which it was filed; and because the Exchange provided the Commission with written notice of its intent to file the proposed rule change at least five business days prior to the filing date, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act[9] and Rule 19b–4(f)(6) thereunder.[10] 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 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. 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 persons, 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, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Exchanger. All submissions should refer to File No. SR–Amex–99–4 and should be submitted by March 24, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[11]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–5722 Filed 3–8–99; 8:45 am]

BILLING CODE 8010–01–M

[9] 15 U.S.C. 78s(b)(3)(A).

[10] 17 CFR 240.19b–4(f)(6).

[11] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41121; File No. SR–CBOE–98–35]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to Proposed Rule Change Relating to Order Book Rates and Floor Brokerage Subsidies

February 26, 1999.

I. Introduction

On July 27, 1998, 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[2] thereunder, a proposal to allow CBOE market-makers in a trading crowd to subsidize the limit order book rate and the activity of stationary floor brokers who represent orders in that crowd. The proposed rule change was published for comment in the **Federal Register** on September 16, 1998.[3] The Commission received one comment letter on the proposal.[4]

On February 26, 1999, CBOE filed Amendment No. 1 to the proposed rule change.[5] This notice and order approves the proposed rule change, as amended, and seeks comments from interested persons on Amendment No. 1 to the proposal.

II. Description of the Proposal

A. Background

Many options traded on CBOE are traded in crowds where the quotes are established by competing market-makers.[6] In CBOE's competing market-maker crowds, the agency function is performed by OBOs, who are CBOE employees, and floor brokers, including stationary floor brokers (''SFBs'') who remain at stations where the option classes are traded. An OBO maintains the limit order book in each options class, and generally only limit orders away from the current market price may be placed with an OBO. Orders in which any CBOE member or another broker-dealer has an interest may not be placed with an OBO. Orders that cannot be placed with an OBO can be routed through CBOE's order routing system to the floor terminal of an SFB. Other exchanges, such as the American Stock Exchange, have a specialist system that is akin to CBOE's DPM system. Unlike CBOE's market-maker crowds, DPMs and specialists can serve both the agency and principal functions.

As a result of the differences between competing market-maker crowds and specialist systems, the OBO's rates at CBOE compete with rates charged by specialists with respect to orders that can be placed with an OBO, and the SFB's rates at CBOE compete with the rates of specialists with respect to most other agency orders. CBOE contends that specialists can reduce their brokerage rates to attract order flow and can offset such reductions through revenue they earn from the principal part of their business. Because CBOE's market-makers (which cannot represent agency orders) and SFBs (which do not have a proprietary business) lack the flexibility over pricing enjoyed by specialists, CBOE developed the current proposal to allow CBOE and its member firms to better compete with other exchanges in floor brokerage and order book rates.

B. General Description of the Proposal

The Exchange is proposing a new Rule 2.40 that would allow the Exchange to impose a fee on market-makers (''Surcharge'') for contracts traded by market-makers in a particular option class. This fee, not to exceed $0.25 per contract,[7] will be collected by

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

[2] 17 CFR 240.19b–4.

[3] Securities Exchange Act Release No. 40419 (September 9, 1998), 63 FR 49619.

[4] Comment Letter, from the United States Department of Justice, dated October 21, 1998 (''DOJ Letter''). CBOE submitted a letter responding to the DOJ Letter. *See* letter from William Brodsky, Chairman, CBOE, to Richard Lindsey, Director, Division of Market Regulation (''Division''), SEC, dated December 17, 1998 (''CBOE Response Letter'').

[5] *See* letter from Timothy Thompson, Director—Regulatory Affairs, to Michael Walinskas, Deputy Associate Director, Division, SEC, dated February 26, 1999 (''Amendment No. 1''). Among other things, in Amendment No. 1 CBOE proposes to cap the Market-Maker Surcharge at $0.25 per contract, to grant the authority to impose the Surcharge to the appropriate Floor Procedure Committee rather than to the Resident Market-Makers as was originally-proposed, and to operate the proposal as a pilot program through March 31, 2000.

