

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41127; File No. SR-CBOE-98-41]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1 and 2 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. To Amend its Minor Rule Violation Plan With Respect to the Exercise of American-Style, Cash-Settled Index Options

March 2, 1999.

I. Introduction

On September 21, 1998, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to 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 to amend its Minor Rule Violation Plan with respect to the exercise of American-style, cash-settled index options. On December 3, 1998, and February 17, 1999, respectively, the Exchange submitted to the Commission Amendment Nos. 1³ and 2⁴ to the proposed rule change.

The proposed rule change was published for comment in the **Federal Register** on October 29, 1998.⁵ The Commission received no comments on the proposal. This order approves the proposal, as amended.

II. Description of the Proposal

CBOE proposes to amend its summary fine rule to add a schedule of fines for CBOE members who violate provisions of Exchange Rule 11.1 governing the exercise of American-style, cash-settled index options. Currently, CBOE trades one American-style, cash-settled index option, Standard & Poor's 100 Index

option ("OEX"). The following violations would be subject to a summary fine: failing to submit an exercise advice; submitting an advice without subsequently exercising an option; submitting an exercise advice after the designated cut-off time; and submitting an exercise advice for an amount different than the amount exercised. Violations occurring on a single trade date will generally be treated as one occurrence.⁶

There are three reasons why the Exchange determined to propose the schedule of summary fines discussed below for the above violations. First, the Exchange believes most violations are inadvertent. Second, processing routine violations under the summary fine program would significantly decrease the administrative burden of regulatory and enforcement staff as well as that of the BCC.⁷ Third, the membership of the Exchange would be more cognizant of the severity of penalties imposed and staff would be better able to process expeditiously routine violations under the summary fine program. The Exchange believes that the escalating schedule will deter members from considering fines for these violations as "a cost of doing business."

The summary fine schedule for Exchange Rule 11.1 violations, to be imposed as a rolling year look back period, would be as follows:

- *Violations No. 1 and 2*—Letter of Caution. However, if the violation

⁶ For example, if on any given day an individual member submits an exercise advice late to the Exchange and on the same day subsequently exercises a larger number of contracts than noted on the advice, both of these rule infractions (late advice submission and contract discrepancy) would be treated under the summary fine program as one violation. On the other hand, if two different market maker nominees of the same member firm each separately submit late exercise advices, such independent actions would be treated as two separate rule violations, even though they occurred on the same day. Where a matter is referred to the Business Conduct Committee ("BCC") for action, instead of being handled under the summary fine program, the BCC would not be precluded from handling similar fact patterns differently. Telephone conversation between Mary Bender, Senior Vice President, Regulation, CBOE, and Robert B. Long, Attorney, Division, Commission, on September 24, 1998.

⁷ From January 1996 through May 1998, approximately 111 investigative reports were reviewed at the pre-BCC level and resulted in the issuance of Letters of Caution. A total of 15 Statement of Charges were authorized and/or settled by the BCC during the same time period. Five of these violations could have been resolved via the proposed summary fine program. The remaining violations either involved significant fines or the dissemination of news. Under the proposed program, investigative reports will not be prepared describing violative conduct and presented to the BCC and/or pre-BCC. Rather, upon receipt and review of all necessary documentation, the Letter of Caution or Summary Fine Disciplinary Notice will be immediately issued to the member.

involves 5 contracts or less and no unusual circumstances are noted, a Letter of Information will be issued. Letters of Information will not be counted for escalation purposes and a member cannot receive more than two Letters of Information during the rolling year look back period.

- *Violation 3*—Summary Fine of \$1,000 plus \$10 per contract*
- *Violation 4*—Summary Fine of \$2,000 plus \$10 per contract*
- *Violation 5*—Summary Fine of \$4,000 plus \$10 per contract*
- *Violation 6 and Subsequent*—Referral to the BCC.

* Fines in excess of \$5,000 will be deferred to the BCC.⁸

Some violations of CBOE Rule 11.1 with respect to American-style, cash-settled index options will not be resolved by summary fine. For example, violations that occur following the dissemination of significant news will not be resolved by way of summary fine. Additionally, violations where mitigating or aggravating circumstances are evident and it appears that a summary fine is inappropriate will be forwarded to the BCC.

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, and in particular with the requirements of Section 6(b) and (d) of the Act.⁹ Specifically, the Commission believes the proposal is consistent with Sections 6(b)(1), (5), (6), and (7), 6(d)(1) and (3), and 19(d).¹⁰

Section 6(b)(5) requires, in part, that the rules of an exchange be designed to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest; these rules must not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.¹¹ The Commission finds that CBOE's proposed summary fines are equitable, non

⁸ Any fine imposed in excess of \$2,500 will be subject to reporting on SEC Form BD in addition to the immediate, rather than periodic, reporting requirement of Section 19(d)(1) of the Act. Compare Exchange Act Release No. 30280 (January 22, 1992), 57 FR 3452 (noting that fines in excess of \$2,500, assessed under New York Stock Exchange, Inc. Rule 476A, are not considered pursuant to the NYSE's minor rule violation plan and are thus subject to the current reporting requirements of Section 19(d)(1) of the Act).

