from $0.07 to $0.19 per contract side for member firm proprietary orders and from $0.08 to $0.17 per contract side for specialist and market maker orders. To further offset the elimination of options transaction, clearance and brokerage fees for customer equity option orders, the Exchange proposes to increase the equity options transaction fee for non-member broker-dealer orders from $0.07 to $0.19 per contract side. This revised fee will also apply to both LEAPS [6] and FLEX [7] options. Equity options clearance and floor brokerage fees for non-member broker-dealers will remain unchanged at $0.04 and $0.03 per contract side, respectively.

III. Discussion

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and in particular, with the requirements of Section 6 of the Act.[8] Specifically, the Commission finds that the proposal is consistent with Section 6(b)(4) of the Act, which requires a registered national securities exchange to promulgate rules that provide for the equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities.[9] The Commission believes that the proposed increase in the equity options transaction fee for non-member broker-dealer orders is not unreasonable and should not discriminate unfairly among market participants. In addition, the Commission notes that member firm proprietary orders are charged the same options transaction fee as is proposed for non-member proprietary orders.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Approval of the proposal will enable the Exchange to offset the recent elimination of options transaction, clearance, and floor brokerage fees for customer equity options orders in an expeditious manner. The Commission notes that the Exchange recently raised the equity options transaction fee for member firm proprietary orders to help offset the elimination of options transaction, clearance, and floor brokerage fees for customer equity options orders, and no comments were received on that proposal.[10] Therefore, the Commission believes it is consistent with Section 6(b)(5) and Section 19(b)(2) of the Act to grant accelerated approval to the proposed rule change.[11]

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[12] that the proposed rule change (SR–Amex–00–18) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[13]

Margaret H. McFarland,

Deputy Secretary.

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[6] LEAPS are Long Term Equity Anticipation Securities or options with durations of up to 36 months. *See* Amex Rule 903c.

[7] FLEX options are customized options with individually specified terms such as strike price, expiration date, and exercise style. *See* Amex Rule 900G.

[8] 15 U.S.C. 78f. 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).

[9] 15 U.S.C. 78f(b)(4).

[10] *See* Securities Exchange Act Release No. 42675, (April 13, 2000), 65 FR 21223 (April 20, 2000) (approving SR–Amex–00–15).

[11] 15 U.S.C. 78f(b)(5) and 78s(b)(2).

[12] 15 U.S.C. 78s(b)(2).

[13] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42870; File No. SR–CBOE–97–37]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment Nos. 1, 2, 3, 4 and 5 to the Proposed Rule Change Relating to Eligibility Requirements for Participation on the RAES System

May 31, 2000.

I. Introduction

On August 6, 1997, the Chicago Board Options Exchange, Inc. (''CBOE'' or ''Exchange'') submitted to the Securities and Exchange Commission (''SEC'' or ''Commission''), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'') [1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend its Retail Automatic Execution System (''RAES'') eligibility requirements for market makers. The proposed rule change was published in the **Federal Register** on August 20, 1997.[3] The Commission received three comment letters on the proposed rule change.[4]

On July 23, 1998, the CBOE submitted Amendment No. 1 to the proposed rule change. [5] On September 28, 1999, the CBOE submitted Amendment No. 2 to the proposed rule change.[6] On December 8, 1999, the CBOE submitted Amendment No. 3 to the proposed rule change.[7] On March 22, 2000, the CBOE submitted Amendment No. 4 to the proposed rule change.[8] Finally, on May 19, 2000, the CBOE submitted

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

[2] 17 CFR 240.19b–4.

[3] Exchange Act Release No. 38928 (August 12, 1997), 62 FR 44296.

[4] Letters from James I. Gelbort to the Commissioners, SEC, dated September 7, 1997 (''Gelbort Letter''); Scott Kilrea, President, Letco, Lee E. Tenzer Trading Company, to Jonathan G. Katz, Secretary, SEC, dated February 20, 1998 (''Letco Letter No. 1''); and Scott Kilrea, President Letco, Lee E. Tenzer Trading Company, et al, to Heather Seidal, Division of Market Regulation (''Division''), SEC, dated August 7, 1998 (''Letco Letter No. 2'').