[6] Other options on CBOE are traded in a Designated Primary Market-Maker (''DPM'') system. The DPM functions in approved classes of options as a market-maker, floor broker, and in the place of the Order Book Official (''OBO''). *See* CBOE Rules Chapter VIII, Section C: Modified Trading System. This proposal does not apply to DPM option classes. *See* Amendment No. 1, *supra* note 5.

[7] *See* Amendment No. 1, *supra* note 5. Bids and offers in options series trading below $3 are expressed in sixteenths of a dollar, *i.e.* $0.0625. Because standard options contracts have a multiplier of 100 (*i.e.*, they represent interest in 100 shares of the underlying security), the value of the minimum spread between any option contract

Continued

the Exchange and will be used for two purposes. First, it will be used to reimburse the Exchange to the extent the OBO brokerage rate is reduced if such reduction is based upon a recommendation of the Resident Market-Makers.[8] Any remaining amount of the Surcharge collected will then be paid to SFBs[9] to induce them to reduce the brokerage rates they charge their customers, which are primarily other broker-dealers representing customer orders as agent.[10] Therefore, the proposed Surcharge would allow CBOE to compete with other exchanges in two respects: (1) based on the respective fee each exchange charges a firm to place an order on the limit order book, and (2) by anticipated reductions in fees SFBs charge their customers to place orders with them.

C. How the Surcharge Will be Determined

Under proposed Rule 2.40, the Appropriate Floor Procedure Committee (''Committee''),[11] under authority delegated to it by CBOE's Board of Directors, will determine the option classes for which the Surcharge would be assessed as well as what that Surcharge, if any, will be.[12] Any Resident Market-Maker can recommend a Surcharge amount. All Resident Market-Makers then vote on the recommended amounts of the Surcharge, with each person having an equal vote.[13] Any amount that receives a majority of the votes is the Surcharge amount that is recommended to the Committee, which then decides the actual Surcharge. In reaching its decision, the Committee must consider the vote of the Resident Market-Makers and the views of any market-maker in favor of or opposed to the recommended Surcharge.[14] The Committee is not bound, however, to follow the Resident Market Makers' recommendation. The Committee is free to impose a different Surcharge than the one recommended or to impose no Surcharge at all.[15] Any market-maker may appeal the decision of the Committee to the Exchange's Appeals Committee pursuant to Chapter XIX of CBOE's Rules. The Surcharge will remain in effect until the appeal has been decided.

Once the Committee determines to implement a Surcharge and change the OBO fee, it will file a rule proposal with the SEC pursuant to Section 19(b)(3)(A) under the Act.[16] After determining to impose or amend a Surcharge, the Committee will notify CBOE's Board at the meeting following the determination.[17] Any Surcharge to be paid by the market-makers would be in effect for at least one month to avoid disrupting normal Exchange billing and accounting procedures.

D. Disclosure Requirements

Proposed Rule 2.40(h) requires that SFBs disclose to their customers any Surcharge they receive. This disclosure will be akin to that required under Exchange Act Rule 10b–10 regarding payment for order flow.[18]

III. Summary of Comment and CBOE Response

A. DOJ Comment

As discussed, the Commission received one comment on the proposal, from the Department of Justice (''DOJ'').[19] DOJ urged that the proposed rule not be approved until the Exchange has adequately explained why the proposal will not adversely affect competition and until the Exchange has provided a fuller explanation of how the proposal will promote competition between it and other exchanges. Specifically, DOJ objected to allowing market-makers to agree on matters that could affect the public pays.[20] DOJ was also concerned about the possibility that the Surcharge may increase pressure on market-makers to increase their spreads to finance the Surcharge, thus increasing consumer costs. DOJ contended that the risk of an adverse effect could be greatest for small retail market orders that are executed automatically without intervention by the OBO or a floor broker because these customers may not receive any benefit from lower floor broker commissions.