⁹ 15 U.S.C. 78f(b) and (d).

¹⁰ 15 U.S.C. 78f(b)(1), (5), (6) and (7), 78f(d)(1) and (3), and 78s(d).

¹¹ 15 U.S.C. 78f(b)(5).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Patricia L. Cerny, Director, Department of Market Regulation, CBOE, to Robert Long, Attorney, Division of Market Regulation ("Division"), Commission dated December 2, 1998 ("Amendment No. 1"). Amendment No. 1 added the summary fine schedule approved herein to CBOE Rule 17.50(c)(1).

⁴ See letter from Timothy Thompson, Director, CBOE, to Robert Long, Attorney, Division, Commission, dated February 17, 1999 ("Amendment No. 2"). Pursuant to Amendment No. 2, the time stamping of an advice or exercise instruction memorandum prior to purchasing contracts will not constitute a violation of the summary fine schedule because the practice of pre-time stamping is no longer relevant as a result of recent changes to CBOE's rules.

⁵ See Exchange Act Release No. 40572 (October 19, 1998), 63 FR 58081.

discriminatory, and protect investors and the public interest by implementing an efficient means to punish the violations of Exchange rules discussed above (*i.e.*, failing to submit an exercise advice; submitting an advice without subsequently exercising an option; submitting an exercise advice after the designated cut-off time; and submitting an exercise advice for an amount different than the amount exercised). By using the Exchange's summary fine program to punish these violations that the exchange represents are often inadvertent should allow the Exchange to allocate its resources to monitoring and punishing more serious and intentional offenses.

The Commission also believes that the proposal is consistent with the Section 6(b)(6) requirement that the rules of an exchange provide that its members and persons associated with its members shall be appropriately disciplined for violations of rules of the exchange.¹² In this regard, the proposal may provide an efficient procedure for the appropriate disciplining of members in those instances when a rule or policy violation is either minor or inadvertent.¹³

The Commission finds good cause for approving Amendments No. 1 and No. 2 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. CBOE's original proposal did not provide persons fined under the summary fine schedule with an opportunity to contest the exchange's determination. Amendment No. 1 ensures that alleged violators of the summary fine schedule are entitled to contest violations and request hearings, in accordance with CBOE Rule 1750(c)(1). In addition, the original proposal included time-stamping of an advice or exercise instruction memorandum prior to purchasing contracts in the list of minor rule violations. Amendment No. 2 removed this violation from the list of violations. The violation was removed because current CBOE rules require Exchange regulatory staff to time-stamp exercise advises upon depositing them into the exercise advice box. As a result, the practice of pre-time stamping is not relevant.

¹² 15 U.S.C. 78f(b)(6).

¹³ The Commission notes that under the proposal, a member could potentially receive two letters of information and two letters of caution in a given year before receiving a fine for a violation. The Commission believes that such a scenario could undermine the deterrent effect of the summary fine program with respect to the violations discussed in the proposal. As a result, the Commission has advised the Exchange to monitor this potential problem.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendments No. 1 and No. 2, including whether they are consistent with the Act. person making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 that are filed with the Commission, and all written communication 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-CBOE-98-41 and should be submitted by April 1, 1999.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁴ that the proposed rule change (SR-CBOE-98-41), as amended, is approved.

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

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99-6005 Filed 3-10-99; 8:45 am]

BILLING CODE 8010-01-M

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-41128; File No. SR-NASD-99-09]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to the Establishment of an Agency Quotation in Nasdaq

March 2, 1999.

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 February

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.

3, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association") through its wholly owned subsidiary the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. 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

Nasdaq is proposing to permit the separate display of customer orders by market makers in Nasdaq through a market maker agency identification symbol. Below is the text of the proposed rule change. Proposed new language is italicized; proposed deletions are in brackets.

Rule 4613. Character of Quotations.

(a) Two-Sided Quotations

(1) For each security in which a member is registered as a market maker, the member shall be willing to buy and sell such security for its own account on a continuous basis and shall enter and maintain two-sided quotations in The Nasdaq Stock Market, subject to the procedures for excused withdrawal set forth in Rule 4619.

(A) If a market maker updates the price of its bid or offer without any accompanying update to the size of such bid or offer, the size of the updated bid or offer shall be the size of the previous bid or offer.

(B) Notwithstanding any other provision in this paragraph (a), in order to display a limit order in compliance with SEC Rule 11Ac1-4, a registered market maker's displayed quotation size may be for one normal unit of trading or a larger multiple thereof.

(C) A registered market maker in a security listed on The Nasdaq Stock Market must display a quotation size for at least one normal unit of trading (or a larger multiple thereof) when it is not displaying a limit order in compliance with SEC Rule 11Ac1-4, provided, however, that a registered market maker may augment its displayed quotation size to display limit orders priced at the market maker's quotation.

(D) A market maker registered as such in a Nasdaq National Market Security may also maintain a separate agency quotation for that security, pursuant to the requirements of subparagraph (b) of this rule ("Agency Quotation").

(2)-(5) No Change.