20549–0609. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov.* All comment letters should refer to File No. 600–19. This file number should be included on the subject line if e-mail is used. Comment letters will be available for public inspection and copying in the Commission's Public Reference Room, 450 5th Street, NW, Washington, DC. Electronically submitted comment letters also will be posted on the Commission's Web site (*http://www.sec.gov*).[13]

It is therefore ordered that:

(1) Effective December 31, 2002, Philadep's registration as a clearing agency under Section 17A of the Exchange Act and Rule 17Ab2–1 thereunder is terminated and

(2) Phlx for a period of 5 years from the effective date of the termination of Philadep's registration as a clearing agency will maintain all the records required to be maintained pursuant to Rule 17a–1(a) which are in Philadep's possession and will produce such records upon the request of any representative of the Commission.

By the Commission.

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 02–32641 Filed 12–26–02; 8:45 am]

BILLING CODE 8010–01–P

[13] We do not edit personal, identifying information such as names, or e-mail addresses, from electronic submissions. Submit only information you wish to make publicly available.

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47017; File No. SR–Amex–2002–96]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the American Stock Exchange LLC To Permit Limited Side-by-Side Trading and Integrated Market Making of Certain iShares Lehman Treasury Index Exchange-Traded Fund Shares and Their Related Options

December 18, 2002.

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 November 20, 2002, the American Stock Exchange LLC (''Amex'' or ''Exchange'') 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 the Exchange. The Exchange filed Amendment No. 1 to the proposed rule change on December 3, 2002.[3] The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

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

The Exchange proposes to amend Exchange rules 175, 900 and 958 to permit the trading of the iShares Lehman 1–3 Year Treasury Bond Fund (the ''1–3 Year Bond Fund''), the iShares Lehman 7–10 Year Treasury Bond Fund (the ''7–10 Year Bond Fund''), the iShares Lehman 20+ Year Treasury Bond Fund (the ''20+Year Bond Fund'') (collectively, the ''iShares Lehman Treasury Index ETFs''),[4] and any other exchange-traded fund shares (''ETFs'') approved by the Commission, and their related options contracts by the same specialist unit and registered options traders (''ROTs'') and the approved persons of such specialist unit or ROT without informational or physical barriers. The text of the proposed rule change appears below. New text is in *italics.*

Specialist Prohibitions

Rule 175

(a)–(b) No change.

(c) No specialist or his member organization or any member, limited partner, officer, or approved person thereof shall act as an options specialist or function in any capacity involving market making responsibilities in any option as to which the underlying security is a stock in which the specialist is registered as such. Notwithstanding the foregoing:

(1) A specialist member organization or an approved person of a specialist registered in a stock admitted to dealings on an unlisted basis may act as a specialist, Registered Options Trader or other registered market maker in the related option provided that such persons have established and obtained Exchange approval for procedures restricting the flow of material, non-public corporate or market information between them pursuant to Exchange rule 193, and

(2) A specialist, specialist member organization or approved person of a specialist or specialist member organization registered in an Exchange Traded Fund Share or Trust Issued Receipt that meets the criteria set forth in Commentary .03(a) to Amex rule 1000 or Commentary .02(a) to Amex rule 1000A *or approved by the Securities and Exchange Commission for trading arrangements under this paragraph and rule 958(e)* may act as a specialist, Registered Options Trader or other registered market maker in the related option without implementing procedures to restrict the flow of information between them and without any physical separation between the underlying Exchange Traded Fund Share or Trust Issued Receipt and the related option. In addition, paragraph (b) of this rule and the Guidelines to this rule are inapplicable to a specialist or specialist member organization registered in an Exchange Traded Fund Share or Trust Issued Receipt that meets the criteria set forth in Commentary .03(a) to Amex rule 1000 or Commentary .02(a) to Amex rule 1000A *or approved by the Securities and Exchange Commission for trading arrangements under this paragraph and rule 958(e)* and the approved persons of such specialist or specialist member organization.

*   *   *   *   *

Applicability, Definitions and References

Rule 900

A. (a) No change.

(b) Definitions—The following terms as used in the Rules of this Chapter shall, unless the context otherwise indicates, have the meanings herein specified:

(1) through (37). No change.