DOJ also noted that there was no guarantee that the proposal will reduce consumer commission costs because SFBs are under no obligation to reduce their commission rates under the proposed rule change. Moreover, DOJ argues that even if SFB's commission rates were reduced to off-floor brokers, off-floor brokers may not reduce charges to their public customers. DOJ also noted that off-floor brokers would have an incentive to route orders to CBOE

listed on the Exchange would be $6.25 ($0.0625 times 100). Options priced over $3 have a minimum spread of one eighth of a dollar ($12.50 value for the minimum spread). Thus, the 25-cent cap on the Surcharge will ensure that it remains far below the minimum quote increment for options traded on CBOE.

[8] The proposal defines a ''Resident Market-Maker'' as someone who transacted at least 80% of his market-maker contracts in option classes traded in the trading crowd in the prior calendar month. If the Exchange decides on its own initiative to reduce the OBO rate for a particular option class, then the Surcharge would not be used to reimburse the Exchange.

[9] An SFB is defined in the proposal as a floor broker (A) who has established a business in the trading crowd for that options class of accepting and executing orders for members of registered broker-dealers, and (B) who transacted at least 80% of his orders for the previous month in the trading crowd at which that option class is traded. According to the Exchange, the definition is designed to ensure that those floor brokers who have made a commitment to the particular option class and who are willing to accept orders from a wide variety of market participants are the ones who will benefit from the subsidy.

[10] Generally, there is only one SFB in a trading crowd. Where there is more than one SFB in a trading crowd, the amount of the Surcharge remaining after the Exchange has been reimbursed will be paid to the SFBs on a *pro rata* basis based on the number of the Exchange's order routing system (''ORS'') orders executed by each floor broker. For purposes of proposed Rule 2.40, an ORS Order is an order that is sent over ORS and given an ORS identification number, and that is not an order of the firm for whom the SFB acts as a nominee or for whom the SFB has registered his membership. Non-ORS orders—such as spreads, large telephone orders, and complex or contingent orders—are excluded from the proposal because they require a higher level of service and thus are not as price sensitive as ORS orders. In addition, the Exchange determined not to allow ORS orders executed by an SFB on behalf of the firm for whom the SFB is a nominee or for whom he has registered his membership because these orders will be executed by the SFB by virtue of the relationship rather than the brokerage rate charged.

[11] CBOE has three Floor Procedure Committees, although only one, the Equity Floor Procedure Committee (''EFPC''), governs equity options that are multiply traded (*i.e.*, those to which the proposal applies). Generally, the EFPC consists of 15 to 25 members who trade on the floor. The Chairman of the EFPC is almost always a member of CBOE's Board of Directors. EFPC members that would be impacted by the Surcharge would be required to recuse themselves from that vote. *See* Amendment No. 1, *supra* note 5.

[12] The proposal is limited, however, to options classes in competing market-maker crowds that are multiply traded, and does not include DPM options classes. *See* Amendment No. 1, *supra* note 5. As of February 1, 1999, there were 1375 options classes traded on CBOE. Two hundred and seventy of these were multiply traded at market maker stations.

[13] *See* Amendment No. 1, *supra* note 5. Under the original proposal, the vote was to be weighted in accordance with each Resident Market-Maker's percentage of the contracts traded in the relevant options class during the six calendar months prior to the month in which the vote is taken.

[14] The Committee must give notice of its meeting schedule for the consideration of the Surcharge and the deadline for the submission of other materials for its consideration.

[15] The Committee may delegate responsibility for reviewing submitted materials and to review other positions to a Sub-Committee. The full Committee, however, makes the final decision regarding whether the fee should be imposed and the amount, if any, of the Surcharge or any changes in the Surcharge.

[16] *See* Amendment No. 1, *supra* note 5.

[17] *Id.*

[18] *Id.*

[19] *See* DOJ Letter, *supra* note 4.

[20] DOJ was also concerned about the fact that Resident Market-Maker's vote was to be weighted by market share, thus creating an opportunity for market-makers with substantial order flow to set the Surcharge that competing market-makers must also pay. The Commission notes that under the proposal as amended each Resident Market-Maker would have an equal vote in determining whether to impose a Surcharge and the amount of the Surcharge. *See* Amendment No. 1, *supra* note 5.

because of reduced commissions, thus creating a form of ''payment for order flow'' and harming customers because the customers could receive a better execution if orders are routed elsewhere.

