including Amendment No. 3, in approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43517; File No. SR–CBOE–99–51]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 by the Chicago Board Options Exchange, Inc. Relating to the Maximum Size of Option Orders Eligible for Automatic Execution

November 3, 2000.

I. Introduction

On September 1, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 amending its rules regarding the automatic execution of options orders to increase the maximum number of contracts eligible to be executed on the Exchange's Retail Automatic Execution System ("RAES") from fifty contracts to seventy-five contracts. Notice of the proposal was published in the **Federal Register** on June 21, 2000.[3] The Commission received no comments on the proposal. On October 3, 2000, the Exchange submitted Amendment No. 1 to the proposal.[4] This order approves the proposal and grants accelerated approval of Amendment No. 1.

II. Description of the Proposal

RAES automatically executes public customer market and marketable limit orders that fall within designated order size parameters. Generally, the maximum size of public customer market and marketable limit orders

eligible for automatic execution through the RAES is fifty contracts.[5] The Exchange proposes to increase from fifty contracts to seventy-five contracts the maximum size of orders for equity options and certain classes of index options that are eligible to be executed through RAES.[6] In addition, the Exchange seeks to make certain complementary changes to the Exchange's firm quote rule and Interpretation .03 thereunder.[7]

The Exchange notes that increasing the maximum size of orders eligible for execution through RAES to seventy-five contracts will not permit orders up to this size to be entered into RAES unless, for a particular options class, the appropriate Floor Procedure Committee ("FPC") of the Exchange has determined, in its discretion, not to restrict the size of eligible orders in that options class.[8] In addition, the Exchange represents that increasing automatic execution levels should provide the benefits of automatic execution to a larger number of customer orders. Further, the Exchange represents that RAES affords prompt and efficient executions at the CBOE displayed price or, in most cases, at the National Best Bid or Offer ("NBBO") if the NBBO is better than the CBOE's displayed bid or offer.[9]

The Exchange notes that its rules contain several safeguards to ensure the proper handling of RAES orders, even as the maximum order size is increased. First, the Commission has approved the implementation of variable RAES on the CBOE.[10] Variable RAES allows market makers to specify the maximum size of orders that they are willing to trade at any one time on RAES; however, this determination is subject to a minimum size that may be established by the appropriate FPC. Variable RAES was proposed to ensure that market makers are willing to continue participating on RAES even as the maximum contract

size is increased. The Exchange represents that the appropriate FPC will likely implement Variable RAES in any options class that has a contract limit of seventy-five contracts to ensure that there is adequate market-maker participation in that class.

Second, the Exchange requires Designated Primary Market-Makers ("DPMs") to participate in any automated execution system which may be open in appointed option classes.[11] Further, Interpretation .07 to CBOE Rule 8.7 states that market makers are expected to participate in and support Exchange-sponsored automated programs, including but not limited to, RAES. The Exchange is in the process of assigning a large percentage of its option classes that were formerly traded in market-maker crowds to DPMs.[12]

Third, the Exchange's rules allow for RAES to be suspended when a fast market has been declared in order to maintain a fair and orderly market.[13] CBOE Rule 6.6(b)(vi) provides the Exchange with the flexibility to intervene if it determines that there is inadequate market maker participation or capital requirements. In addition, CBOE Rule 8.16(b) requires a market maker who has logged onto RAES at any time during an expiration month to log onto RAES in that option class whenever he is present in the trading crowd until the next expiration. Further, CBOE Rule 8.16(c) provides that Floor Officials of the appropriate Market Performance Committee may require market makers who are members of the trading crowd to log on to RAES absent reasonable justification or excuse for nonparticipation if there is inadequate participation on RAES. Alternatively, the Floor Officials may allow market makers in other classes of options to log on to RAES in such classes.

Finally, the Exchange notes that its rules provide a minimum net capital requirement regarding DPMs, which is currently set forth in CBOE Rule 8.86. Further, the clearing firms for market makers and DPMs perform risk management functions to ensure that the market makers have sufficient financial resources to cover their positions throughout the day.

In addition to increasing the maximum size for RAES-eligible orders in certain classes of options, the Exchange proposes to amend its firm quote rule, CBOE Rule 8.51. Currently,

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[13] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b-4.

[3] *See* Securities Exchange Act Release No. 42930 (June 13, 2000), 65 FR 38618 (June 21, 2000).