(38) Paired Security—The term ''Paired Security'' means a security which is the subject of securities trading on the Exchange and Exchange option trading, provided, however, that the term ''Paired Security'' shall not mean an Exchange-Traded Fund Share or Trust Issued Receipt which is the subject of securities trading on the Exchange and Exchange option trading if the Exchange-Traded Fund Share or Trust Issued Receipt meet the criteria

[3] *See* letter from Jeffrey P. Burns, Assistant General Counsel, Amex, to Kelly McCormick Riley, Senior Special Counsel, Division of Market Regulation, Commission, dated November 27, 2002 (''Amendment No. 1''). In Amendment No. 1, the Exchange revised the rule text of the proposal to clarify that the Commission must approved integrated market making and side-by-side trading in Exchange Traded Fund (''ETF'') or Trust Issued Receipt (''TIR'') that does not meet the criteria set forth in Commentary .03(a) or Amex rule 1000 or Commentary .02(a) to Amex rule 1000A.

[4] *See* Securities Exchange Act Release No. 46252 (July 24, 2002), 67 FR 49715 (July 31, 2002), (''iShares Treasury Index ETF Approval''). *See also* Investment Company Act Release Nos. 25622 (June 25, 2002), (approval0; and 25594 (May 29, 2002), 67 FR 38681 (June 5, 2002), (notice) (Trust, Advisor and Distributor of the funds applied and received a Commission order exemption the funds from various provisions of the Investment Company Act of 1940 (''1940 Act'')).

set forth in Commentary .03(a) to Amex rule 1000 or Commentary .02(a) to Amex rule 1000A or approved by the Securities and Exchange Commission for trading arrangements under rule 175(c)(2) and rule 958(e).

(39) through end. No change.

* * * * *

Options Transactions of Registered Traders

Rule 958. No Registered Trader shall initiate an Exchange options transaction on the Floor for any account in which he has an interest except in accordance with the following provisions:

(a) through (d). No change.

(e) No equity specialist, odd-lot dealer or NASDAQ market maker may act as a registered trader in a class of stock options on a stock in which he is registered in the primary market therefor, provided, however, that an equity specialist may act as a registered trader in a class of stock options on an Exchange-Traded Fund Share or a Trust Issued Receipt in which he is registered in the primary market therefor if the Exchange-Traded Fund Share or Trust Issued Receipt meets the criteria set forth in Commentary .03(a) to Amex rule 1000 or Commentary .02(a) to Amex rule 1000A *or approved by the Securities and Exchange Commission for trading arrangements under this paragraph and rule 175(c)(2).*

(f) through end. No change.

* * * * *

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 IV 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, Proposed Rule Change

1. Purpose

The purpose of this proposed rule change is to permit the trading of the iShares Lehman Treasury Index ETFs and their related options by the same specialist, specialist firm, and the approved persons of such specialist or specialist firm without any information or physical barriers on the floor of the Exchange. Accordingly, this proposal would permit integrated market making[5] and side-by-side trading[6] in iShares Lehman Treasury Index ETFs and their related options. It would exempt the underlying ETF specialists and their approved persons from Amex rule 175(b) and the Guidelines to Amex rule 175.

The Exchange files this rule change in connection with its listing and trading of options on the iShares Lehman Treasury Index ETFs.[7] Current Exchange rules impose certain restrictions on the approved persons[8] and other persons that are affiliated with a specialist or specialist unit (collectively "specialist affiliates"). Among these rules, Amex rule 175(c) generally prohibits the specialist affiliates of an Amex equity specialist from acting as an options specialist or functioning in any capacity involving market making responsibilities in any option as to which stock the specialist is registered.[9] A recent amendment to Amex rule 175(c) added paragraph (c)(2), which permits integrated market making of certain "broad-based" equity ETFs.[10] Here, the Exchange proposes to amend Amex rules 175, 900 and 958 to allow integrated market making and side-by-side trading in the iShares Lehman Treasury Index ETFs and their related options as well as integrated market making and side-by-side trading of any ETF and its related option with separate Commission approval.