B. CBOE's Response

In its Response Letter, CBOE first explained in greater detail its market-maker system, how it differs from the specialist systems employed at other options exchanges, and the reasons for the proposal.[21] CBOE argued generally that the proposal would enable the Exchange and its members to compete better with other options exchanges without creating an adverse competitive effect.

1. Widening of Spreads

COBE argued that the widening of spreads as a result of pressure on market-makers to finance the Surcharge is extremely unlikely for a number of reasons. First, since the purpose of the proposal is to attract order flow by providing brokerage rates competitive with other exchanges, it would be contrary to each market-maker's own economic interest to widen its spreads and thereby risk losing order flow. Second, CBOE argued that the Surcharge amount, expected to be $0.10 per contract or less, was not great enough to force market-makers to widen their spreads.[22] Third, CBOE noted that there is no evidence to suggest that spreads have widened when specialists at other exchanges lower their brokerage feeds.

2. Effect on Retail Orders

CBOE argued that retail orders would not be adversely affected by the proposal. According to the Exchange, these orders are automatically executed by its Retail Automatic Execution System (''RAES'') at the best bid or offer (''BBO'') then existing on CBOE. However, if that bid of offer is inferior to the current quote on another exchange, RAES automatically executes the order at the better quote on the other exchange if it is one tick better than CBOE's BBO. If the other market's quote is more than one tick better, the order will not be automatically executed by RAES. Instead, it will be ''kicked out'' of RAES and the market-maker will attempt to obtain the superior price quoted in the other market for that order. According to CBOE, under normal trading conditions ''kicked out'' orders are almost always filled at a price no worse than the CBOE bid/offer that was available at the time the order was kicked out, even if the CBOE market moves against the price in the interim.[23] According to CBOE, in most instances, the trading crowd will fill the order at a price equal to or better than the better bid or offer displayed in the other market. How this will be accomplished varies from crowd to crowd. Some crowds may attempt to ascertain whether the other quote is in fact available and will fill the order at the better price if it is available. Other trading crowds may fill the order at the better price and attempt to trade against the other market after doing so.

3. No Benefit to Public Customers

CBOE acknowledged that customers may not benefit even if the SFBs reduced their rates because they may decide to keep the savings for themselves. The Exchange noted, however, that, although the proposal would not require SFBs to pass savings on to customers, customers would be in a better position to negotiate for lower commissions if their firm's costs were reduced.

4. Payment for Order Flow

In response to DOJ's argument that the proposal could be considered a payment for order flow, CBOE contended that orders would not be sent to it when better executions are available elsewhere because of the best execution obligations of brokers and market-makers. In addition, CBOE suggested that RAES and other similar systems are designed to ensure that orders are sent to the market that can provide best execution.[24] In any event, CBOE argues that payment for order flow is not improper as long as there is adequate disclosure.[25]

IV. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations under the Act that apply to a national securities exchange, and, in particular, with the requirements of Section 6(b)(5).[26] That section provides that the rules of a national securities exchange must be designed, among other things, to facilitate transactions in securities and 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. It also provides that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers or dealers. Moreover, the Commission believes that the proposal, as amended, is consistent with Section 3(f) under the Act.[27] That provision states that: ''Whenever pursuant to [the Act] the Commission is engaged in . . . the review of a rule of a self-regulatory organization, and is required to consider or determine whether an action is necessary or appropriate in the public interest, the Commission shall also consider, in addition to the protection of investors, whether the action will promote efficiency, competition, and capital formation.''

A. Competitive Issues

The Commission believes that the proposed rule change, as amended, is a reasonable effort by CBOE to better enable its competitive market-maker crowds to compete for multiply listed options with other exchanges that employ a specialist system. While transaction charges are not the only means of competition among exchanges, they are an important area for distinguishing between the mix of prices and services offered by the competing options markets. As a result, the Commission believes that by potentially lowering the execution costs on CBOE, the proposal should help to promote interexchange competition. Although there is no guarantee that public customers will ultimately benefit from the reduction in brokerage rates as a result of the Surcharge, the Commission believes that CBOE intends for the proposal to have that effect. This is not to say that the proposal could not have unintended collateral effects.

