

systems.¹⁰ The Commission believes that the compliance thresholds proposed in this letter provide a reasonable first step and should assist the Exchange in disciplining its members for violations of the Exchange's order handling rules. The Commission expects, however, that as compliance rates improve, the Exchange will adjust the compliance thresholds accordingly. Consequently, the Commission's approval of the proposed rule change is contingent on the Exchange providing notice to the Commission's Office of Compliance Inspections and Examinations of any future changes to this letter, and to any other sanctioning guidelines not codified in the Exchange's rules.

At this time, the Commission believes the proposed sanctioning guidelines are reasonably designed to effectively enforce compliance with the options order handling rules. Nevertheless, the Commission expects the Exchange to continue to evaluate the adequacy of the proposed sanctioning guidelines to determine whether they do, in fact, effectively enforce compliance with the options order handling rules.¹¹

Furthermore, the Commission finds good cause for accelerating approval of the proposed rule change and Amendment No. 1 thereto prior to the thirtieth day after publication in the **Federal Register**. The Commission notes that the proposed rule change was noticed for the full comment period and the Commission is accelerating approval of the filing on the twenty-ninth day after publication of the proposed rule change in the **Federal Register**. The Commission believes that accelerated approval will permit the Exchange to implement, and investors to benefit from, the proposed rule change without undue delay. Amendment No. 1 clarifies when the Exchange may aggregate multiple violations and when subsequent offenses would be referred to the Exchange's BCC and not treated under the Exchange's MRP. Amendment No. 1 also clarifies that the Exchange may aggregate multiple violations into a single offense only where such aggregation is based upon a comprehensive automated surveillance program. In addition, the Commission notes that it received no comments on the proposed rule change. For these reasons, the Commission finds good cause exists, consistent with sections

6(b)(5)¹² and 19(b)(2) of the Act,¹³ to approve the proposed rule change and Amendment No. 1 thereto on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether Amendment No. 1 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 filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to file number SR-CBOE-2001-71 and should be submitted by April 12, 2002.

V. Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-CBOE-2001-71) and Amendment No. 1 thereto are approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45577; File No. SR-CBOE-2001-64]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange Inc. Relating to AutoQuote Parameters

March 15, 2002.

I. Introduction

On December 17, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to the Exchange's AutoQuote System. The **Federal Register** published the proposed rule change for comment on February 12, 2002.³ The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of Proposal

The CBOE submitted the proposed change to Interpretation and Policy .07 to CBOE Rule 8.7 pursuant to subparagraph IV.B.j of the Commission's September 11, 2000 Order,⁴ which requires in part that certain options exchanges, including the CBOE, adopt new, or amend existing, rules to make express any practice or procedure "whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class * * *." The proposed amendment to Interpretation and Policy .07 to CBOE Rule 8.7 would permit market makers to coordinate in setting the components of the formula used by an automated quotation updating system, or AutoQuote.⁵

AutoQuote is the Exchange's electronic quotation system that

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Securities Exchange Act Release No. 45394 (February 5, 2002), 67 FR 6556.

⁴ See Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000).

⁵ For purposes of this filing and the proposed interpretation, the term AutoQuote is used to refer to both the Exchange's own automatic quotation system that is offered to trading crowds to generate quotes and to proprietary automated quotation updating systems that are used by trading crowds, DPMs, LMMs, SMMs, or appointed market-makers to generate quotes in lieu of or in addition to the Exchange's own AutoQuote system.

¹⁰ See *supra* note 6.

¹¹ The Commission's examination staff will also monitor the application of these guidelines to determine whether they do, in fact, improve member compliance with the options order handling rules.

¹² 15 U.S.C. 78f(b)(5).

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).

automatically monitors and updates market quotations using a mathematical formula measuring certain characteristics of the option and the underlying interest. According to the Exchange, AutoQuote provides a means to update the quotes for the tens of thousands of series the Exchange lists.⁶ AutoQuote formulas require the selection and input of the following components or variables: an option pricing calculation model, volatility, interest rate, dividend, and the measure used to represent the value of the underlying.

