

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 filings will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-Amex-2001-68 and should be submitted by March 6, 2002.

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. 34-45419; File No. SR-CBOE-2001-63]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Lead Market-Makers and Supplemental Market-Makers

February 7, 2002.

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 December 17, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" 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 CBOE. The Exchange filed an amendment to the proposed rule change on February 7, 2002.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The CBOE proposes to amend its CBOE Rule 8.15 to make clear that Lead Market-Makers and Supplemental

Market-Makers may determine a formula for generating automatically updated market quotations during the trading day. The text of the proposed rule change is set forth below. Additions are in italics; deletions are in brackets.

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#### Rule 8.15. Lead Market-Makers and Supplemental Market-Makers

The appropriate Market Performance Committee (the "Committee") may appoint one or more market-makers in good standing with an appointment in an option class [the S&P 100 options or in options on the DJIA] *for which a DPM has not been appointed* as Lead Market-Makers ("LMMs") and Supplemental Market-Makers ("SMMs") to participate in the modified opening rotation described in Interpretation .02 to Rule 24.13, including participating in opening rotations using the Exchange's Rapid Opening System., *and/or to determine a formula for generating automatically updated market quotations during the trading day as described in paragraph (d) below.*

(a) LMMs and SMMs shall be appointed on the first day following an expiration for a period of one month ("expiration month") and shall be assigned to a zone with one or more LMMs or SMMs. The Committee shall select the series to be included in a zone.

1. Factors to be considered by the Committee in selecting LMMs and SMMs include: Adequacy of capital, experience in trading index options, presence in the [S&P] trading crowd, adherence to Exchange rules and ability to meet the obligations specified below. An individual may be appointed as an LMM in only one zone for an expiration month but may also be appointed as an SMM in other zones. An individual may be appointed to be an SMM in more than one zone. When individual members are associated with one or more other members, only one member may receive an LMM appointment.

2.-4. No change.

(b) The obligations of an LMM are as follows:

1.-3. No change.

4. to perform the above obligations for a period of one expiration month commencing on the first day following an expiration. Failure to perform such obligations for such time may result in suspension of up to three months from trading in all series of the [S&P 100] option class [or in options on the DJIA as appropriate].

(c) No change.

*(d) Each LMM or SMM appointed in accordance with this Rule to determine a formula for generating automatically*

*updated market quotations shall for the period in which its acts as LMM or SMM use the Exchange's AutoQuote system or a proprietary automated quotation updating system to update market quotations during the trading day. In addition, the LMM or SMM shall disclose the following components of the formula to the other members trading at the trading station at which the formula is used: option pricing calculation model, volatility, interest rate, dividend, and what is used to represent the price of the underlying. Notwithstanding the foregoing, the appropriate Market Performance Committee shall have the discretion to exempt LMMs and SMMs using proprietary automated quotation updating systems from having to disclose proprietary information concerning the formulas used by those systems.*<sup>4</sup>

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#### 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 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 text of these statements may be examined at the places specified in Item IV below. 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

The purpose of the proposed rule change is to amend CBOE Rule 8.15 to make explicit in the rule that the appropriate Market Performance Committee ("MPC") may appoint Lead Market-Makers ("LMMs") and Supplemental Market-Makers ("SMMs") to determine a formula for generating automatically updated market quotations and to use the Exchange's Autoquote system or to provide a proprietary automated quotation updating system to monitor and automatically update market quotations

<sup>4</sup> The Exchange has agreed to submit an amendment adding a cross-reference to Interpretation and Policy .07 to CBOE Rule 8.7 to clarify that all of the requirements of Interpretation and Policy .07 apply to proposed CBOE Rule 8.15(d). Telephone call between Patrick Sexton, Assistant General Counsel, CBOE, and Deborah Flynn, Assistant Director, Division, Commission (February 6, 2002).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>11</sup> 15 U.S.C. 78s(b)(1).

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

<sup>3</sup> See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Deborah Flynn, Assistant Director, Division of Market Regulation ("Division"), Commission ("Amendment No. 1"). Amendment No. 1 requests the Commission to designate the proposed rule change as having been filed pursuant to Section 19(b)(2) of the Act.

during the trading day in an options class for which a Designated Primary Market-Maker ("DPM") has not been appointed. CBOE Rule 8.15 currently provides that the appropriate MPC may appoint LMMs and SMMs for a specified period of time to participate in opening rotations in S&P 100 options ("OEX") and options on the Dow Jones Industrial Average ("DJX") pursuant to the terms of Interpretation .02 to CBOE Rule 24.13,<sup>5</sup> including by employing the Exchange's Rapid Opening System ("ROS").