[5] Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Heather Seidel, Division, SEC, dated July 22, 1998 (''Amendment No. 1''). In Amendment No. 1, the Exchange amended the proposal by establishing a floor percentage that may be set by the Market Performance Committee (''MPC'') that limits a market maker's total transactions and contract volume executed on RAES. The CBOE also proposed that the market maker percentages should be established and calculated on a quarterly basis. Amendment No. 1 contained guidelines to be used by the MPC when determining whether to exempt market maker activity on one or more trading days during the applicable calendar quarter and guidelines for the exercise of discretion by the MPC pursuant to Interpretation .01 of the proposed rule change, which permits the MPC to apply the eligibility requirements to fewer than all classes traded at a particular trading station. Finally, the CBOE responded to issues raised in Letco Letter No. 1 (*see supra* note 4).

[6] Letter from Timothy Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Richard Strasser, Division, SEC, dated September 23, 1999 (''Amendment No. 2''). In Amendment No. 2, the CBOE amended the proposal to limit its application to those options classes identified by the Exchange as having market makers that trade an inordinate percentage of their transactions on RAES. The Exchange also reiterated its belief that the proposed rule language afforded protections against potential discrimination by the MPC when it determines which trading days to exempt from the percentage calculations because the MPC will not know the identity of market makers from the data it reviews. Finally, the Exchange responded to issues raised in Letco Letter No. 2 (*see supra* note 4).

[7] Letter from Stephanie C. Mullins, Attorney, CBOE, to Kelly Riley, Division, SEC, dated December 7, 1999 (''Amendment No. 3''). In Amendment No. 3, the CBOE amended the proposed rule change to provide an exemption from the proposed RAES percentage requirements for designated primary market makers (''DPMs'') and their designees, when acting in the capacity as a DPM in an option class.

[8] Letter from Timothy Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Kelly Riley, Division, SEC, dated March 21, 2000 (''Amendment No. 4''). In Amendment No. 4, the CBOE corrected rule language submitted in Amendment No. 3, which failed to reflect the revisions proposed in Amendment No. 2.

Amendment No. 5 to the proposed rule change.[9]

This order approves the proposed rule change, as amended. The Commission is also soliciting comment on Amendment Nos. 1, 2, 3, 4 and 5 to the proposed rule change from interested persons.

II. Description of the Proposal

The CBOE proposes to establish two additional eligibility requirements that market makers must satisfy to be eligible to participate in the RAES system.[10] The Exchange also proposes to clarify that CBOE Rule 8.16 applies to RAES eligibility in all CBOE options except options on the Standard & Poor's 100 Stock index (''OEX''), options on the Standard & Poor's 500 Stock Index (''SPX'') and options on the Dow Jones Industrial Average (''DJX''), which have separate RAES rules.

The Exchange proposes to implement a limit on the percentage of a market maker's overall trades, both in terms of total transactions and contract volume, that a market maker may transact on RAES during a quarterly period. The proposed eligibility requirements, however, will not apply to DPMs.[11] The eligibility requirements have two distinct parts, both of which must be satisfied. First, a market maker's RAES transactions may not exceed a maximum percentage of his or her total transactions for a calendar quarter. Second, a market maker's contract volume resulting from his or her RAES transactions must not exceed a maximum percentage of his or her overall contract volume during a calendar quarter.

These percentages will be determined by the MPC. The MPC's authority to determine the applicable percentages, however, will be limited so that neither of the percentages may be set at less than fifteen percent. In other words, the MPC may not establish a maximum RAES transaction or contact volume percentage under fifteen percent.

Further, the MPC will only implement these eligibility requirements on those options classes that have been identified as having market makers that are not actively fulfilling their market making obligations.[12] If the MPC determines to implement the eligibility requirements on an options class, a regulatory circular will be issued setting forth the applicable percentages and the effective date for the application of the percentages before the beginning of the quarterly period.

