Security from being a vehicle for trading options on a security not otherwise options eligible.

The Exchange has also developed delisting criteria that will permit PCX to suspend trading of an Index Security in case of circumstances that make further dealings in the product inadvisable. The Commission believes that the delisting criteria will help ensure a minimum level of liquidity exists for each Index Security to allow for the maintenance of fair and orderly markets. Also, the Exchange will commence delisting proceedings in the event that the value of the underlying index or index is no longer calculated and widely disseminated on at least a 15-second basis.

#### B. Surveillance

The Exchange must surveil trading in any products listed under the generic listing standards. In that regard, the Commission believes that a surveillance sharing agreement between an Exchange proposing to list a stock index derivative product and the exchange(s) trading the stocks underlying the derivative product is an important measure for surveillance of the derivative and underlying securities markets. When a new derivative securities product based upon domestic securities is listed and traded on an exchange pursuant to Rule 19b-4(e) under the Act, the exchange should determine that the markets upon which all of the U.S. component securities trade are members of the Intermarket Surveillance Group ("ISG"), which provides information relevant to the surveillance of the trading of securities on other market centers.<sup>37</sup> For new derivative securities products based on securities from one or more foreign markets, the exchange should have a comprehensive Intermarket Surveillance Agreement that covers the securities underlying the new securities

<sup>31</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>32</sup> 15 U.S.C. 78f(b)(5).

<sup>33</sup> See Securities Exchange Act Release Nos. 41091 (February 23, 1999), 64 FR 10515 (March 4, 1999) (Narrow-Based Index Options); 42787 (May 15, 2000), 65 FR 33598 (May 24, 2000) (ETFs); and 43396 (September 29, 2000), 65 FR 60230 (October 10, 2000) (TIRs).

<sup>34</sup> 17 CFR 240.19b-4(e).

<sup>35</sup> See *supra* note 6.

<sup>36</sup> The Commission notes that the failure of a particular index to comply with the proposed generic listing standards under Rule 19b-4(e), however, would not preclude the Exchange from submitting a separate filing pursuant to Section 19(b)(2), requesting Commission approval to list and trade a particular index-linked product.

<sup>37</sup> See Securities Exchange Act Release No. 40761 (December 8, 1998), 63 FR 70952 (December 22, 1998) (File No. S7-13-98). 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. The Commission notes that all of the registered national securities exchanges, including the ISE, as well as the NASD, are members of the ISG.

product.<sup>38</sup> Accordingly, with respect to indexes not previously approved by the Commission, the Commission finds that PCX's commitment to implement comprehensive surveillance sharing agreements,<sup>39</sup> as necessary, and the definitive requirements that (i) each component security shall be a registered reporting company under the Act and (ii) no more than 20 percent of the weight of the Underlying Index or Underlying Indexes may be comprised of foreign country securities or ADRs not subject to a comprehensive surveillance sharing agreement,<sup>40</sup> will make possible adequate surveillance of trading of Index Securities listed pursuant to the proposed generic listing standards.

With regard to actual oversight, PCX represents that its surveillance procedures are sufficient to detect fraudulent trading among members in the trading of Index Securities pursuant to proposed PCXE Rule 5.2(j)(6).

### C. Acceleration

The Commission finds good cause for approving proposed rule change, as amended, prior to the 30th day after the date of publication of notice of filing thereof in the **Federal Register**. The proposal implements generic listing standards substantially identical to those already approved for the Amex. The Commission does not believe that the Exchange's proposal raises any novel regulatory issues. The proposed generic listing criteria should enable more expeditious review and listing of Index Securities by PCX, thereby reducing administrative burdens and benefiting the investing public. Thus, the Commission finds good cause to accelerate approval of the proposed rule change, as amended.

### V. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>41</sup> that the proposed rule change (SR-PCX-2005-63), as amended, is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>42</sup>

**J. Lynn Taylor,**

*Assistant Secretary.*

[FR Doc. E5-4326 Filed 8-9-05; 8:45 am]

**BILLING CODE 8010-01-P**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-52201; File No. SR-SCCP-2004-03]

### Self-Regulatory Organizations; Stock Clearing Corporation of Philadelphia; Notice of Filing of Proposed Rule Change by Relating Anonymous Features on Trading Systems

August 3, 2005.

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> notice is hereby given that on September 7, 2004, Stock Clearing Corporation of Philadelphia ("SCCP") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in items I, II, and III, below, which items have been prepared by SSCP. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The proposed rule change would allow SSCP to process trades executed on a trading system that provides for anonymous trading.<sup>3</sup>

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

In its filing with the Commission, SSCP included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. SSCP 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

Currently, SSCP receives and processes its participants' trades. In the future, SSCP may receive locked-in trade data from a trading system that

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

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

<sup>3</sup> The proposed rule change is similar to a rule change approved by the Commission in 2003 that allowed the National Securities Clearing Corporation ("NSCC") to accommodate the reporting of trades executed on a system that provides trading anonymity. Securities Exchange Act Release No. 48526 (September 23, 2003), 68 FR 56367 (September 30, 2003) [File No. SR-NSCC-2003-14].

provides anonymity. In such a situation, SSCP would report such trades to its participants using an anonymous acronym instead of naming or identifying the actual contra side account number.

In the event that SSCP ceases to act for a participant in an anonymous trade, the operator of the trading system shall have the responsibility to identify to its users the trades, which are generally included in reports produced by SSCP, involving the affected participant. SSCP would forward to the operator of the trading system the appropriate information to facilitate its notification of its users. In addition, should SSCP receive information from NSCC that NSCC had ceased to act for an NSCC member that is an unidentified contra side of any such trade, SSCP would also forward this information to the operator of the trading system.<sup>4</sup>

SCCP believes that its proposed rule change is consistent with the requirements of section 17A(b)(3)(F) of the Act because it is designed to promote the prompt and accurate clearance and settlement of securities transactions and to remove impediments to and perfect the mechanism of a national system for the prompt and accurate clearance and settlement of securities transactions in that the proposed rule change should allow SSCP to accommodate trades executed on an anonymous trading system and should provide for the prompt and accurate clearance of those trades.

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

SCCP does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

<sup>4</sup> NSCC's anonymous trading rule includes similar notification requirements.

<sup>38</sup> See *id.*

<sup>39</sup> Proposed PCXE Rule 5.2(j)(6)(j).

<sup>40</sup> Proposed PCXE Rule 5.2(j)(6)(g)(vii).

<sup>41</sup> 15 U.S.C. 78s(b)(2).

<sup>42</sup> 17 CFR 200.30-3(a)(12).