Historically, one of the factors considered by the appropriate MPC in selecting LMMs and SMMs to participate in the OEX openings is the willingness of a market-maker or market-maker group to provide automatically updated quotations during the trading day in the options series traded by the OEX crowd.<sup>6</sup> In the early part of 2000, the Index Market Performance Committee ("IMPC") introduced a proprietary automated quotation updating system ("Vendor Quote") into the OEX trading crowd to replace the Exchange's Autoquote system.<sup>7</sup> In conjunction with the introduction of the Vendor Quote system in the OEX, the IMPC instituted a program in OEX whereby the IMPC will approve a certain number of market-makers or market-maker groups to act as LMMs and SMMs and also to provide an intra-day proprietary quote feed to the Vendor Quote system. The Exchange proposes to amend CBOE Rule 8.15 to codify the practice of the appropriate MPC appointing LMMs and SMMs to provide automatically updated quotations during the trading day.

The CBOE proposed to amend Paragraph (a) of CBOE Rule 8.15 to state that LMMs and SMMs may be appointed by the appropriate MPC to determine a formula for generating

automatically updated market quotations during the trading day in their appointed classes, in addition to participating in the opening rotations. Proposed new paragraph (d) provides that LMMs and SMMs appointed pursuant to the CBOE Rule 8.15 to determine a formula for generating automatically updated market quotations must for the period in which its acts as LMM or SMM use the Exchange's AutoQuote system or a proprietary automated quotation updating system to update market quotations during the trading day. Proposed paragraph (d) requires LMMs to disclose to the trading crowd the variables of the formula for generating automatically updated market quotations unless exempted by the appropriate Market Performance Committee. This new language tracks the language of Exchange Rule 8.85(a)(x) regarding a DPM's obligation for generating and providing automatically updated market quotations, as well as disclosing to the trading crowd the variables of the formula.<sup>8</sup>

The Exchange also proposes to make an additional housekeeping change to CBOE Rule 8.15. Specifically, the Exchange proposes to eliminate the references to S&P 100 options and options on the DJIA from the rule so that the appropriate Market Performance Committee may appoint LMMs and SMMs in other options classes without having to file a rule change simply to identify the class. The Exchange proposes to revise paragraph (a) to permit the appropriate MPC to appoint as an LMM or SMM a market-maker in good standing with an appointment in an option class for which a DPM has not been appointed.<sup>9</sup>

## 2. Statutory Basis

By codifying the practice of the appropriate MPC appointing LMMs and SMMs to determine a formula for generating automatically updated market quotations during the trading day in their appointed options classes, thereby adding accountability for market quotations, the CBOE believes that the proposed rule change is consistent with and furthers the

objectives of Section 6(b)(5) of the Act<sup>10</sup> in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change, as amended, will impose a burden on competition that is not necessary or appropriate in furtherance of 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 CBOE 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 filings will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No.

<sup>5</sup> The rules governing opening rotations in OEX were approved by the Commission on March 31, 1988. See Securities Exchange Act Release No. 25545 (March 31, 1988), 53 FR 11720 (April 8, 1988). The LMM system was put in place to allow for speedier openings in the OEX crowd and to add accountability to the openings in OEX by making particular market-makers responsible for opening quotes.

<sup>6</sup> Paragraph (a)(1) of CBOE Rule 8.15 describes the factors to be considered by the appropriate MPC in making its selections for LMMs and SMMs. These factors include: Adequacy of capital, experience in trading index options, presence in the S&P trading crowd, adherence to Exchange rules, and ability to meet the obligations specified in the rule. One of the obligations of an LMM specified in the Rule is to quote a two-sided market during the opening in all option series in the LMM's assigned zone.

<sup>7</sup> The Vendor Quote system accepts a quote stream from a firm's proprietary quote system and then sends this quote information to the Exchange's Trading Support System to be disseminated as market quotes.

<sup>8</sup> Since CBOE's establishment of the Modified Trading System pilot program in 1987 that allowed CBOE to assign DPMs to certain options classes, CBOE rules have provided that the DPM should determine and disclose to the trading crowd the elements of the formula for automatically updating quotations. See Securities Exchange Act Release No. 24934 (September 22, 1987), 52 FR 36122 (September 25, 1987).

<sup>9</sup> Currently, all equity options classes and the NDX, MNX, QQQ and RUT options classes are DPM trading crowds.

<sup>10</sup> 15 U.S.C. 78f(b)(5).

SR-CBOE-2001-63 and should be submitted by March 6, 2002.