The proposed amendment to Interpretation and Policy .07 to CBOE Rule 8.7 would set forth a more thorough description of AutoQuote. The proposed rule change also would identify who has responsibility under Exchange rules to determine a formula for generating automatically updated market quotations. For classes of options in which a DPM is appointed, the DPM would have primary responsibility to determine the formula, which includes determining the components or variables used in the AutoQuote formula.⁷ For classes of options in which an LMM or SMM is appointed, such as the S&P 100 option class ("OEX"), the LMM or SMM would have primary responsibility to determine the formula for generating automatically updated market quotations.⁸ For classes of options in which a DPM, LMM, or SMM has not been appointed, the appropriate Exchange Committee would be permitted to appoint one or more market makers in good standing with an appointment in the particular option class ("Appointed Market-Makers") to determine a formula for generating automatically updated market quotations, using the Exchange's

AutoQuote system or a proprietary automated quotation updating system.

Although DPMs, LMMs, SMMs, and Appointed Market-Makers would have the responsibility for determining the formula for generating automatically updated market quotations, the proposed amendment to Interpretation and Policy .07 expressly would provide that the DPM, LMM, SMM, or Appointed Market-Maker may, but is not required to, consult with and/or agree with other market makers in the trading crowd in setting the components or variables of the formula. However, members of the trading crowd would not be required to provide input to the DPM, LMM, SMM, or Appointed Market-Maker about these decisions and the decision is ultimately that of the DPM, LMM, SMM or Appointed Market-Maker in the particular class.

For classes of options in which a DPM, LMM, SMM or Appointed Market-Maker does not have the responsibility to determine a formula for generating automatically updated market quotations, the market makers would be permitted to coordinate and agree upon the variables for the AutoQuote formula. In some trading crowds, one or a few market makers may take responsibility (with the crowd's approval) for updating the AutoQuote variables without seeking input on a continual basis. The CBOE believes that such market maker coordination is necessary and appropriate because an AutoQuote system is centralized and applicable to all market participants. Thus, the obligations resulting from the quotes generated by AutoQuote, such as the firm quote obligation, are imposed on the crowd as a whole.⁹ Moreover, although AutoQuote is essential to ensure that quotes are updated on the numerous series traded by the Exchange on a timely basis, individual market makers can and do compete among each other to gain a larger share of orders by verbalizing quotes that improve the AutoQuote generated quotes. These verbalized quotes by market makers override the AutoQuote generated quotes for the particular series that is the subject of the verbalized quote.

Finally, the proposed amendment to Interpretation .07 would provide that

the provisions described above and set forth in the proposed amendment to Interpretation .07 would also apply to the use of automated quotation updating systems that generate indicative prices that are indications of interest and not firm quotes.¹⁰

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹¹ Specifically, the Commission believes that the proposed rule change is consistent with the Section 6(b)(8)¹² requirement that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The Commission believes that the proposed rule change should deter collective action, except as authorized by the Exchange's rules, by clearly establishing in the Exchange's rules the responsibilities of, and conduct permitted by, Exchange members in setting AutoQuote parameters. For instance, the proposal would permit the DPM, LMM, or SMM, or Appointed Market-Maker, as applicable, to receive input from members of the crowd in setting the parameters of the formula used to automatically update options quotations. At this time, the Commission believes it is reasonable for the Exchange's rules to permit the members of the crowd to be given a voice in setting autoquote parameters because, pursuant to the Exchange's rules, they will be obligated to execute orders at the resultant quote. In addition, the proposal codifies a more complete description of AutoQuote, which the Commission believes should protect investors and the public interest by providing important information regarding how options prices on the Exchange are derived. Moreover, the Commission notes that individual market makers can compete among each other to gain a larger share of orders and override the AutoQuote generated quotes by verbalizing quotes that improve the AutoQuote generated

⁶ Although the Exchange believes that AutoQuote is necessary, the Exchange notes that individual market makers can and do manually improve the quote themselves in order to gain a larger share of orders than competing market makers. In these instances, the manual quote overrides the AutoQuote for that particular series.

⁷ See CBOE Rule 8.85(a)(x).

⁸ On December 17, 2001, the CBOE filed SR-CBOE-2001-63 which amends CBOE Rule 8.15 to make explicit in the rule that the appropriate Market performance Committee ("MPC") may appoint LMMs and SMMs to determine a formula for generating automatically updated market quotations and use the Exchange's AutoQuote system or a proprietary automated quotation updating system to update market quotations during the trading day in an options class for which a DPM has not been appointed. See Securities Exchange Act Release No. 45419 (February 7, 2002), 67 FR 6772 (February 13, 2002). The Commission is approving SR-CBOE-2001-63 simultaneously with the proposed rule change.