In light of the Commission's recent approval to permit side-by-side trading and integrated market making on the Amex in certain equity-based ETFs,[11] the Exchange believes that iShares Treasury Index ETFs should be similarly treated. The ETF Integrated Market Making Approval established a generic criteria for equity-based ETFs that requires such ETFs to be "broad-based" in order be for integrated market making and side-by-side trading to apply.[12] For purposes of the instant proposal, the Exchange requests that the Commission approve certain fixed-income ETFs, based on various segments or durations of the U.S. Treasury securities market (arguably, the most liquid and active securities market in the world), for integrated market making and side-by-side trading separate from the previously adopted equity-based ETF generic standards. Accordingly, the Exchange proposes to amend Amex rule 175(c)(2) to permit the same specialists, their member organizations, and their approved persons to trade an ETF and its related options, if approved to do so by the Commission, without reference to the limitations of Amex rule 175(b) and the Guidelines to Amex rule 175. The Exchange also proposes to amend the definition of "Paired Security" in Amex rule 900 to provide that in addition to those ETFs that meet the equity-based generic criteria, those ETFs that are specifically approved for integrated market making and side-by-side trading by the Commission.

a. The Market for Treasury Securities

The market for U.S. Treasury securities is the largest and most liquid securities market in the world.[13]

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[5] "Integrated market making" refers to the trading of options and their underlying securities by the same specialist and/or specialist firm.

[6] "Side-by-side trading" refers to the trading of options and the underlying stocks at the same location, though not necessarily by the same specialist.

[7] The underlying iShares Treasury Index ETFs commenced trading on the Amex on July 26, 2002. *See* iShares Treasury Index ETF Approval, *supra* note 4.

[8] The Exchange defines an "approved person" as an individual or corporation, partnership or other entity which controls a member or member organization, or which is engaged in the securities business and is under common control with, or controlled by, a member or member organization or which is the owner of a membership held subject to a special transfer agreement. *See* article I, section 3(g) of the Exchange Constitution. The term "control" is defined in Exchange Definitional rule 13.

[9] This rule was adopted in connection with the Exchange's application in the late 1980s to list options on its listed equities. *See* Securities Exchange Act Release No. 26147 (October 3, 1988), 53 FR 39556 (October 7, 1988) (File No. SR–Amex–88–16).

[10] *See* Securities Exchange Act Release No. 46213 (July 16, 2002), 67 FR 48232 (July 23, 2002) ("ETF Integrated Market Making Approval").

[11] *See id.* The Exchange has filed a proposed rule change that would allow the trading on a pilot program basis of specified Nasdaq stocks, ETFs, TIRs and their related options at the same location on the Trading Floor and by the same specialist units and registered traders. *See* SR–Amex–2001–75 (September 6, 2001). The ETF Integrated Market Making Approval neither amended nor withdrew SR–Amex–2001–75.

[12] Commentary .03(a) to Amex rule 1000 and Commentary .02(a) to Amex rule 1000A provide that each component of an index or portfolio underlying an ETF must meet the following criteria: (1) Component securities that in the aggregate account for at least 90% of the weight of the portfolio must have a minimum market value of at least $75 million; (2) the component securities representing 90% of the weight of the portfolio each have a minimum monthly trading volume during each of the last six months of at least 250,000 shares; (3) the most heavily weighted component security cannot exceed 25% of the weight of the portfolio and the five most heavily weighted component securities cannot exceed 65% of the weight of the portfolio; (4) the underlying portfolio must include a minimum of 13 securities; and (5) all securities in the portfolio must be listed on a national securities exchange or the Nasdaq Stock Market (the "broad-based criteria").

[13] *See The Treasury Securities Market: Overview and Recent Developments,* The Federal Reserve

Continued

Through the 3rd quarter of 2002, total daily average transaction volume for primary dealers [14] in U.S. Treasury coupon securities was approximately $316 billion. During this same period, primary dealer average daily transaction volume in the 1–3 year range was approximately $132.07 billion; average daily transaction volume in the 3–6 year range was approximately $92.73 billion; average daily transaction volume in the 6–11 year range was approximately $74.8 billion; and average daily transaction volume in the more than 11 year range was approximately $18.9 billion.[15] In the 3rd quarter of 2002, average daily transaction volumes for the same duration U.S. Treasury coupon securities were $134.03 billion, $106.97 billion, $83.57 billion and $20.57 billion, respectively. Most of this trading volume occurs in the most recently issued security in a particular maturity class.[16]

The secondary market for Treasury securities is the over-the-counter (''OTC'') market. Many dealers, and particularly primary dealers, make markets in Treasury securities. Trading activity takes place between primary dealers, non-primary dealers, and customers of these dealers, including financial institutions, non-financial institutions and individuals. Increasingly, trading in Treasury securities occurs through automated trading systems.[17]

The primary dealers are among the most active participants in the secondary market for Treasury securities. The primary dealers and other large market participants frequently trade with each other, and most of these transactions occur through an interdealer broker.[18] The interdealer brokers provide primary dealers and other large participants in the Treasury market with electronic screens that display the bid and offer prices among dealers and allow trades to be consummated.

