

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

1. Purpose

Last year CBOE imposed a \$.40 per contract marketing fee to collect funds that the appropriate Designated Primary Market Maker ("DPM") may use for marketing its services and attracting order flow to the CBOE.<sup>3</sup> Initially, this fee was applicable to all market-maker to market-maker options transactions. Thereafter, the Exchange determined that the fee was making it unprofitable for market makers to do reversal and conversion transactions, in which a market maker trades a given amount of an underlying security against an equivalent number of call/put "combos" through buying the call and selling the put (or vice versa) in equal quantities with the same strike price in the same expiration month. The Exchange therefore amended its marketing fee to waive the fee in the case of call/put combo transactions used in reversals and conversions.<sup>4</sup>

The Exchange is now filing this rule change proposal to exempt certain "spreads"<sup>5</sup> as well as "by write" and "synthetic" transactions<sup>6</sup> involving "deep in the money"<sup>7</sup> options. In the CBOE's view, these transactions, like reversals and conversions, enable popular trading strategies that contribute to market liquidity, but they usually have smaller profit margins than other types of trades. The CBOE believes that, when the \$.40 marketing fee is imposed upon the call/put combo

transactions, the trades may become unprofitable.

Consequently, the Exchange has decided to exempt from the marketing fee all buy-write and synthetic transactions involving at least 200 deep-in-the-money options contracts for a particular class, as well as spread transaction involving a total of at least 400 deep-in-the-money option contracts for a particular class. The Exchange will use trade data to determine qualifying transactions, and may require market makers to submit documentation showing that specific trades qualify for the exemption.

2. Statutory Basis

The CBOE believes the proposed rule change is consistent with Section 6(b) of the Act<sup>8</sup> in general, and furthers the objectives of Section 6(b)(4)<sup>9</sup> in particular, in that it is designed to provide for the equitable allocation of reasonable dues, fees, and other changes among CBOE members.

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

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

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

The CBOE neither solicited nor received written comments with respect to the proposed rule change.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>10</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder<sup>11</sup> because it establishes or changes a due, fee, or other charge imposed by the Exchange. At any time within 60 days of the filing of the 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 proposal 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-2001-18 and should be submitted by June 26, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

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

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-44365; File No. SR-NASD-2001-35]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Elimination of the Interval Delay Between Executions in the Nasdaq National Market Execution System and the Effect of Odd-Lot Orders on Market Makers' Displayed Quotations in the Nasdaq National Market Execution System**

May 29, 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 10, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary,

<sup>3</sup> See Securities Exchange Act Release No. 43112 (August 3, 2000), 65 FR 49040 (August 10, 2000) (SR-CBOE-2000-28).

<sup>4</sup> See Securities Exchange Act Release No. 44095 (March 23, 2001), 66 FR 17459 (March 30, 2001) (SR-CBOE-2001-09).

<sup>5</sup> For purposes of this filing, the term "spread" means an options transaction involving the simultaneous purchase and/or sale of one or more contracts of at least two different series of the same class of options (i.e., options covering the same underlying security), which transaction is executed at limit or market prices on the floor of the Exchange. E-mail from Chris Hill, Attorney, CBOE, to Cyndi Nguyen, Attorney, SEC, dated May 18, 2001.

<sup>6</sup> In a "buy write," a market maker buys stock and sells calls of a given series in a 1-to-1 ratio, creating the equivalent of a sale of puts of the same series. A "synthetic" is the opposite: The market maker sells stock and buys calls in a 1-to-1 ratio, creating the equivalent of a purchase of puts of the same series.

<sup>7</sup> For purposes of marketing fee waivers, the CBOE defines "deep in the money" options as options that are "in the money" by a minimum of both \$10 and 20% of the closing value of the underlying security on either the trade date or the date immediately prior to the trade date.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(4).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>11</sup> 17 CFR 240.19b-4(f)(2).

<sup>12</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.

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. On May 24, 2001, the NASD, through Nasdaq, filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change and Amendment No. 1 from interested persons.