One potential adverse collateral effect could be that CBOE market-makers that favored the Surcharge could use the fee as a competitive weapon to drive smaller market-makers out of a particular trading crowd. The Commission believes that the proposal has been amended in a way that should significantly reduce the likelihood that the proposal will have such an unintended effect. In this regard, the

[21] *See* CBOE Response Letter, *supra* note 4.

[22] The Commission notes that in Amendment No. 1, CBOE capped the Surcharge at $.25 per contract.

[23] *See* Amendment No. 1, *supra* note 5.

[24] For example, as discussed above, RAES will automatically execute at the other market's quote if it is one tick better than CBOE's best bid or offer. If the other market's quote is more than one tick better, then the order will be handled manually. The Commission notes that currently no options exchange system (including CBOE's RAES) re-routes orders to another market showing the best bid or offer.

[25] In Amendment No. 1, CBOE added a requirement that SFBs' customers be informed when they receive a Surcharge from CBOE market-makers.

[26] 15 U.S.C. 78f(b)(5).

[27] 15 U.S.C. 78c(f).

Commission notes that the amendments made by CBOE, such as imposing a ceiling on the Surcharge of $0.25 per contract, establishing equal weighting of Resident Market-Maker votes, and resting the ultimate authority of whether to impose a Surcharge and the amount in the Committee rather than with the Resident Market-Makers, all serve to reduce the potential for anti-competitive effects of the proposal.[28]

Another possible collateral effect of the proposal would be that CBOE market-makers might widen spreads to make up for the costs of providing floor brokers with the Surcharge First, the Commission notes generally that options market-makers are required to establish quote ranges that promote fair and orderly markets. Artificially wide quote spreads are inconsistent with that requirement.[29] In addition, competition for order flow among competing market-makers as well as between those firms and specialists on other markets serves to narrow quote spreads. The Commission does not believe that there is anything particularly unique in the current proposal that would make it more likely that a market-maker would widen spreads. The same potential concern is present under existing specialist systems. Theoretically, options specialists could, without regulatory approval, eliminate their transaction and limit order book fees, or pay for order flow, and subsidize such activities by widening their quote spreads. Under CBOE's proposal, on the other hand, the Exchange (under SEC oversight) is accountable for the Surcharge.

Additionally, the best execution obligations of the upstairs order routing firms should reduce the likelihood that spreads will be widened by requiring that those firms direct order flow to the markets that are disseminating superior quotes. The duty of best execution requires a broker-dealer to seek the most favorable terms reasonably available under the circumstances for a customer's transaction. A broker-dealer routing orders for automated execution would need to assess periodically the quality of competing markets to assure that aggregated order flow was directed to markets providing the most advantageous terms for its customers' orders.[30] Thus, any broker-dealer who sends order flow to CBOE to benefit itself from reduced brokerage commissions generally would be in violation of its duty of best execution if the orders it represents received worse executions on CBOE than available at other exchanges. Additionally, it generally would be inconsistent with a broker's best execution obligations if a broker-dealer were automatically to route orders to the exchange with the lowest brokerage/book rates when better options prices are available on another exchange. Consistent with best execution responsibilities, a broker-dealer generally should only consider routing orders to one exchange over another based on reduced brokerage/book rates under two circumstances: (1) where competing exchanges offer identical prices; or (2) where the reduced brokerage/book rates will be passed on to the broker-dealer's customers to an extent that compensates for otherwise inferior execution. The Commission anticipates that CBOE will continue vigilantly to enforce the applicable best execution duties of its member firms generally and with respect to this proposal.

Although, for the reasons discussed above, the Commission believes it is unlikely that the proposal would have the unintended result of widening spreads on CBOE, in an abundance of caution, the Commission is asking CBOE to gather and analyze data to permit comparisons of spreads on CBOE before and after a Surcharge is implemented. Should these comparisons suggest that the proposal is having such an unintended consequence, the Commission would weigh that as a factor in determining whether the proposal should be approved permanently.