[4] *See* letter from Timothy Thompson, Assistant General Counsel, Legal Department, CBOE, to Gordon Fuller, Special Counsel, Division of Market Regulation, Commission, dated September 29, 2000. ("Amendment No. 1").

[5] Options subject to the fifty contract maximum include all classes of equity options, all classes of sector index options and all other classes of index options, except options on the S&P 500 Index, options on the Nasdaq 100 Index, options on the Dow Jones Industrial Average ("DJIA"), options on the High Yield Select Ten, and interest rate options. The RAES eligibility maximum is currently 100 contracts for options on the S&P 500 Index, the Nasdaq 100 Index, the DJIA, the High Yield Select Ten, and interest rate options. *See* Securities Exchange Act Release No. 41821 (September 1, 19999), 64 FR 50313 (September 16, 1999).

[6] The proposed increase to seventy-five contracts will not apply to those classes of index options cited in footnote 5 above.

[7] *See* CBOE Rule 8.51.

[8] *See* CBOE Rule 6.8(e).

[7] *See* CBOE Rule 6.8, Interpretation .02.

[10] *See supra* note 5 (citing to the order implementing Variable RAES on the CBOE).

[11] *See* CBOE Rule 8.85(a)(9).

[12] All equity options have now been assigned to DPMs. Telephone conversation between Timothy Thompson, Director-Regulatory Affairs, CBOE, and Gordon Fuller, Special Counsel, Commission, on March 9, 2000.

[13] *See* CBOE Rule 6.6(b)(vi).

the firm quote requirement may not be less than the RAES contract limit applicable to that class of options. The Exchange proposes to amend CBOE Rule 8.51(a) to provide that if the RAES contract limit is established at a level of higher than fifty contracts, then the firm quote requirement will remain at fifty contracts. The Exchange believes that because, for the most part, the RAES contract limit and the firm quote limit are of comparable levels on the CBOE, a firm representing a customer will always receive firm quote protection to the extent of fifty contracts.[14]

The Exchange also proposes to change Interpretation .03 to CBOE Rule 8.51. Interpretation .03 to CBOE Rule 8.51 currently provides that orders for accounts exempted from the firm quote requirement should not be reflected in the displayed quote when those orders are for less than the firm quote requirement applicable for that class of options and are represented in the crowd by a Floor Broker or DPM.[15] With respect to broad-based index option classes, the Exchange proposes to change this requirement such that orders represented in the crowd by a Floor Broker or DPM for less than the firm quote requirement need not be reflected in the displayed market quote.[16] In addition, with respect to classes other than broad-based index options, orders for less than ten contracts need not be reflected in the displayed quote.[17] Thus, the DPM or another member of the trading crowd may determine to reflect the price of a market-maker or proprietary broker-dealer order in the displayed market quote even if that order is for less than the firm quote requirement for broad-based index options, or if the order is for less than ten contracts for all other options classes.[18] Once the price of such an order is reflected in the displayed market quote, the trading crowd would be subject to the firm quote obligations

of CBOE 8.52(a)(2) even though the firm quote limit may be greater than the size of the displayed market-maker or proprietary broker-dealer order. By reflecting the price of that order in the quote, the trading crowd will be obligated to sell (buy) at least the established firm quote limit for that option class at the approved offer (bid) which the crowd determined to display when a buy (sell) order reaches the trading station where the particular option class is located for trading (as long as the improved bid or offer remains displayed), even though the firm quote limit will be greater than the size of the market-maker order or other proprietary broker-dealer order.[19] Furthermore, any RAES order that is entered while that improved price is displayed will be executed at that improved price even if that order is for more contracts than was the size of the displayed market-maker or proprietary broker-dealer order.[20] The CBOE represents that this change should ensure that any broker-dealer order represented in the crowd will be represented in the Exchange's quote and thus may become the basis for a quote at which an order may be executed. The Exchange represents that it will conduct further review to determine whether to include broad-based index option classes under the proposed change in the future.

The Exchange represents that its systems capacity is sufficient to accommodate the increased number of automatic executions anticipated to result from the implementation of this proposal. The Exchange believes that automatic execution of orders for up to seventy-five contracts will provide customers with quicker executions for a larger number of orders, by providing automatic rather than manual executions, thereby reducing the amount of orders subject to manual processing.