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

Nasdaq proposes to amend NASD Rule 4710, "Participant Obligations in NNMS," to: (1) Eliminate the interval delay between executions against the same market maker at the same price level in the Nasdaq National Market Execution System ("NNMS" or "SuperSOES"),<sup>4</sup> and (2) establish rules governing the decrementation of market makers' displayed quotations by odd-lot orders in the NNMS.

Proposed new language is *italicized*; proposed deletions are in brackets.

\* \* \* \* \*

### **4710. Participant Obligations in NNMS**

(a) No Change

(b) Market Makers

(1) An NNMS Market Maker in an NNM[S] [S]security<sup>5</sup> shall be subject to the following requirements.

(A) No change.

(B) No change.

(C) (i) The size of the displayed quotation will be decremented upon the execution of an NNMS order in an amount equal to or greater than one normal unit of trading; provided, however that the execution of an NNMS order that is a mixed lot (i.e., an order that is for more than a normal unit of trading but not a multiple thereof) will only decrement a displayed quotation's size] by the member of shares represented by the number of round lots contained in the [mixed lot] order.

(ii) *The size of the displayed quotation will also be decremented by the number of shares represented by one normal unit of trading when the number of shares executed against a displayed quotation as the result of:*

a. *orders in an amount less than a round lot, and*

b. *the portion of an order for a mixed lot (i.e., an order that is for more than a normal unit of trading but not a multiple thereof) that is in excess of the number of shares represented by the number of round lots contained in such mixed-lot order, equals one normal unit of trading.*

(D) [(1) Except as provided in subparagraphs (2) and (3) below, after the NNMS system has executed an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall not be required to execute another order at its bid or offer in the same security until 5 seconds has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system.]

[(2) For securities included in the Nasdaq 100 Index, after the NNMS system has executed an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall not be required to execute another order at its bid or offer in the same security until 2 seconds has elapsed from the time the order was executed, as measured by the time of execution in the Nasdaq system.]

[(3) For both the first day of trading of the securities of initial public offerings and the first day of trading of the securities of secondary offerings,<sup>6</sup> a]After the NNMS system has executed an order against a market maker's displayed quote and reserve size (if applicable), that market maker shall be required to execute another order at its posted bid or offer in that same security as soon as the NNMS system delivers another order to that market maker's quote. [After the first day of trading, subsequent multiple executions against the same market maker's quote at the same price level in such securities shall be processed pursuant to subparagraph (D)(2) of this rule if the security is included in the Nasdaq 100 Index, or if not included in that index, multiple executions against the same market

[<sup>6</sup>In order to obtain immediate processing of executions in secondary offerings, the lead underwriter of the secondary offering shall communicate its request in writing to the Nasdaq Market Operations Department no later than the business day immediately prior to the start of the trading in the secondary offering. Failure to do so may result in the secondary offering being processed pursuant to the interval delay time frames applicable to the currently trading shares of the issuer.]

maker's quote at the same price level in such securities shall be processed pursuant to subparagraph (D)(1) of this rule.]

\* \* \* \* \*

(c) Through (e)—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, Nasdaq 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. Nasdaq 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**

*Elimination of Interval Delays.* Currently, the rules governing the Nasdaq Small Order Execution System establish a delay of 17 seconds (15 seconds for quote management and two seconds for system processing) between executions against the same market maker in the same security at the same price level. It was originally anticipated that with the launch of SuperSOES<sup>7</sup> this delay would be reduced to five seconds (plus two seconds system processing time) for the vast majority of NNM securities. Nasdaq market participants, however, raised concerns that significant order flow could potentially produce queuing within the system, especially for Nasdaq 100 securities and securities that have recently been the subject of initial public offerings or secondary offerings. Accordingly, Nasdaq filed proposals with the Commission to: (i) Reduce the interval delay between executions in Nasdaq 100 securities to two seconds,<sup>8</sup> and (ii) reduce the interval delay between round-lot executions for the first day of trading of all SuperSOES-eligible initial public offerings and

<sup>7</sup> The implementation of SuperSOES is currently scheduled for July 9, 2001.

<sup>8</sup> See Securities Exchange Act Release No. 43720 (December 13, 2000), 65 FR 79909 (December 20, 2000) (notice of filing and immediate effectiveness of File No. SR-NASD-00-67).