The MPC will have the authority to implement the eligibility requirements on those options classes that it identifies as having market makers that are not actively fulfilling their market making obligations on the floor of the Exchange. The factors to be considered by the MPC when determining whether to apply the percentage requirements include complaints from floor brokers or other market makers; the results of routine market performance surveys; data concerning the percentage of RAES trades performed by a particular market maker or market maker trading crowd; or any other factor that the MPC deems relevant.[13]

At the end of each quarter, the market maker transaction and volume percentages will be calculated. The MPC will have the authority to exempt from the percentage tabulations certain trading days. When determining which days to exempt, however, the MPC will not be privy to individual market maker identities. It will consider whether a particular day experienced an unusually high percentage of RAES trades compared to normal trading days and any other relevant factors. Generally, the MPC will exempt market maker activity for any option class on days where the percentage of RAES trades out of total trades exceeds the requirement set for the class by the MPC.

If a market maker is found to be in violation of the eligibility requirements, he or she may be determined ineligible to participate on RAES. In addition, a market maker may be subject to disciplinary or other remedial action by the MPC under paragraph (d) of Rule 8.16. Market makers, pursuant to Chapters XIX and XVII, as applicable, may appeal such actions taken by the MPC.[14]

III. Summary of Comments

The Commission received three comment letters from two commenters on the proposed rule change.[15] One commenter stated that he believed that the proposed rule change was unnecessary.[16] The other commenter, while generally supporting the underlying motivation of the proposed rule change, questioned its application on DPMs[17] and requested that approval of the proposal be postponed until the ramifications on DPMs could be resolved.[18] The Exchange submitted to the Commission a letter in response to the issues raised by one commenter.[19] In addition, the Exchange addressed the issues raised in the comment letters in Amendment Nos. 1, 2, and 3. The following discussion summarizes the issues raised by the commenters and the Exchange's response.

1. Gelbort Letter

In his comment letter, Mr. Gelbort questioned the appropriateness of the proposed rule change and suggested that current Exchange rules should be able to sufficiently address the concerns described by the Exchange relating to market makers who fail to adequately fulfill their market making obligations. Specifically, Mr. Gelbort suggested that by filing the proposal the Exchange implied that it had been unable to enforce the provisions of CBOE Rule 8.7.[20] Mr. Gelbort stated that he believed that other current Exchange rules, if employed effectively, could adequately address the problems identified by the Exchange. For example, according to Mr. Gelbort, CBOE Rule 8.2(a) provides

[9] Letter from Timothy Thompson, Director, Regulatory Affairs, Legal Department, CBOE to Kelly Riley, Division, SEC, dated May 18, 2000 (''Amendment No. 5''). In Amendment No. 5, the CBOE amended the proposed language of Interpretation .01 of Rule 8.16. Specifically, Interpretation .01 is proposed to contain factors to be considered by the MPC when it determines whether to impose the percentage requirements on a particular options class. Further, the Exchange deleted factors proposed in Amendment No. 1, which were to be used by the MPC to determine whether to exempt an options class from the percentage requirements. However, because the proposal, as amended in Amendment No. 2, is no longer proposed to be implemented floor wide but only applied to specific options classes that have been identified by the MPC as having market makers that are not actively fulfilling their market making obligations, the deleted factors were no longer necessary.

[10] RAES is the Exchange's automatic execution system for small (generally less than 50 contracts) public customer market or marketable limit orders. When RAES receives an order, the system automatically will attach to the order its execution price, determined by the prevailing market quote at the time of the order's entry into the system. A buy order will pay the offer; a sell order will sell at the bid. An eligible market maker who is signed onto RAES at the time the order is received will be designated to trade with the public customer at the assigned price.

[11] *See* Amendment No. 3.

[12] *See* Amendment No. 2.

[13] *See* Amendment No. 5.

[14] The Exchange also noted that the MPC might determine to require an ineligible market maker to participate in RAES if there is inadequate participation in a particular options class. *See* CBOE Rule 8.16(c).

[15] *See supra* note 4.

