

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46020; File No. SR-CBOE-2002-18]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by Chicago Board Options Exchange, Inc. Relating to its DPM Membership Ownership Requirement

June 3, 2002.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 19, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. 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

The CBOE proposes to amend Rule 8.85(e) pertaining to the Designated Primary Market-Maker ("DPM") seat ownership requirement. The text of the proposed rule change appears below.

New text is in *italics*; deletions are in [brackets].

Chicago Board Options Exchange, Incorporated Rules

Rule 8.85(e) Requirement to Own Membership. Each DPM organization shall own at least one Exchange membership *for each trading location in which the organization serves as a DPM, as determined by the MTS Committee.* An Exchange membership shall include a transferable regular membership or a Chicago Board of Trade full membership that has effectively been exercised pursuant to Article Fifth(b) of the Certificate of Incorporation. [A DPM shall be deemed to satisfy this ownership requirement if the DPM or a senior principal of the DPM owns an

Exchange membership. No single] *The same* Exchange membership(s) may *not* be used to satisfy this ownership requirement for *different* [more than one] DPM *organizations or different trading locations operated by the same DPM organization.* Each DPM shall have until [February 21, 2002] *insert date 90 days from date of SEC approval* to satisfy this ownership requirement, *but each DPM organization must continually own at least one membership until that date.*

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

In its filing with the Commission, CBOE 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 CBOE 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

On August 21, 2000, the Commission approved a CBOE rule filing adopting a DPM membership ownership requirement.³ This requirement is contained in Rule 8.85(e). Currently, it provides, among other things, that each DPM must own at least one Exchange membership. It also states that this requirement would be deemed satisfied if the senior principal of the DPM owned the required membership(s). Pursuant to the terms of the rule, DPMs were required to comply with Rule 8.85(e) by February 21, 2002. The Exchange now seeks to modify Rule 8.85(e) to make clear that the requirements of the Rule are applicable to each DPM trading location (as opposed to each DPM organization), and to eliminate the concept that a senior principal can own a membership in place of the DPM organization.

CBOE proposed the seat ownership requirement at roughly the same time it was seeking to convert the entire equity option trading floor to the DPM system. At that time, each CBOE DPM managed only one trading location (trading post) on the CBOE trading floor. Thus, at that time, each DPM trading location would have been subject to the seat ownership requirement. Further, because Rule

8.85(e) does not state that each DPM organization needs to own a membership, Rule 8.85(e) could arguably apply to each DPM trading location on the floor, since for many purposes (including the allocation of option classes) different DPM trading locations managed by the same DPM organization are treated as separate DPMs.⁴ Since that time, there has been a significant consolidation of DPM operations at CBOE resulting in several DPM organizations each operating multiple DPM trading locations on CBOE's floor.

CBOE believes it is more consistent with the Exchange's original intent to modify the rule to make clear that each DPM organization must own at least one Exchange membership for each trading location in which the organization acts as a DPM. Such a change is also consistent with the Exchange's original rationale for these requirements: to contribute toward assuring that DPMs have a long-term commitment to the Exchange given the important functions performed by DPMs and that DPMs are a pivotal component of the Exchange's marketplace.

With respect to the use of the term "trading location," generally, a trading location is meant to be a trading station on CBOE's floor. However, because certain spots on the trading floor are structured in a way that makes it difficult to distinguish the boundaries of a trading station, CBOE proposes that the Exchange's Modified Trading System Appointments Committee ("MTS Committee"),⁵ determine the number of trading locations in which a DPM organization serves as a DPM.

Lastly, in order to simplify the application and enforcement of the DPM membership ownership requirement, CBOE is proposing to eliminate the provision allowing a senior principal of a DPM to own a required membership instead of the DPM organization. As proposed, each DPM organization would be required to own any seats required to be owned under Rule 8.85(e).