B. Payment for Order Flow Issues

The Commission acknowledges that the Surcharge, which is intended to attract order flow to CBOE, could be considered a form of ''payment for order flow.'' The practice of paying for order flow has generated much debate and controversy in the past.[31] The Commission ultimately decided not to ban the practice, but instead required broker-dealers to inform customers in writing about their policies regarding the receipt of payment for order flow, including whether payment for order flow is received and a detailed description of the nature of the compensation.[32] The Exchange has amended the proposal to include a requirement that SFBs disclose to their customers the payment in a manner satisfactory to the Exchange and consistent with the broker-dealer's obligations under the federal securities laws.[33] The Commission believes that requiring SFBs to provide notice to their customers (most of which are broker-dealers) that they have received a payment to attract their orders to CBOE will provide those customers necessary information with regard to the Surcharge arrangement. In turn, those customers may use the information to negotiate better commissions from the SFB or to take other appropriate action.

C. Exchange and Continued Commission Oversight

Under the proposal, as amended, the Appropriate Procedure Committee, pursuant to authority delegated to it by the Exchange, rather than the market-maker crowd,[34] would determine whether to impose the Surcharge and, if so, its amount.[35] Although under the proposal the Committee must consider the result of the vote of the Resident Market-Makers in reaching its decision, it must also consider the views of any market-maker opposing the Surcharge or favoring a different amount.[36] Thus, under the revised proposal, the Resident Market-Makers play only an advisory role, while the Committee has the final decision-making authority.[37] Although, under the proposal, the Exchange would narrowly delegate authority to the

[28] *See* Amendment No. 1, *supra* note 5.

[29] *See, e.g.,* CBOE Rule 8.7(a), which states ''[t]ransactions of a Market-Maker should constitute a course of dealing reasonably calculated to contribute to the maintenance of a fair and orderly market, and no Market-Maker should enter into transactions or make bids or offers that are inconsistent with such a course of dealings.'' Moreover, collusive activity by market-makers to keep spreads artificially wide would, of course, violate the federal securities laws.

[30] *See* Exchange Act Release No. 36310 (September 29, 1995), 60 FR 57292 (October 10, 1995).

[31] *See* Exchange Act Release No. 33026 (October 6, 1993), 58 FR 36262 (October 13, 1993) (discussing the practice and the history of the debate).

[32] *See* Exchange Act Release No. 34902 (October 27, 1994), 59 FR 55006 (November 2, 1994) (adopting amendments to Exchange Act Rules 10b–10 and 11Ac1–3). At the same time, the Commission proposed for comment whether these disclosure requirements should apply to the options market. *See* Exchange Act Release No. 34903 (October 27, 1994), 59 FR 55014 (November 2, 1994). The Commission has yet to adopt such requirements.

[33] *See* Amendment No. 1, *supra* note 5.

[34] CBOE has also amended the vote weighting provision so that each Resident Market-Maker vote is now weighted equally. *See* Amendment No. 1, *supra* note 5.

[35] After the Surcharge and OBO rates are determined or any changes are made to them, the Committee through authority delegated by the Board will submit a rule filing to the Commission pursuant to Section 19(b)(3)(A) of the Act before the fee is implemented. *See* Amendment No. 1, *supra* note 5.

[36] Any market-maker may appeal the Committee's decision to the Exchange's Appeals Committee pursuant to Chapter XIX of CBOE Rules.

[37] Although the Board would delegate its authority to impose a Surcharge to the Committee, the Board itself could at any time impose such a fee, subject, of course to CBOE's responsibilities under the Act, on its own accord or at the suggestion of the Resident Market-Makers.

Committee to impose a Surcharge, the Committee will notify the Board of any such action at the Board meeting following the Committee's decision to impose a Surcharge.[38] this notification will ensure that the Exchange is made aware of the Committee's action and give the Exchange an opportunity to eliminate or change the fee if it decides to do so. All Surcharges would of course need to be filed with the Commission.

