

accommodation liquidations as defined in Rule 6.54 are exempted from the systematization requirement. However, the Exchange maintains quotation, order and transaction information for accommodation liquidations in the same format as the COATS data is maintained, and will make such information available to the SEC upon request.

The Exchange also has added a new Interpretation and Policy .05 to CBOE Rule 6.24, which states that FLEX options, as described in Chapter 24A of the Exchange's rules, are exempt from the requirements of this Rule. However, the Exchange will maintain as part of its audit trail quotation, order and transaction information for FLEX options in a form and manner that is substantially similar to the form and manner as the COATS data is maintained, and will make such information available to the SEC upon request.

The proposed rule change also includes a new Interpretation .06 which provides that any proprietary system approved by the Exchange on the Exchange's trading floor that receives orders will be considered an Exchange system for purposes of paragraph (a)(1) of this Rule. Any proprietary system approved by the Exchange shall comply with the requirements of COATS.

Finally, the proposed rule change includes a new Interpretation .07 which provides that each order transmitted by a Market-Maker while on the floor, including any cancellation of or change to such order, must be systematized in accordance with the procedures described in Paragraph (a) and (b) of this Rule, as applicable. Currently paragraph (d) of CBOE Rule 6.24 requires that each order transmitted by a Market-Maker while on the floor, including any cancellation of or change to such order, must be recorded legibly in a written form that has been approved by the Exchange, and must be time stamped immediately prior to its transmission. This new interpretation thus requires that each order transmitted by a Market-Maker while on the floor, including any cancellation of or change to such order, is systematized in accordance with CBOE Rule 6.24.

## 2. Statutory Basis

CBOE believes the proposed rule change is consistent with Section 6(b) of the Act<sup>13</sup> in general and furthers the objectives of Section 6(b)(5)<sup>14</sup> in particular in that it should promote just and equitable principles of trade, and

protect investors and the public interest. CBOE believes that the proposed rule change will promote just and equitable principles of trade and protect investors and the public interest by electronically enhancing the audit trail for orders by incorporating non-electronic orders into COATS. This enhanced audit trail will permit CBOE to conduct surveillance of the activity on the Exchange and reconstruct markets in a more efficient and effective manner.

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

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

The Exchange neither received nor solicited written comments on the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) By order approve such proposed rule change, or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

## IV. Solicitation of Comments

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

### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-77 on the subject line.

### Paper Comments

- Send paper comments in triplicate to Jonathan G. Katz, Secretary,

Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-77. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. 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-CBOE-2004-77 and should be submitted on or before December 27, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jill M. Peterson,**

*Assistant Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50748; File No. SR-NASD-2004-153]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the National Association of Securities Dealers, Inc. To Provide a Delta Hedge Exemption From Stock Option Position Limits for OTC Derivatives Dealers Affiliated With NASD Member Firms When Certain Conditions Are Satisfied

November 29, 2004.

On October 12, 2004, the National Association of Securities Dealers, Inc.

<sup>13</sup> 15 U.S.C. 78f(b).

<sup>14</sup> 15 U.S.C. 78(b)(5).

<sup>15</sup> 17 CFR 200.30-3(a)(12).

("NASD") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its Rule 2860(b) to provide a delta hedging exemption from stock option position limits for OTC Derivatives Dealers affiliated with NASD member firms when certain conditions are satisfied.<sup>3</sup> The Commission published the proposed rule change for comment in the **Federal Register** on October 21, 2004.<sup>4</sup> The Commission received no comments on the proposed rule change.

Under the proposal, a stock option position of an OTC Derivatives Dealer that is delta neutral<sup>5</sup> would be exempt from position limits, provided that, among other things, the NASD member with which the OTC Derivatives Dealer is affiliated has received a written representation from the OTC Derivatives Dealer stating that it is hedging its stock options positions in accordance with its internal risk management control and pricing models approved by the Commission. Any stock options position of an OTC Derivatives Dealer that is not delta neutral would remain subject to position limits.<sup>6</sup>

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities association.<sup>7</sup> In particular, the Commission believes that the proposed rule change is consistent with Section 15A(b)(6) of the Act,<sup>8</sup> which requires,

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

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

<sup>3</sup> The proposal relates to options positions of an "OTC Derivatives Dealer" as that term is defined in Rule 3b-12 under the Act. See 17 CFR 240.3b-12.