2. Statutory Basis

The Exchange believes the proposed rule change will contribute toward assuring that DPMs have a long-term commitment to the Exchange. Accordingly, the Exchange believes the proposed rule change is consistent with

⁴ However, because of the ambiguity in Rule 8.85(e), CBOE has applied the Rule to DPM organizations and not DPM trading locations on the Exchange floor.

⁵ The MTS Committee is the Committee responsible for reviewing and ensuring compliance with Rule 8.85.

¹⁰ 17 CFR 200.30-2(a)(12).

¹¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Exchange Act Release No. 43186 (August 21, 2000), 65 FR 51880 (August 25, 2000) (Order approving File No. SR-CBOE-99-37).

Section 6(b) of the Act,⁶ in general, and further the objectives of section 6(b)(5),⁷ in particular, in that it is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest.

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

This proposed rule change does not 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

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 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 Section. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to the File No. CBOE-2002-18 and should be submitted by July 1, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45998; File No. SR-NASD-2001-66]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the National Association of Securities Dealers, Inc. Relating to Display Requirements When Using Reserve Size in the Nasdaq National Market Execution System

May 29, 2002.

I. Introduction

On October 4, 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"),¹ and Rule 19b-4 thereunder,² a proposed rule change relating to display requirements when using reserve size in the Nasdaq National Market Execution System ("NNMS" or "SuperSOES"). On October 23, 2001 and October 29, 2001, NASD submitted Amendment Nos. 1 and 2 to the proposed rule change, respectively.³ The proposed rule change, as amended, was published for comment in the **Federal Register** on November 13, 2001.⁴ The Commission received 233 comment letters on the proposed rule change.⁵

⁸ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letters from Thomas P. Moran, Associate General Counsel, Nasdaq, to Katherine England, Assistant Director, Division of Market Regulation ("Division"), Commission, dated October 23, 2001 ("Amendment No. 1"); and October 29, 2001 ("Amendment No. 2").

⁴ See Securities Exchange Act Release No. 45016 (November 5, 2001), 66 FR 56875 (November 13, 2001).

⁵ A list of the commenters appears in the Appendix.

In addition, Nasdaq submitted two letters in response to comments.⁶ This order approves the proposed rule change, as amended.

II. Description of Proposal

Under the NNMS, market makers are allowed to keep shares in reserve. Known as reserve size, shares kept in reserve are available for execution through SuperSOES, but are not shown to the marketplace.⁷ Currently, the SuperSOES rules prohibit the use of the system's reserve size functionality unless a market maker is displaying at least 1000 shares in its public quote. Nasdaq proposes to eliminate the 1000-share display requirement for using reserve size. Under the proposed rule change, market makers would be allowed to use NNMS' reserve size any time they displayed a quote of at least one round lot (100 shares). Nasdaq would continue its policy of allowing the use of reserve size even if a particular displayed quotation dropped below 100 shares based on partial, interim executions against that un-updated quote.

III. Summary of Comments

As noted above, the Commission received 233 comment letters regarding the proposed rule change.⁸ A large majority of the letters were submitted by registered representatives, but commenters also included broker-dealer and market making firms, private investors, and a professional association. Five commenters supported the proposal,⁹ while the remaining 228 commenters opposed the proposal.

IV. Discussion

After carefully considering all the comments, the Commission finds, for the reasons discussed below, that the proposed rule change is consistent with the Act and the rules and regulations applicable to the NASD.¹⁰ In particular, the Commission finds that the proposal

⁶ See letters from Thomas P. Moran, Associate General Counsel, Nasdaq, to Jonathan G. Katz, Secretary, Commission, dated March 8, 2002 ("Nasdaq Letter I") and April 17, 2002 ("Nasdaq Letter II").

⁷ Under NNMS's execution algorithm, the system executes against all publicly-displayed shares at the same price level before executing in time priority against reserve size at that same price.

⁸ See *supra* note 5.

⁹ See Davenport Letter, Levine Letter, Morgan Keegan Letter, Robertson Stephens Letter, and STA Letter.

¹⁰ In approving the proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).