III. Discussion

After careful review, 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 and, in particular, the requirements of section 6 of the

Act.[21] Among other provisions, section 6(b)(5) of the Act requires that the rules of an exchange be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating securities transactions; remove impediments to and perfect the mechanism of a free and open market and a national securities system; and protect investors and the public interest.[22]

While increasing the maximum order size limit from fifty contracts to seventy-five contracts for RAES eligibility by itself does not raise concerns under the Act,[23] the Commission believes that this increase raises collateral issues that the CBOE will need to monitor and address. Increasing the maximum order size for particular option classes will make a larger number of option orders eligible for the Exchange's automatic execution system. These orders may benefit from greater speed of execution, but at the same time create greater risks for market maker participants. Market makers signed onto the RAES system will be exposed to the financial risks associated with larger-sized orders being routed through the system for automatic execution at the displayed price. When the market for the underlying security changes rapidly, it may take a few moments for the related option's price to reflect that change. In the interim, customers may submit orders that try to capture the price differential between the underlying security and the option. The larger the orders accepted through RAES, the greater the risk market makers must be willing to accept. The Commission does not believe that, because the Exchange's appropriate FPC determines to approve orders as large as seventy-five contracts as eligible for RAES, the FPC or any other CBOE committee or officials should disengage RAES more frequently by, for example, declaring a "fast" market. Disengaging RAES can negatively affect investors by making it slower and less efficient to execute their option orders. It is the Commission's view that the Exchange, when increasing the maximum size of orders that can be sent through RAES, should not disadvantage all customers—

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[14] For the remainder of the order in excess of fifty contracts, the trading crowd will attempt to fill the order at the same price as the first fifty contracts. Telephone conversation between Timothy Thompson, Assistant General Counsel, Legal Department, CBOE, and Gordon Fuller, Special Counsel, Division of Market Regulation, Commission, on October 30, 2000. An order entered into RAES can trade directly with an order on the Exchange's customer limit order book in those cases where the prevailing market bid or offer is equal to the best bid or offer on the Exchange's book. *See* Securities Exchange Act Release No. 41995 (October 8, 1999), 64 FR 56547 (October 20, 1999).

[15] In Amendment No. 1, the Exchange made technical changes to the proposed rule text to conform with recent amendments to Interpretation .03. *See* Securities Exchange Act Release No. 42558 (March 22, 2000), 65 FR 16676 (March 29, 2000).

[16] *See* Amendment No. 1, *supra* note 4.

[17] *Id.*

[18] *Id.*

[19] *See* CBOE Rule 8.51(a)(2).

[20] *See* CBOE Rule 6.8(a)(ii). Of course, pursuant to the terms of Interpretation .02 to Exchange Rule 6.8, the RAES order may instead be filled at the NBBO if the NBBO is no more than the designated number of ticks better than the CBOE best bid or offer, or the order may be rejected for manual handling if the NBBO is more than the designated number of ticks better than the CBOE best bid or offer. The appropriate FPC has determined that the designated number of ticks shall be one tick.

[21] The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

[22] 15 U.S.C. 78f(b)(5).

[23] The Commission notes that it is concurrently approving similar proposals filed by the American Stock Exchange, LLP ("Amex"), the Pacific Stock Exchange, Inc. ("PCX"), and the Philadelphia Stock Exchange, Inc. ("Phlx"). *See* Securities Exchange Act Release Nos. 43516 (November 3, 2000) (SR–Amex–99–45); 43518 (November 3, 2000) (SR–PCX–00–32); and 43515 (November 3, 2000) (SR–Phlx–99–32).

the vast majority of which enter orders for less than seventy-five contracts—by making the RAES system less reliable.

Finally, the Commission finds good cause for approving Amendment No. 1 prior to the 30th day after notice of the Amendment is published in the **Federal Register** pursuant to section 19(b)(2) of the Act.[24] Amendment No. 1 makes technical changes to the proposed rule text to reflect changes to Interpretation .03 to Rule 8.51 made in the filing of the proposed change. In addition, Amendment No. 1 clarifies that the DPM or another member of the trading crowd may determine to reflect the price of a market maker or other proprietary broker-dealer order in the displayed quote, even if that order is for less than the firm quote requirement (in the case of broad-based index options) or if the order is for less than ten contracts (in the case of all other option contracts.)[25] The Commission believes that the proposal may increase price transparency at the Exchange by expanding the kinds of orders eligible to be reflected in the Exchange's displayed quote. The Commission finds that accelerated approval of Amendment No. 1 is appropriate in order to permit the opportunity for increased transparency for market-maker orders or other proprietary broker-dealer orders.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether it 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–99–51 and should be submitted by December 6, 2000.