<sup>4</sup> Securities Exchange Act Release No. 50539 (October 14, 2004), 69 FR 61884 (October 21, 2004).

<sup>5</sup> The term "delta neutral" as defined in the proposed rule change describes a stock options position that has been hedged, in accordance with a Commission-approved pricing model, with a portfolio of instruments relating to the same underlying stock to offset the risk that the value of the options position will change with changes in the price of the stock underlying the options position.

<sup>6</sup> See proposed NASD Rule 2860(b)(3)(A)(vii)(b)(3). The Commission notes that NASD Rule 2860(b)(3)(A)(vii) provides for multiple, independent hedge exemptions. Of course, to the extent that a position is used to hedge for the purpose of one exemption from position limit requirements, such as the delta hedge exemption, such position cannot be used to take advantage of another exemption from position limit requirements.

<sup>7</sup> In approving this rule, 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).

<sup>8</sup> 15 U.S.C. 78o-3(b)(6).

among other things, that NASD rules 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 of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission has previously stated its support for recognizing options positions hedged on a delta neutral basis as properly exempted from position limits.<sup>9</sup>

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-NASD-2004-153) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-50753; File No. SR-NASD-2004-147]

### Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 To Modify the Bid Price Compliance Periods on the Nasdaq National Market and SmallCap Market and To Require Non-Canadian Foreign Issuers To Satisfy the Bid Price and Market Value of Publicly Held Shares Requirements Applicable to Domestic Issuers for Continued Listing on the SmallCap Market

November 29, 2004.

#### I. Introduction

On October 1, 2004, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to modify the bid price

<sup>9</sup> Securities Exchange Act Release No. 40594 (October 23, 1998), 63 FR 59362, 59380 (November 3, 1998) (adopting rules relating to OTC Derivatives Dealers).

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

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

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

compliance periods on the Nasdaq National Market and the Nasdaq SmallCap Market and to require non-Canadian foreign issuers to satisfy the minimum bid price and market value of publicly held shares requirements applicable to domestic issuers for continued listing on the Nasdaq SmallCap Market. The proposed rule change was published for notice and comment in the **Federal Register** on October 21, 2004.<sup>3</sup> The Commission received no comments on the proposal. On November 24, 2004, Nasdaq filed Amendment No. 1.<sup>4</sup> This order approves the proposed rule change. Simultaneously, the Commission provides notice of filing of Amendment No. 1 and grants accelerated approval of Amendment No. 1.

#### II. Description of the Proposal

##### A. Modification of the Bid Price Compliance Periods

Nasdaq rules relating to the minimum bid price requirement were approved on a pilot basis by the Commission in February 2002<sup>5</sup> and modified in March 2003<sup>6</sup> and December 2003.<sup>7</sup> The pilot, which expires on December 31, 2004, provides 180 calendar days for a National Market issuer trading below \$1.00 to regain compliance. Upon the expiration of the first 180 calendar days, an issuer able to satisfy all initial listing criteria is eligible for an additional grace period of another 180 calendar days. Thereafter, a National Market issuer may phase down to the SmallCap Market to take advantage of an additional grace period if it meets all SmallCap initial listing criteria except for bid price.<sup>8</sup> If a National Market issuer is not in compliance 45 days before the expiration of its second grace period, Nasdaq would send a warning letter to the issuer and the issuer could request a hearing at that time, if one were desired.

The current pilot also provides 180 calendar days for a SmallCap Market issuer to regain compliance. Upon the expiration of the first 180-day grace period, an issuer satisfying all initial

<sup>3</sup> See Securities Exchange Act Release No. 50541 (October 14, 2004), 69 FR 61888.

<sup>4</sup> In Amendment No. 1, Nasdaq made a technical correction to the text of NASD Rule 4450(i)(1).

<sup>5</sup> See Securities Exchange Act Release No. 45387 (February 4, 2002), 67 FR 6306 (February 11, 2002) (SR-NASD-2002-13).

<sup>6</sup> See Securities Exchange Act Release No. 47482 (March 11, 2003), 68 FR 12729 (March 17, 2003) (SR-NASD-2003-34).

<sup>7</sup> See Securities Exchange Act Release No. 48991 (December 23, 2003), 68 FR 75677 (December 31, 2003) (SR-NASD-2003-44), amended by Securities Exchange Act Release No. 48991A (February 5, 2004), 69 FR 6707 (February 11, 2004).

<sup>8</sup> See *infra* Section III.