

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 parts of such statements.

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

1. Purpose

The purpose of the proposed rule change is to waive all public customer fees for XEO through October 31, 2001.<sup>4</sup> These fee waivers will be in effect beginning with the launch of trading in XEO on July 23, 2001.

Specifically, the Exchange proposes to waive the transaction fee, trade match fee, floor brokerage fee, and Retail Automatic Execution Systems ("RAES") fee for public customer XEO orders. The Exchange has decided to waive these fees through October 31, 2001, to promote the launch of the XEO product. The Exchange believes these fee waivers will serve to make XEO competitive with competing products at other exchanges while generating significant saving for its customers.<sup>5</sup>

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>6</sup> in general, and furthers the objectives of Section 6(b)(4) of the Act<sup>7</sup> in particular, in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other charges among CBOE members.

*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 Exchange Act.

<sup>4</sup> These public customer fees are fees assessed on CBOE members relating to public customer XEO orders executed by CBOE members. Telephone conversation between Chris Hill, Attorney II, CBOE, and Yvonne Fraticelli, Special Counsel, Division of Market Regulation, Commission, on July 30, 2001.

<sup>5</sup> The Commission notes that this fee waiver is similar to that granted for reduced-value Nasdaq 100 Index ("NMX") options. Securities Exchange Act Release No. 43221 (August 29, 2000), 65 FR 54333 (notice of filing and immediate effectiveness of File No. SR-CBOE-00-39).

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(4).

*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**

Because the foregoing proposed rule change establishes or changes a due, fee, or other charge imposed by the Exchange, the proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>8</sup> and Rule 19b-4(f)(2)<sup>9</sup> thereunder.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**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. 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 No. SR-CBOE-2001-42 and should be submitted by September 4, 2001.

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>9</sup> 17 CFR 240.19b-4(f)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**  
*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-44659; File No. SR-ISE-2001-18]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the International Securities Exchange LLC, Relating to Priority Principles on Complex Orders**

August 6, 2001.

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 May 25, 2001, the International Securities Exchange LLC ("ISE" 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 ISE. On July 11, 2001, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> On July 24, 2001, the Exchange filed Amendment No. 2 to the proposed rule change.<sup>4</sup> On August 2, 2001, the Exchange filed Amendment No. 3 to the proposed rule change.<sup>5</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>10</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.

<sup>3</sup> Amendment No. 1 expanded upon the discussion contained in the purpose section of the filing, corrected various typographical errors, and added a one-year sunset to the proposed rule that the Exchange inadvertently omitted in its original filing. See letter from Jennifer M. Lamie, Assistant General Counsel, ISE to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated July 10, 2001.

<sup>4</sup> Amendment No. 2 made a technical change to the text of the one-year sunset provision of the proposed rule change. See letter from Jennifer M. Lamie, Assistant General Counsel, ISE to Nancy Sanow, Assistant Director, Division, Commission, dated July 23, 2001.

<sup>5</sup> In Amendment No. 3, the Exchange added text to the proposed rules relating to stock-option orders, and the effect of price increments on order priority. The Exchange also amended the purpose section of the filing by adding a further description of the operation of the proposed allocation procedures. See letter from Jennifer M. Lamie, Assistant General Counsel, ISE to Nancy Sanow, Assistant Director, Division, Commission, dated August 2, 2001.

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

The Exchange is proposing to adopt Rule 722 (Complex Orders) to establish priority and order handling principles for complex orders, such as spreads, straddles, and other multi-legged transactions, similar to other options exchanges. Below is the text of the proposed rule change. Proposed new language is in *italics*. Proposed deletions are in [brackets].

\* \* \* \* \*

### Rule 722. Complex Orders

(a) *Complex Orders Defined.* A complex order is any order for the same account as defined below:

(1) *Spread Order.* A spread order is an order to buy a stated number of option contracts and to sell the same number of option contracts, of the same class of options.

(2) *Straddle Order.* A straddle order is an order to buy (sell) a number of call option contracts and the same number of put option contracts on the same underlying security which contracts have the same exercise price and expiration date (e.g., an order to buy two XYZ July 50 calls and to buy two XYZ July 50 puts).

(3) *Strangle Order.* A strangle order is an order to buy (sell) a number of call option contracts and the same number of put option contracts in the same underlying security, which contracts have the same expiration date (e.g., an order to buy two ABC June 40 calls and to buy two ABC June 35 puts).