Quote and trade information regarding Treasury securities is widely available to market participants from a variety of sources. The electronic trade and quote systems of the dealers and interdealer broker are one such source. Groups of dealers also furnish trade and quote information to vendors such as Bloomberg, Reuters, Bridge, Moneyline Telerate, and CQG. GovPX,[19] for example, is a consortium of government securities interdealer brokers that provides market data from these government securities interdealer brokers to market data vendors. TradeWeb, another example, is a consortium of 18 primary dealers that, in addition to providing a trading platform, also provides market data direct to subscribers or to other market data vendors.[20] In addition, the leading interdealer broker of government securities (Cantor Fitzgerald) for many years has provided Moneyline Telerate with market data.

b. iShares Lehman Treasury Index ETFs

The Lehman U.S. Treasury Indexes are each market capitalization weighted and include all of the securities that meet the particular Index criteria. Each Index includes all publicly issued, U.S. Treasury securities that have a remaining maturity of between 1–3 years, 7–10 years or over 20 years (depending on the Index), are non-convertible, are denominated in U.S. dollars, are rated investment grade (Baa3 or better) by Moody's Investors Service, are fixed rate, and have more than $150 million par outstanding. Excluded from each Index are certain special issues, such as flower bonds,[21] targeted investor notes (TINs), state and local government series bonds (SLGs), and coupon issues that have been stripped from assets that are already included in the Index. Each Index's constituents are updated on the last calendar day of each month.

Each Index is valued using end of day bid side prices, as marked by Lehman. Intra-month cash flows contribute to monthly returns, but they are not reinvested during the month and do not earn a reinvestment return. Total returns are calculated based on the sum of price changes, gain/loss on repayments of principal, and coupon received or accrued, expressed as a percentage of beginning market value.[22]

i. Lehman 1–3 Year Treasury Bond Fund (1–3 Year Bond Fund). The 1–3 Year Bond Fund invests primarily in a portfolio of fixed income securities with the objective of approximating the total rate of return of the short term sector of the U.S. Treasury market as defined by the Lehman Brothers 1–3 Year U.S. Treasury Index. The Lehman 1–3 Year U.S. Treasury Index represents public obligations of the U.S. Treasury that have a remaining maturity of between 1 and 3 years. As of September 30, 2002, there were 31'issues included in the Index with the Fund using a representative sampling strategy to track the Index.[23]

ii. Lehman 7–10 Year Treasury Bond Fund (7–10 Year Bond Fund) The 7–10 Year Bond Fund invests primarily in a portfolio of fixed income securities with the objective of approximating the total rate of return of the intermediate term sector of the U.S. Treasury market as defined by the Lehman Brothers 7–10 Year U.S. Treasury Index. The Lehman 7–10 Year U.S. Treasury Index represents public obligations of the U.S. Treasury that have a remaining maturity of between 7 and 10 years. As of September 30, 2002, there were 12 issues included in the Index with the Fund using a representative sampling strategy to track the Index.[24]

iii. Lehman 20+ Year Treasury Bond Fund (20+ Year Bond Fund). The 20+ Year Bond Fund invests primarily in a portfolio of fixed income securities with the objective of approximating the total rate of return of the long term sector of the U.S. Treasury market as defined by the Lehman Brothers 20+ Year U.S. Treasury Index. The Lehman 20+ Year U.S. Treasury Index represents public

Bulletin, December 1999, available at *http://www.federalreserve.gov/pubs/bulletin/1999/1299lead.pdf.*

[14] The Federal Reserve Bank of New York selects Primary dealers to act as counter parties for its open market operations (government securities transactions related to the Federal Reserve's implementation of monetary policy). Primary dealers are required to participate meaningfully in both open market operations and Treasury auctions as well as to provide policy relevant market information to The Federal Reserve Bank of New York.

[15] Primary dealers in Treasury securities submit statistics on their transactions in Treasuries to The Federal Reserve Bank of New York. These statistics are available on their web site at *http://www.newyorkfed.org/pihome/statistics/primdeal.html?expand=9.*

[16] *See The Treasury Securities Market: Overview and Recent Developments, supra* note 13.