[24] 15 U.S.C. 78s(b)(2).
[25] *See* Amendment No. 1, *supra* note 4.

Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with section 6(b)(5). [26]

It Is Therefore Ordered, pursuant to section 19(b)(2) of the Act,[27] that the proposed rule change (SR–CBOE–51) is approved, and Amendment No. 1 is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority. [28]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–43514; No. SR–NASD–99–53]

Self-Regulatory Organizations; Notice of Filing of Amendment No. 8 to Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Establishment of Nasdaq Order Display Facility and to Modifications of the Nasdaq Trading Platform

November 3, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act''),[1] and Rule 19(b)(4) thereunder,[2] notice is hereby given that on October 23, 2000, the National Association of Securities Dealers, Inc. (''NASD''), through its subsidiary, The Nasdaq Stock Market, Inc. (''Nasdaq''), filed with the Securities and Exchange Commission (''SEC'' or ''Commission'') Amendment No. 8 to the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the NASD.[3] The proposed rule change and Amendment Nos. 1 and 2 were published for comment in the **Federal Register** on December 6, 1999.[4]

[26] 15 U.S.C. 78f(b)(5).
[27] 15 U.S.C. 78s(b)(2).
[28] 17 CFR 200.30–3(a)(12).
[1] 15 U.S.C. 78s(b)(1).
[2] 17 CFR 240.19b–4.
[3] Exhibit 3 to Amendment No. 8 contains a summary of how the NASD intends that the SuperMontage will operate. The summary incorporates and reconciles the original rule proposal and the subsequent proposed amendments, including Amendment No. 8. Exhibit 3 is available for public inspection in the Commission's Public Reference Room.
[4] *See* Securities Exchange Act Release No. 42166 (Nov. 22, 1999), 64 FR 69125.

On March 16, 2000, the NASD filed Amendment No. 3 to the proposal.[5] On March 30, 2000, Amendment No. 4 was published for comment in the **Federal Register**.[6] On May 16, 2000, the NASD filed Amendment No. 5 to the proposal.[7] On July 6, 2000, the NASD filed Amendment No. 6 to the proposal.[8] On August 7, 2000, the NASD filed Amendment No. 7 to the proposal.[9] On August 15, 2000 Amendment Nos. 5, 6, and 7 were published for comment in the **Federal Register**.[10] The Commission is publishing this notice to solicit comments on Amendment No. 8 from interested persons.

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

The NASD, through its subsidiary Nasdaq, is filing substantive and technical amendments to File No. SR–NASD–99–53, which proposes to establish the Nasdaq Order Display Facility (''NODF'') and make changes to the Nasdaq National Market System (''NNMS'').[11] Because the NASD is proposing alternative approaches to preferenced orders, there are two versions of the proposed rule text reflecting Alternative A and Alternative B. Except for the provisions relating to

[5] *See* letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division of Market Regulation (''Division''), Commission (March 15, 2000) (''Amendment No. 3''). In Amendment No. 3, the NASD responded to comment letters and submitted substantive, clarifying, and technical amendments to the proposal.

[6] *See* Securities Exchange Act Release No. 42573 (March 23, 2000), 65 FR 16981 (''Amendment No. 4'').

[7] *See* Letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (May 16, 2000) (''Amendment No. 5'').

[8] *See* letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (July 6, 2000) (''Amendment No. 6'').

[9] *See* letter from Richard G. Ketchum, President, NASD, to Belinda Blaine, Associate Director, Division, Commission (August 7, 2000) (''Amendment No. 7'').

[10] *See* Securities Exchange Act Release No. 43133 (August 10, 2000), 65 FR 149842 (''August 15, 2000 Notice'').

[11] The amended rule language contained in this notice reflects the Commission's approval of SR–NASD–99–11, regarding the estabishment of the Nasdaq National Market System (''NNMS''). See Securities Exchange Act Release No. 42344 (January 14, 2000), 65 FR 3987 (January 25, 2000) (Order for File No. SR–NASD–99–11 functionally integrating the Small Order Execution System (''SOES'') and SelectNet system to become the foundation of the NNMS). In addition, the amended rule language replaces, in the entirety, the rule language contained in the original filing, as well as Amendment Nos. 1 through 7.