⁹ CBOE has always used, and the applicable CBOE rules envision, a centralized autoquote system. Although it may be technologically feasible at some point in the future to have a system that would permit each individual market-maker to have his or her own automatic quote updating capability (and although CBOE may eventually develop such a model), CBOE believes that its centralized autoquote system is essential to preserving CBOE's current model of a floor-based, open-outcry market that includes joint crowd obligations pursuant to rules that have been approved by the Commission.

¹⁰ Interpretation and Policy .10 to CBOE Rule 8.7 provides that "[m]arket-makers may display indicative spread prices on the websites of member organizations through a system licensed from a third party, developed by the Exchange or otherwise. Such indicative prices shall not be regarded as firm quotes, and a market-maker shall not be obligated to execute at the indicative prices spread orders that are entered into the market."

¹¹ In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(8).

quotes, which should limit any anticompetitive effects of the proposed rule change.

The Commission notes that in its filing, the Exchange states its belief that the proposed rule change is "procompetitive" because it is necessary to provide for a fair and orderly market in the thousands of options series traded on the Exchange. While the Commission does not agree that the proposed rule change enhances competition, the Commission finds that the burden that the proposal imposes on competition is appropriate in furtherance of the purposes of the Act and, thus, is not inconsistent with the Act.¹³ Finally, the Commission finds that the proposed rule change is designed to effectively limit the circumstances in which collective action is permissible.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-CBOE-2001-64) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45585; File No. SR-CHX-2002-06]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Confirming Changes Arising From the Securities Industry Transition to a Decimal Pricing Environment

March 18, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on March 1, 2002, the Chicago Stock Exchange, Incorporated ("CHX" 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 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

In this submission, the Exchange proposes to confirm the amendment of certain CHX rules that were impacted by the securities industry transition to a decimal pricing environment. The text of the proposed rule change is available at the Commission and at the CHX.

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 its proposal and discussed any comments it received regarding the proposal. 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, the Proposed Rule Change

1. Purpose

The Exchange proposes to confirm its amendment of certain CHX rules that were impacted by the securities industry transition to a decimal pricing environment. The amendments described in this submission consist of changes that: (1) Confirm that the Exchange's minimum trading variation is \$.01; (2) delete references to the procedures and conventions that were used during the conversion from quoting in fractions to quoting in decimals; and (3) remove all fractional price increments set forth in the current version of certain CHX rules.

Minimum Price Variation. The Exchange's rules currently state that all issues quoting in decimals will quote in increments of \$.01 or any other variation required by the joint decimalization implementation plan filed with the Commission. This submission confirms the \$.01 quoting increment and deletes references to the joint decimalization plan.

Removing references to the conversion from fractional to decimal pricing. Article XXB of the Exchange's Rules

currently contains rules relating to the transition from a fractional pricing environment to one based on decimals. Now that this process has been completed, the Exchange believes it is appropriate to formally remove this Article from its rules.

Removing other fractional references. The remaining text contained in this submission removes fractional references in other Exchange rules.

None of the changes proposed in this submission effect any substantive change in the CHX rules or the operations of the Exchange. Instead, this submission confirms that the rules that the Exchange put in place as it began its transition to quoting in decimals continue to govern its operations.³

2. Statutory Basis

The Exchange believes 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 exchange and, in particular, with the requirements of Section 6(b).⁴ In particular, the proposed rule change is consistent with section 6(b)(5) of the Act⁵ in that it is designed to promote just and equitable principles of trade, to remove impediments and to 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 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.

³ These changes were included in a rule change proposal submitted pursuant to section 19(b)(3)(A) of the Act, which took effect upon filing. See Securities Exchange Act Release No. 43256 (September 6, 2000), 65 FR 55659 (September 14, 2000) (SR-CHX-00-25). That proposal contained language that sought to remove fractional references automatically once the transition to decimal trading had been completed. In addition to confirming the Exchange's minimum trading increment, this submission recognizes that that automatic removal was not an available alternative and formally removes the fractional references from the Exchange's rules.

⁴ 15 U.S.C. 78(f)(b).

⁵ 15 U.S.C. 78(f)(b)(5).

¹³ The Commission expects the Exchange to monitor the collective actions that are undertaken pursuant to the rule change approved herein for any undesirable or inappropriate anticompetitive effects. The Commission's examination staff will monitor the Exchange's efforts in this regard.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.