[17] *See, e.g., eCommerce in the Fixed-Income Markets: The 2001 Review of Electronic Transaction Systems,* November 2001, *http://www.bondmarkets.com/research/ ecommerce/ecommercedraft.shtml.*

[18] *E.g.,* BrokerTec Global LLC, Cantor Fitzgerald, Inc., Garban-Intercapital, and Liberty Brokerage Investment Corp.

[19] *www.govpx.com.*

[20] *www.tradeweb.com.*

[21] A ''flower bond'' is a type of U.S. government bond that, regardless of its cost price, is acceptable at par value in payment of estate taxes if the decedent was the legal holder at the time of death.

[22] The Monthly Statement of the Public Debt of the United States may be obtained at *www.publicdebt.treas.gov.*

[23] As of September 30, 2002, the Index exhibited the following characteristics: (1) Weighted average maturity of 1.77 years; (2) weighted average coupon of 4.58%; (3) an effective duration of 1.68 years; (4) yield to maturity of 1.64% and (5) a current yield of 4.37%. In addition, the top holding of the Index constituted 6% of the Index while the top five (5) holdings represented 30% of the Index.

[24] As of September 30, 2002, the Index exhibited the following characteristics: (1) Weighted average maturity of 8.55 years; (2) weighted average coupon of 5.98%; (3) an effective duration of 6.65 years; (4) yield to maturity of 3.63% and (5) a current yield of 5.36%. In addition, the top holding of the Index constituted 17% of the Index while the top five (5) holdings represented 76% of the Index.

obligations of the U.S. Treasury that have a remaining maturity greater than 20 years. As of September 30, 2002, there were 18 issues included in the Index with the Fund using a representative sampling strategy to track the Index.[25]

c. Broad-Based ETF Criteria

As discussed above, the Commission has approved a proposal to permit integrated market making and side-by-side trading of equity-based ETFs that meet the broad-based criteria.[26] For the purpose of this proposal, the Exchange submits that the iShares Treasury Index ETFs comply with the broad-based criteria, as applicable, to fixed income U.S. government securities.

First, the broad-based criteria requires that at least 90% of the component securities of an Index have a minimum market value of at least $75 million. The Exchange submits that all three iShares Treasury Index ETFs meet this criteria based on the requirement that all Treasury securities of each respective U.S. Treasury Index must have more than $150 million outstanding in par value. Second, the broad-based criteria also requires that at least 90% of the component securities of an Index have a minimum monthly trading volume during each of the last six months of at least 250,000 shares. Because the trading of U.S. Treasury securities is based on the underlying transaction or notional amount rather than ''share'' amounts, the Exchange submits that this second criteria cannot strictly be applied to the U.S. Treasury Indexes. However, the Exchange believes that a comparison can be made if the monthly trading volumes identified in the broad-based criteria are converted to U.S. dollar amounts. In connection with the iShares Treasury Index ETFs the average daily transaction volume through the 3rd quarter of 2002 for primary dealers in the 1–3 Year Treasury security was approximately $132.07 billion; for the 3–6 Year Treasury security the average daily transaction volume for primary dealers was $92.73 billion; for the 6–11 Treasury security the average daily transaction volume was $74.8 billion; and for Treasury securities over 11 Years the average daily trading volume was approximately $18.9 billion. For comparison purposes, Microsoft Corporation (MSFT) which is a component in several broad-based Indexes underlying ETFs, would be required to have a minimum monthly trading dollar value of at least $13.25 million given the current price of MSFT of $53 per share on October 23, 2002 (250,000 × $53). Clearly, the monthly trading volumes for the U.S. Treasury securities of the Indexes underlying the three iShares Treasury Index ETFs far exceeds the comparative dollar amounts for the largest-capitalized components of the equity-based indexes under this second requirement of the broad-based criteria.

Third, under the broad-based criteria, a component security cannot exceed 25% of the weight of the Index and the five most heavily weighted component securities cannot exceed 65% of the weight of such Index. The Lehman 1–3 Year U.S. Treasury Index and the Lehman 20+ Year U.S. Treasury Index strictly comply with this requirement of the broad-based criteria applicable to equity-based ETFs. However, the Lehman 7–10 Year U.S. Treasury Index does not meet the 65% test for the top five (5) holdings of an Index. The broad-based criteria originally developed for equity-based ETFs does not correspond well to the U.S. Treasury securities market. The Exchange believes that the nature of the U.S. Treasury securities market, renders this third criteria particularly difficult to apply to certain U.S. Treasury indexes or portfolios because of the specific duration of the yield curve that the U.S. Treasury index or portfolio is attempting to track or benchmark. Furthermore, the Exchange submits that the only differences in these U.S. Treasury securities held by the corresponding indexes are related to the rate of interest and maturities. Accordingly, the Exchange believes that the market for U.S. Treasury securities, which is the most liquid market in the world, is not particularly susceptible to manipulation. The Exchange also notes that in connection with the sale and issue of U.S. Treasury bills, notes and bonds, the Department of the Treasury limits to 35% the amount that any one bidder may be awarded in any auction.[27]