<sup>3</sup> See Letter from John M. Yetter, Assistant General Counsel, Nasdaq, to Katherine A. England, Division of Market Regulation, Commission, dated May 22, 2001 ("Amendment No. 1). In Amendment No. 1, the Nasdaq made a minor technical correction to the rule text of NASD Rule 4710(b)(1). See *infra* note 5.

<sup>4</sup> The Commission approved the NNMS, a new platform for trading Nasdaq National Market ("NNM") securities, on January 14, 2000. See Securities Exchange Act Release No. 42344 (January 14, 2000), 65 FR 3897 (January 25, 2000), (order approving File No. SR-NASD-99-11).

<sup>5</sup> Nasdaq revised the rule text of NASD Rule 4710(b)(1) to replace the phrase "NNM security" with the phrase "NNMS Security." See Amendment No. 1, *supra* note 3.

secondary offerings to zero seconds (plus system processing time).<sup>9</sup>

Nasdaq has now determined that it is technically feasible to reduce the interval delay to zero seconds (plus system processing time) for all transactions on SuperSOES. This would mean that a market maker would be available for executions as quickly as the system can transmit instructions between the execution and quote-update engines, an operation that generally requires from one to one and a half seconds. Nasdaq market participants have indicated to Nasdaq that they would support elimination of the interval delay for all transactions on SuperSOES because this would further minimize the risk of queuing within the system. Accordingly, the proposed rule change would provide that market makers will be required to execute orders against their displayed quotes whenever the SuperSOES system delivers such orders.

*Decrementation of Market Makers' Quotations.* The rules governing the NNMS currently provide that an NNMS market maker's displayed quotation will be decremented upon the execution of an NNMS order in an amount equal to or greater than a round lot, and that in the event of the execution of an NNMS order for a mixed lot (*i.e.*, an order that is for more than a round lot but not a multiple thereof), the displayed quotation size will be decremented only by the number of shares represented by the number of round lots contained in the mixed-lot order.

The proposed rule change would establish a mechanism for decrementing the displayed quotation size to take account of odd-lot orders and the portion of mixed-lot orders that is not covered by the current rule. Nasdaq has determined that it is technically feasible for SuperSOES to track the number of shares executed against a displayed quotation as the result of: (i) Orders in an amount less than a round lot, and (ii) the portion of an order for a mixed lot that is in excess of the number of shares represented by the number of round lots contained in the mixed-lot order. When the total quantity of such shares equals a round lot, the size of the displayed quotation would then be decremented accordingly. Nasdaq market participants have indicated that they would support this change because it will guard against the possibility that a market participant could execute multiple odd-lot orders against a market maker's quote without

the size of the displayed quotation being decremented.

## 2. Statutory Basis

Nasdaq believes that the proposed rule change is consistent with Section 15A(b)(6)<sup>10</sup> of the Act, in that the proposed rule change is designed to promote just and equitable principles of trade, foster cooperation and coordination with persons engaged in processing information with respect to and facilitating transactions in securities, as well as to remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest.

Nasdaq believes that eliminating the interval delay between executions on the NNMS will ensure that customer orders are processed in the most expeditious manner possible. Similarly, providing a mechanism for decrementing market makers' displayed quotations for all orders executed against such quotations will allow the NNMS to provide more up-to-date information about the size of displayed quotations. In turn, these improvements in order processing and display will improve market function and aid in the crucial price discovery process.

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

Nasdaq does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

## 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 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.

## 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 filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to File No. SR-NASD-2001-35 and should be submitted by June 26, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>11</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44363; File No. SR-NASD-2001-32]

## Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Level 1 Market Data Fees

May 29, 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 4, 2001, the Nasdaq Stock Market, Inc. ("Nasdaq") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule changes as described in Items I and II

<sup>9</sup> See Securities Exchange Act Release No. 44142 (April 2, 2001), 66 FR 18331 (April 6, 2001) (order approving File No. SR-NASD-01-03.)

<sup>10</sup> 15 U.S.C. 78o-3(b)(6).

<sup>11</sup> 17 CFR 200.30-30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.