(4) *Combination Order.* A combination order is an order involving a number of call option contracts and the same number of put option contracts in the same underlying security and representing the same number of shares at option.

(5) *Stock-Option Order.* A stock-option order is an order to buy or sell a stated number of units of an underlying stock or a security convertible into the underlying stock ("convertible security") coupled with either (i) the purchase or sale of option contract(s) on the opposite side of the market representing either the same number of units of the underlying stock or convertible security or the number of units of the underlying stock necessary to create a delta neutral position; or (ii) the purchase or sale of an equal number of put and call option contracts, each having the same exercise price, expiration date, and each representing the same number of units of stock, as and on the opposite side of the market

from, the stock or convertible security portion of the order.

(6) *Ration Order.* A spread, straddle or combination order may consist of a different number of contracts, so long as the number of contracts differs by a permissible ratio. For purposes of this paragraph, a permissible ratio of contracts is any of the following: one-to-one, one-to-two and two-to-three.

(7) *Butterfly Spread Order.* A butterfly spread order is an order involving three series of either put or call options all having the same underlying security and time of expiration and, based on the same current underlying value, where the interval between the exercise price of each series is equal, which orders are structured as either (i) a "long butterfly spread" in which two short options in the same series offset by one long option with a higher exercise price and one long option with a lower exercise price or (ii) a "short butterfly spread" in which two long options in the same series are offset by one short option with a higher exercise price and one short option with a lower exercise price.

(8) *Box Spread Order.* A box spread order is an order involving (a) a long call option and a short put option with the same exercise price, coupled with (b) a long put option and a short call option with the same exercise price; all of which have the same underlying security and time of expiration.

(9) *Collar Order.* A collar order is an order involving the sale of a call option coupled with the purchase of a put option in equivalent units of the same underlying security having a lower exercise price than, and same expiration dates as, the sold call option.

(b) *Applicability of Exchange Rules.* Except as otherwise provided in this Rule, complex orders shall be subject to all other Exchange Rules that pertain to orders generally.

(1) *Minimum Increments.* Bids and offers on complex orders may be expressed in any decimal price regardless of the minimum increments otherwise appropriate to the individual legs of the order. Complex orders expressed in net price increments that are not multiples of the minimum increment are not entitled to the same priority under subparagraph (b)(2) of this Rule as such orders expressed in increments that are multiples of the minimum increment.

(2) *Complex Order Priority.* Notwithstanding the provisions of Rule 713, a complex order, as defined in paragraph (a) of this Rule, may be executed at a total credit or debit price with one other member without giving priority to bids or offers established in

the marketplace that are no better than the bids or offers comprising such total credit or debit; provided, however, that if any of the bids or offers established in the marketplace consist of a Public Customer limit order, the price of at least one leg of the complex order must trade at a price that is better than the corresponding bid or offer in the marketplace. Under the circumstances described above, the option leg of a stock-option order, as defined in subparagraph (a)(5)(i) of this Rule, has priority over bids and offers established in the marketplace by Non-Customer orders and market maker quotes that are no better than the price of the options leg, but not over such bids and offers established by Public Customer Orders. The option legs of a stock-option order as defined in subparagraph (a)(5)(ii), consisting of a combination order with stock, may be executed in accordance with the first sentence of this subparagraph (b)(2).

(3) *Execution of Orders.* Complex orders will be executed without consideration of any prices that might be available on other exchanges trading the same options contracts.

(4) *Types of Complex Orders.* Complex orders may be entered as fill-or-kill or immediate-or-cancel orders, as defined in Rule 715(b), or as all-of-none orders, which are resting limit orders to be executed in their entirety or not all.

(5) *Limitations on Complex Orders.*

(i) A member may execute as principal up to forty percent (40%) of an order it represents as agent without complying with the thirty (30) second exposure requirement contained in Rule 717(d).

(ii) A member may execute up to forty percent (40%) of an order it represents as agent against an order solicited from a Member and non-member broker-dealer to transact with such order without complying with the thirty (3) second exposure requirement contained in Rule 717(e).

(iii) The restrictions on order entry contained in paragraphs (f) and

(h) of Rule 717 shall not apply to complex orders.

### Supplementary Material to Rule 722

.01 This Rule 722 will be in effect until [INSERT DATE ONE YEAR FROM COMMISSION APPROVAL OF SR-ISE-2001-18].