In contrast, an index or portfolio of equity securities depends on several corporate issuers rather than the full faith and credit of the U.S. Government in the case of U.S. Treasury securities. As a result, the broad-based criteria includes a diversification requirement so that integrated market making and side-by-side trading would not be permitted if such Index underlying or ETF was dominated by one (1) or a few stocks. The Exchange submits that iShares Treasure Index ETFs do not have similar diversification concerns because the objective of each such ETF is to approximate the total return of their respective sector or duration of the U.S. Treasury market.

Fourth, the broad-based criteria requires an index or portfolio underlying an equity-based ETF to have at least 13 component securities. The Lehman 7–10 year U.S. Treasury Index currently contains 12 component securities, and therefore, fails this requirement of the broad-based criteria. The Exchange believes that because the Lehman 7–10 Year U.S. Treasury Index measures a specific duration of the U.S. Treasury securities market, the application of this fourth criteria is unnecessary here. For example, from the time of the launch of the 7–10 Year Bond Fund through September 30, 2002, the Index contained 13 component securities. The Exchange submits that slight modifications to the Index to better reflect the appropriate market should not determine whether integrated market making and side-by-side trading are permissible. Therefore, the Exchange believes that the Lehman 1–3 Year U.S. Treasury Index and the Lehman 20+ Year U.S. Treasury Index both strictly comply with this requirement of the broad-based criteria by containing 31 and 19 U.S. Treasury securities, respectively.

Fifth, the broad-based criteria requires that all securities in the portfolio be listed on a national securities exchange or the Nasdaq Stock Market. The Exchange contends that this requirement is inapplicable on its face to all iShares Treasury Index ETFs because the component securities of each related Index are not listed on a national securities exchange or traded through the Nasdaq Stock Market. As described above, U.S. Treasury securities are traded OTC through a network of designated primary dealers, non-primary dealers, financial institutions, non-financial institutions and individuals.

The Exchange further submits that the application of the broad-based criteria that was developed to ensure that equity-based ETFs are not susceptible to manipulation is not particularly useful in connection with this proposal for the integrated market making and side-by-side trading of ETFs based on U.S. Treasury Indexes. In particular, the Exchange contends that the nature of the U.S. Treasury securities market itself

[25] As of September 30, 2002, the Index exhibited the following characteristics: (1) Weighted average maturity of 24.18 years; (2) weighted average coupon of 6.30%; (3) an effective duration of 13.70 years; (4) yield to maturity of 5.14% and (5) a current yield of 5.45%. In addition, the top holding of the Index constituted 11% of the Index while the top five holdings represented 44% of the Index.

[26] *See supra,* note 12; *see also ETF Integrated Market Making Approval,* supra note 10.

[27] *See* 31 CFR 356.22; Department of the Treasury, Final Rules Relating to the Sale and Issue of Marketable Book-Entry Treasury Bills, Notes and Bonds, 58 FR 412 (January 5, 1993).

suggests that it is not susceptible to manipulation due to the tremendous liquidity and limits on the percentage ownership in any Treasury auction. As a result, the Exchange believes that the iShares Treasury Index ETFs are broad-based ETFs that represent a specific duration of the U.S. Treasury securities market as measured by the Lehman U.S. Treasury Indexes, and, therefore, such ETFs should be permitted to be part of an Integrated Market Making environment on the floor of the Exchange.

d. Integrated Market Making and Side-by-Side Trading

The Amex believes that integrated market making and side-by-side trading of ETFs and their related options is appropriate. The Exchange expects that the ability to engage in integrated market making and side-by-side trading of iShares Treasury Index ETFs would help to develop deeper, more liquid and efficient markets, as acknowledged by the Commission Staff's Special Study of the Options Markets.[28]

The Exchange believes that the Commission's conclusions and analysis set forth in the ETF Integrated Market Making Approval equally apply to the iShares Treasury Index ETFs and their related options. As the Exchange has previously asserted in connection with equity-based ETFs, the primary trading market will not enjoy perceived informational advantages that may be available in the case of individual stock options, because the pricing of an ETF is not based on the supply and demand of the ETF itself, but instead, on the prices of and information on the underlying portfolio of securities and other associated derivatives.