The Commission believes that these safeguards should help to ensure that any Surcharge is imposed fairly and in a manner designed to promote interexchange competition. Ultimately, such enhanced competition should benefit the markets and investors.

D. Accelerated Approval of Amendment No. 1

The Commission finds good cause to approve Amendment No. 1 to the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the *Federal Register.* In Amendment No. 1, CBOE changed the proposal in significant ways to respond to the concerns raised by DOJ and Commission staff. Specifically, Amendment No. 1, among other things, proposed to cap the Market-Maker Surcharge at $0.25 per contract, to grant the authority to impose the Surcharge to the Committee rather than to the Resident Market-Makers, and to operate the proposal as a pilot program. Because the amendment responds to the Commission's concerns and those of DOJ, the Commission believes that it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act to approve Amendment No. 1 to the proposal on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1 to the rule proposal, including whether the amendment is consistent with the Act. Persons 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 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 also will be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR–CBOE–98–35 and should be submitted by March 24, 1999.

VI. Conclusion

I is therefore ordered, pursuant to Section 19(b)(2) of the Act,[39] that the proposed rule change (SR–CBOE–98–35) as amended is approved through March 31, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[40]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 99–5719 Filed 3–8–99; 8:45 am]

BILLING CODE 8010–01–M

[38] *See* Amendment No. 1, *supra* note 5.

[39] 15 U.S.C. 78s(b)(2).

[40] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–41120; File No. SR–CSE–98–04]

Self-Regulatory Organizations; Cincinnati Stock Exchange, Inc.; Order Approving Proposed Rule Change to Reduce its Public Agency Guarantee Size

February 26, 1999.

I. Introduction

On October 26, 1998 [1] the Cincinnati Stock Exchange, Inc. (''CSE'' 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'')[2] and Rule 19b-4 thereunder,[3] a proposed rule change to reduce the CSE public agency guarantee size. Notice of the proposal appeared in the **Federal Register** on January 7, 1999.[4] The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of Proposal

The Exchange proposed to amend the public agency guarantee in CSE Rules 11.9(c)(v) and (n). CSE Rules 11.9(c)(v) and (n) provide an execution guarantee for public agency market and marketable limit orders. Currently, public agency orders up to the size of the lesser of the national best bid or offer (''NBBO'') or 2099 shares are guaranteed. No portion of an order larger than 2099 shares is subject to the guarantee. The Exchange proposed to lower the maximum order size of its public agency guarantee. The proposed rule change would lower the size of the public agency guarantee to the lesser of the NBBO or 1099 shares. The public agency guarantee would otherwise remain unchanged.

The Exchange believes that its specialists are exposed to adverse risk in a more volatile trading environment due to higher volume levels and the National Market System change to quoting and trading securities in increments less than 1/8th of a dollar. The Exchange believes that lowering the public agency guarantee will lower the risk its specialists currently experience to a reasonable level. Additionally, the Exchange represents that lowering the public agency guarantee from 2099 to 1099 shares should not significantly impact customers since the majority of customer orders are less than 1000 shares.[5]

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 [6] and, in particular, the requirements of Section 6.[7] The Commission believes that the proposal is consistent with the provisions of Section 6(b)(5), in that it is designed to promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market and a national market system. The Commission believes that the proposal should reduce the risk experienced by the Exchange's specialists without significantly affecting the proper execution of public agency orders. Thus, the Commission concludes that the proposal will strike an appropriate balance between the risk incurred by the Exchange's specialists during a volatile trading environment and the policy to ensure the best possible execution of orders for public investors. Therefore, the Commission believes that lowering the size of the

[1] The Exchange initially filed this proposal on October 26, 1998. However, on November 12, 1998, the Exchange filed Amendment No. 1 the substance of which was incorporated into the notice.

[2] 15 U.S.C. 78s(b)(1).

[3] 17 CFR 240.19b-4.

[4] Securities Exchange Act Release No. 40843 (December 28, 1998), 64 FR 1048.

[5] Telephone conversation between David Colker, President, CSE, and John Roeser, Attorney, Division of Market Regulation, SEC on February 25, 1999.

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

[7] 15 U.S.C. 78f.