### Rule 805. Market Maker Orders

(a) *Options Classes to Which Appointed.* Market makers may not place principal orders to buy or sell options in the options classes to which they are appointed under Rule 802, other than immediate-or-cancel orders,

complex and block-size orders executed through the Block Order Mechanism pursuant to Rule 716(c). Competitive Market Makers shall comply with the provisions of Rule 804(e)(2)(ii) upon the entry of such orders if they were not previously quoting in the series.

(b) Options Classes Other Than Those to Which Appointed.

(1)—A market maker may enter *all order types permitted to be entered by non-customer participants under the Rules* [limit orders, and immediate-or-cancel orders] to buy or sell options in classes of options listed on the Exchange to which the market maker is not appointed under Rule 802, provided that:

\* \* \* \* \*

## 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 ISE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments in received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The ISE has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

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

#### 1. Purpose

Currently, Exchange members wishing to execute complex orders, such as spreads, straddles and other multi-legged transactions, must enter at least two separate orders into the trading system. As a result, the member is at risk in that one part of the order may be filled, while the remainder goes unexecuted. ISE is therefore developing system functionality to permit more efficient and effective execution of certain defined multi-legged orders through entry of a single complex order. The purpose of this proposed rule change is to prescribe the priority and order handling principles that will apply to such complex orders when priced on the basis of a total credit or debit ("net price"). The Exchange believes that these rule changes will facilitate the orderly execution of complex orders in our electronic trading environment.

To qualify for special priority and order handling treatment, complex orders must meet the requirements of proposed Rule 722. As defined in

paragraph (a), orders included within the definition of complex orders are orders entered for the same account which are spread orders, straddle orders, strangle orders, combination orders, stock-option orders, ratio orders, butterfly spread orders, box spread orders and collar orders. When meeting the definitional criteria and entered as a net price, these defined orders will be considered complex orders and will be accorded priority over the displayed bids and offers of members, other broker-dealers and Public Customers on the ISE at the same price if the conditions specified in paragraph (b) of the proposed rule are met.

Paragraph (b) of the rule provides that the legs of a complex order may not be executed at prices inferior to the displayed best bids and offers available in the ISE market. It further provides that a complex order entered at a net price may be executed with one other member without yielding priority to the displayed bids or offers of members and other broker-dealers established in the ISE market provided that the bids and offers comprising the net price of the complex order are the same as or better than the displayed bids or offers. If the displayed bids or offers established in the ISE market consist of a Public Customer Order, the price of at least one leg of the complex order must trade at a price better than the corresponding best bid or offer established in the ISE marketplace. As such, the proposal provides that complex orders entered at a net price have priority over the displayed bids and offers of members and other broker-dealers, but not over Public Customers.<sup>6</sup> The Exchange believes that this approach affords greater protection to Public Customers since one leg of the complex order must at least trade at a better price than the displayed market (while all remaining

<sup>6</sup> This approach of permitting a complex order entered at a net price to take priority over Public Customer orders only when at least one leg of the transaction trades at a better price and the remaining legs at a price at least equivalent to the established market, and over the displayed bids and offers of members and other broker-dealers when all legs of the complex order trade at a price at least equivalent to the displayed market, is similar to that adopted by the Chicago Board Options Exchange ("CBOE"). See CBOE Rule 6.45. By comparison, the American and Philadelphia Stock Exchanges ("Amex" and "Phlx," respectively) appear to require that at least one leg of a complex order trade at a better price to take priority over bids and offers established by both Public Customers and members; whereas, the Pacific Exchange ("PCX") appears to merely require that a complex order trade (other than stock-option orders) at a price at least equivalent to the displayed market to take priority over bids and offers established by both Public Customers and members. See Amex Rule 950(d), Commentary .01, Phlx Rule 1033 and PCX Rule 6.75.

legs must still at least touch the other bids or offers in the displayed market) before a Public Customer will lose priority. In addition, because the proposed rule requires that one member must represent all legs of the trade and that the trade may only be executed against one other member at a net debit or credit, Public Customers are still less likely to lose priority to complex orders. The Exchange believes that this approach is a reasonable effort to accommodate the ability to price complex orders more competitively while at the same time not disadvantaging Public Customers.