The Exchange believes that the proposed integrated market making and side-by-side trading for iShares Treasury Index ETFs will increase market quality and provide both price and operational efficiencies while not raising any significant issues of informational advantage.[29] In the case of ETFs, the Exchange submits that informational advantages are minimal because the pricing of ETFs are based almost entirely on the value of the underlying portfolio of securities and other associated derivatives with little if any price impact arising from the supply and demand for the ETF shares. Accordingly, knowledge of limit orders on the specialist's book for ETF shares does not provide an informational advantage to the specialist when pricing or trading ETF shares.

The Commission has previously stated that ''[t]he integration of trading in options and their underlying securities on an exchange floor may create opportunities to engage in manipulative and other improper trading activities that do not presently exist.''[30] In order for integrated market making and side-by-side trading in iShares Treasury Index ETFs and their related options to potentially create opportunities for the specialist and registered traders to engage in improper activity, market making in both the option and the underlying ETF must yield information that can be used in such an endeavor. With respect to shares of an iShares Treasury Index ETF and related options, the Exchange contends that neither the specialist nor the traders are privy to exclusive market information that is useful in pricing such shares. Like all market participants, they have access to last sale information for each of the component securities, the current quotes for the components and information for any other products that may be used in pricing the fund shares. Exchange specialists and traders are unlikely to obtain relevant information from the Exchange floor that is nor already known by other market participants and already factored into prices and quotes, especially since the Exchange does not list and trade the underlying U.S. Treasury securities of the ETFs. Moreover, showing the specialist's limit order book to the trading crowd substantially lessens these informational advantage concerns. Given the enhanced surveillance systems that monitor all trading floor activity today at the Amex, the Exchange submits that attempts to engage in improper conduct by a specialist or trader will be readily detected.

Among other reasons why limit orders in ETF shares such as the iShares Treasury Index Fund are not a source of informational advantage is the number of such shares issued and outstanding may be increased or decreased at a very low cost in response to changing demand for such shares. A defining characteristic of all Amex listed unit investment trusts and management investment companies that hold securities based on an index or a portfolio of securities is that they are open-ended.[31] New ETF shares in these products may be created on any business day in response to an offer to purchase such shares. As a result, the Exchange submits that there is substantially less potential for manipulation of an ETF share's price, because unlike a market in a thinly traded corporate stock, the market for an ETF share cannot be successfully squeezed or cornered. The Exchange contends that this is untrue because the potential supply of ETF shares is, for all practical purposes, unlimited.

The key point of this proposal is that the market for iShares Treasury Index ETFs is a derivative market of the underlying U.S. Treasury securities markets and that the options market is also a derivative of this underlying U.S. Treasury securities market. The Commission recognized the limitations of the information that specialists and market makers can obtain from the supply and demand in derivative products when it noted in the Options Study:

> * * * that even while unitary options specialists and competing options market makers have market information and competitive advantages of their own, the derivative nature of the options markets may strictly limit the significance of these advantages. Stated differently, because stock prices largely determine the prices of related options, market information concerning the supply of and demand for a stock may be substantially more valuable than information concerning supply and demand for options on the stock.[32]

Integrated market making and side-by-side trading in an ETF and its related options, even for an exchange that was the dominant market for the underlying ETF or option, is far less likely to yield significant non-public stock pricing information which would increase any competitive and market information advantages. Consequently, there is little likelihood that iShares Treasury Index ETFs and their related options order flow would provide a meaningful information advantage to the integrated specialist unit or the market makers in the trading crowd. Indeed, the Exchange expects that the specialist units and market makers for such integrated derivative securities markets would depend primarily upon publicly

[28] *See also* Report of the Special Study of the Options Markets to the Securities and Exchange Commission, H.R. Rep. No. IFC 3, 96th Cong. 1st sess. (Comm. Print 1978) (''Options Study'') at 878, *et. seq.*

[29] *See* Amex File Nos. 2001–75 and 98–23 (precursor to File No. 2001–75 withdrawn by the Amex on July 17, 2001).

[30] *See* Options Study, *supra* note 28 at 885.