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. 34-45410; File No. SR-CHX-2001-26]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to Automatic and Manual Execution Procedures

February 6, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4<sup>2</sup> thereunder, notice is hereby given that on November 14, 2001, the Chicago Stock Exchange, Incorporated ("CHX" 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 Exchange. 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 Exchange proposes to amend Article XX, Rule 37 of the CHX Rules, which governs, among other things, automatic execution of market and marketable limit orders. Below is the text of the proposed rule change. Proposed new language is *italicized*; proposed deletions are [bracketed].

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#### Chicago Stock Exchange Rules, Article XX

##### Guaranteed Execution System and Midwest Automated Execution System

RULE 37. (a) Guaranteed Executions. The Exchange's Guaranteed Execution System (the BEST System) shall be available, during the Primary Trading Session and the Post Primary Trading Session, to Exchange member firms and, where applicable, to members of a participating exchange who send orders

to the Floor through a linkage pursuant to Rule 39 of this Article, in all issues in the specialist system which are traded in the Dual Trading System and NASDAQ/NM Securities. System orders shall be executed pursuant to the following requirements:

1-7. No change.

(b) Automated Executions. The Exchange's Midwest Automated Execution System (the MAX System) may be used to provide an automated delivery and execution facility for orders that are eligible for execution under the Exchange's BEST Rule (Article XX, Rule 37(a)) and certain other orders. In the event that an order that is subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the BEST Rule and the following. In the event that an order that is not subject to the BEST Rule is sent through MAX, it shall be executed in accordance with the parameters of the following:

(1) Size. The MAX System has two size parameters which must be designated by the specialist on a stock-by-stock basis. These parameters are the auto-execution threshold and the auto-acceptance threshold. For both Dual Trading System issues and NASDAQ/NM Securities, the auto-execution threshold must be set at 100 [300] shares or greater and the auto-acceptance threshold must be set at 1000 shares or greater. In no event may the auto-acceptance threshold be less than the auto-execution threshold. If the order sending firm sends an agency market order in a Dual Trading System issue through MAX, such order will be executed in accordance with paragraph (b)(6) of this Rule. If the order sending firm sends an agency market order in a Nasdaq/NM Security through MAX, such order shall be executed in accordance with paragraph (b)(7) of this Rule.

\* \* \* \* \*

#### Interpretations and Policies:

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04. Ability to Switch MAX to Manual Execution. Effective April 4, 1994. Specialists have the ability to switch their MAX terminals off automatic execution at their respective posts. This new functionality is being implemented to allow specialists to timely switch to a manual execution mode when a certain analyst/reporter's report is broadcast on cable T.V., if market conditions in a particular stock warrant it. Specialists should switch to manual mode only when absolutely necessary and are required to return to the automatic execution functionality immediately when the primary market

quotes accurately reflect market conditions. A specialist cannot remain in manual mode, under this paragraph, for more than *five* [10] minutes without securing the permission of two (2) floor officials.

In all other instances, when a specialist believes it is necessary to be in a manual execution mode, he or she must *secure the permission of his/her firm's floor supervisor (who, under normal circumstances should be located on the trading floor) before switching to manual, and the firm supervisor must immediately (but in no event more than three minutes after switching to manual mode) [always] notify and secure [seek] the permission of a [two (2)] floor official[s] to remain in manual mode [before switching to manual]*. This new functionality cannot be used merely because of a volatile market, but shall only be permitted when the primary market quotes are inaccurate due to market conditions. For example, this new functionality might be used if it became apparent that the NYSE invoked its unusual market conditions rule (pursuant to SEC Rule 11Ac1-1). *The [F]loor official[s] must be satisfied that the conditions which permit putting an issue on manual mode are present before granting a specialist's request to switch to the manual mode and such permission shall only be in effect for five minutes. A firm's floor supervisor shall monitor the conditions which formed the basis for the [ir] decision to ensure that specialists' return to the auto-execution feature when such conditions are no longer present. Both the firm's floor supervisor and the [S]pecialist[s] also have the responsibility, and are required, to immediately reinstate MAX's automatic execution functionality when the primary market quotes accurately reflect market conditions. If the specialist and the firm's floor supervisor believe it is necessary to continue in manual mode for longer than five minutes, then the firm supervisor must again secure the permission of the floor official who granted the initial permission, and if such floor official is not available, then from another floor official. Reasons for going to manual mode, the time spent in manual mode, the name of the firm supervisor who permitted the specialist to switch to manual mode and the name of the floor official who granted permission to go to manual mode must be documented and filed with the market regulation department before the next business day's opening.*

When operating in the manual mode. Specialists still have the responsibility to fill customer orders according to CHX Rules—including the BEST Rule. All

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

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

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