The proposed rule specifies that the net price of a complex order may be expressed in any decimal price, regardless of the minimum increments otherwise applicable to the individual legs of the complex order. It also states that complex orders may be entered as fill-or-kill, immediate-or-cancel, or all-or-none. Further, complex orders are not subject to the restrictions on order entry pertaining to the electronic generation of orders and multiple orders for the same beneficial account contained in rule 717(f) and (h).<sup>7</sup> The proposal further provides that the legs comprising a complex order receive neither time-price priority nor away market price protection.<sup>8</sup>

In proposing these complex order provisions, the Exchange also proposes to allow a firm to execute immediately up to forty percent (40%) of a complex order, either as principal or against an order it has solicited, as opposed to applying the 30 second exposure rule that currently applies to orders in the "regular" market under paragraphs (d) and (e) of Rule 717. A firm would still be required to expose the remaining sixty percent (60%) of the complex order for 30 seconds.

The exposure of limit orders required by paragraphs (d) and (e) does not affect the execution price of the orders. Rather, this exposure gives the crowd an opportunity to participate in the execution of the orders before the entering member may trade against the orders as principal. The Exchange is

<sup>7</sup> The risks to market maker quotations that the restrictions contained in paragraphs (f) and (h) of Rule 717 are designed to protect against (i.e., protection against rapid entry of electronic orders and multiple order entry, respectively) are not apparent with respect to complex order entry as such orders do not receive automatic executions.

<sup>8</sup> In connection with establishing an intermarket linkage between the options exchanges, the ISE and other options exchanges are developing rules on which types of orders are and are not subject to trade through protection. When these linkage rules are adopted, ISE will if necessary amend its complex order rule to be consistent with the provisions developed under the intermarket linkage plan.

proposing to permit a member to execute up to 40% of a complex order (which is a limit order by definition because it must be entered with a total debit or credit price) as principal immediately because the Exchange's Facilitation Mechanism contained in Rule 716(d), which guarantees a facilitating firm an execution of at least forty percent (40%) of the original size of a facilitation order in the "regular" market, will not be available for complex orders. Under the proposal, a member that wants to facilitate a complex order will be permitted to enter a proprietary counter-order to trade against up to forty percent (40%) of the initial complex order size prior to the expiration of 30 seconds. Thus, the trading crowd will be given an opportunity to participate in the execution of at least 60% of each complex order. Any portion of an order that remains unexecuted after 30 seconds may be executed by the member by entering another proprietary order.

The Exchange believes that the proposed rule changes strike an appropriate balance because they will not permit trades at prices inferior to the displayed bids and offers available in the ISE market, while providing the added protection that a complex order will not trade ahead of Public Customer orders at the same price unless the net price is better than what is available in the market. In those circumstances where an order meets the criteria contained in proposed Rule 722, the Exchange believes it is fair to give complex orders entered at a net price the prescribed special priority and order handling treatment.

This proposal permits ISE members to execute orders in a manner that is similar to how such orders are executed on the floor-based exchanges today. The Exchange proposes to adopt these rules for one year only, while the Exchange develops technology that might improve upon the existing execution practices of the industry today. The Exchange will file a new proposal with the Commission prior to the expiration of the rule.

Finally, the Exchange is proposing to amend Rule 805 (Market Maker Orders) to permit the entry of complex orders by market makers. In lieu of individually listing the types of orders that a market maker is permitted to enter outside of its appointed classes, the Exchange also proposes to amend the language in paragraph (b) of Rule 805 to clarify that market makers can enter any type of order outside their assigned classes that other non-customers are permitted to

enter as all such order types were listed in the rule.

## 2. Statutory Basis

The basis under the act for this proposed rule change is the requirement under Section 6(b)(5)<sup>9</sup> that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, and, in general, to protect investors and the public interest.

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

The proposed rule change does not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Exchange Act.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

## 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.

### **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. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 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 ISE. All submissions should refer to File No. SR-ISE-2001-18 and should be submitted by September 4, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## **SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34-44651; File No. SR-NASD-2001-38]**

### **Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1 and 2 Thereto Filed by the National Association of Securities Dealers, Inc. Relating to the Listing of Additional Shares**

August 3, 2001.

## **I. Introduction**

On May 29, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), 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 relating to the listing of additional shares. The **Federal Register** published the proposed rule change for comment on July 2, 2001.<sup>3</sup> Nasdaq submitted

<sup>10</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.

<sup>3</sup> Securities Exchange Act Release No. 44467 (June 22, 2001), 66 FR 34973.

<sup>9</sup> 15 U.S.C. 78f(b)(5).