[31] ETFs are registered under the 1940 Act either as unit investment trusts or open-end management investment companies. Each ETF continuously offers and redeems shares in large aggregation amounts (50,000 shares), called Creation Units, at a price established at the end of each business day based on the net asset value of its portfolio. The individual ETF shares are then listed and traded in a secondary trading market, such as the Amex.

[32] *See* Options Study, *supra* note 28 at 916, note 280.

disseminated quotation and transaction information from the U.S. Treasury securities market when making pricing decisions.[33]

Integrated market making in two related derivatives is not unprecedented. Exchange specialist units and market makers have long made integrated markets in stock options bearing differing strike prices and expirations which are separate but closely linked derivative securities markets. In 1985, the Commission approved an NASD proposal for fully integrated market making in stock options and their underlying stock.[34]

The Exchange contends that integrated market making in derivative products does not entail a materially increased potential for price manipulation or other improper trading practices. The Exchange believes that the primary importance of underlying securities market prices and the arbitrage opportunities of other traders provides natural safeguards against this type of activity. Further, such abuses are unlikely to occur due to the limited influence of derivative markets on the underlying securities price. To the extent that any risk remains, the Exchange believes that it is better addressed by surveillance rather than a restriction that threatens liquidity. The Exchange also notes that the Commission previously approved integrated market making and side-by-side trading of related derivative products.[35] The Exchange submits that the analysis and rationale set forth by the Commission in these orders is equally applicable to this Proposal.

Additionally, the Commission has expressed concern that the integration of trading in options and their underlying securities may increase the difficulty of detecting improper trading practices on an exchange floor.[36] The Exchange notes that it currently has in place safeguards to detect and prevent potential abuses or manipulative activities. The Exchange believes that its market surveillance program will mitigate any regulatory risks that arise from integrated market making and side-by-side trading of iShare Treasury Index ETFs. Furthermore, the Commission found that the NASD's surveillance procedures sufficient to address the regulatory concerns raised by the NASD's 1985 side-by-side trading program for Nasdaq listed stocks and options.[37] The advances in developing comprehensive audit trails for options will give us the ability to provide considerably enhanced surveillance oversight compared to the capabilities available in 1985. Accordingly, the Exchange believes its existing surveillance procedures are sufficient to detect any improper trading activity, deter potential manipulative or improper trading activity and minimize the regulatory risks of integrated market making and side-by-side trading. In sum, the Exchange conducts regular surveillance to detect any abuses or attempted manipulations to ensure compliance with its safeguards. The Exchange believes that the proximity of trading activity in related options products will increase the effectiveness of these safeguards.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act,[38] in general, and furthers the objectives of section 6(b)(5) of the Act,[39] in particular, in that it is designed to prevent fraudulent an manipulative practices, promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments and perfect the mechanisms of a free and open market and the national market system, protect investors and the public interest and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers.

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

The Exchange does not believe that the proposed rule change, as amended, will impose any 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 solicited or received with respect to 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 Exchange 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. 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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–Amex-2002–96 and should be submitted by January 17, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[40]

J. Lynn Taylor,

Assistant Secretary.

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[33] *See* Options Study, *supra* note 28 at 906.

[34] *See* Securities Exchange Act Release No. 22026 (May 8, 1985), 50 FR 20310 (May 15, 1985).

[35] *See* Securities Exchange Act Release No. 27383 (October 26, 1989), 54 FR 45846 (October 31, 1989) (Order approving a CBOE proposal to list and trade market basket contracts based on the S&P 100 and S&P 500 at trading posts adjacent to the related index options). *See also* ETF Integrated Market Making Approval, *supra* note 10.

[36] *See* Options Study, *supra* note 28 at 896.

[37] *See* Securities Exchange Act Release Nos. 22439 (September 20, 1985), 50 FR 39191 (September 27, 1985). In the ''Conclusions'' section of the Release, the Commission stated:

For the reasons stated in the OTC Options Release, the Commission continues to believe that side-by-side market making in the six pilot stocks should offer substantial market benefits and, with equity and options audit trails in place, also should reduce to surveillable levels the regulatory concerns raised by side by side market making. The Commission also does not believe that the inclusion of exchange specialists and market makers does not appear to create any additional or unique regulatory problems and provides all relevant markets a fair competitive opportunity.

[38] 15 U.S.C. 78f(b).

[39] 15 U.S.C. 78f(b)(5).

[40] 17 CFR 200.30–3(a)(12).