[16] *See* Gelbort Letter.

[17] *See* Letco Letter No. 1.

[18] *See* Letco Letter No. 2.

[19] Letter from Charles J. Henry, President and Chief Operating Officer, CBOE to Jonathan G. Katz, Secretary, SEC, dated October 31, 1997 (''Response Letter''). The Response Letter addressed the issues raised in the Gelbort Letter.

[20] CBOE Rule 8.7 sets forth the obligations of market makers. Pursuant to CBOE Rule 8.7, market makers are required, among other things, to execute transactions that constitute a course of dealings that are reasonably calculated to contribute to the maintenance of a fair and orderly market. Specifically, market makers are required, among other things, to compete with other market makers to improve markets, to make markets, to update market quotations in response to changed market conditions and to price options contracts fairly.

the Exchange with the authority to deny market maker registration for insufficient ability. In addition, according to Mr. Gelbort, CBOE Rule 8.2(b) permits the MPC to suspend or terminate market maker registrations for incompetence. Further, Mr. Gelbort stated, CBOE Rule 8.3 permits the MPC to suspend or terminate market maker appointments when the interests of a fair and orderly market are served. Finally, Mr. Gelbort described the authority granted to the MPC in CBOE 8.60 to hold informal meetings or hearings that may result in remedial actions against market makers and the disciplinary proceedings that the Exchange may institute under Chapter XVII of its rules.

Mr. Gelbort also suggested that the proposed rule change might create inequities associated with its administration. Specifically, Mr. Gelbort raised concerns about the broad authority sought by the Exchange and questioned the apparent lack of numerical limits. Mr. Gelbort pointed out that the broad authority could result in the proposed rule being applied to exclude certain market makers in an arbitrary manner. He also questioned whether the proposed rule could be applied differently to market makers and DPMs.[21] In addition, Mr. Gelbort suggested that because the Exchange has the authority to compel market maker participation on RAES whenever a market maker is present in the crowd during an expiration cycle after the market maker has signed on to RAES once,[22] that market makers would not be able to self-regulate his or her own RAES trading percentage. Further, Mr. Gelbort stated that the proposed rule would not encourage compliance with the marekt making obligations of CBOE Rule 8.7 in all classes allocated to a crowd.

Mr. Gelbort also questioned the effect of changing the phrase from ''in that trading crowd'' to ''at the trading station'' in proposed Rule 8.16(a)(iv). Mr. Gelbort expressed concern that his change in language could allow a future MPC to interpret the phrase as prohibiting market makers standing in one part of the crowd from trading or participating on RAES in all classes allocated to the crowd. According to Mr. Gelbort, some DPMs arrange their stations to make it difficult for all market makers to trade in all of the classes allocated to the station and he questioned the significance of the language change.

Finally, Mr. Gelbort stated that he believed that the proposed rule change is anticompetitive because he believes it condones disregard for the affirmative market making obligations and because it arbitrarily restricts the number of market makers who may choose to interact with RAES-eligible orders. Further, he believed that the Exchange should clarify the problems sought to be addressed by the proposal and to determine whether current Exchange rules adequately address these problems. If, however, the Exchange finds that the proposal is the best gauge for market maker performance, Mr. Gelbort believes that persistent non-compliance should be met with sanctions stronger than exclusion from RAES.

The Exchange responded to Mr. Gelbort's comments in its Response Letter.[23] The following summarizes the Response Letter.

The Exchange expressed its strong disagreement with Mr. Gelbort's suggestion that is proposal was an indication of its inability to enforce CBOE Rule 8.7. According to the Exchange, the proposal should not be read to suggest that it lacks the ability to enforce compliance with CBOE Rule 8.7, but should be considered as an additional incentive for market makers to meet their market making obligations. The Exchange explained that it utilizes a number of current rules to ensure compliance by its market makers. For example, the Exchange stated that it conducts semi-annual crowd evaluations pursuant to CBOE Rule 8.60 during which the MPC speaks to each member of a trading crowd to explain the obligations of market makers. These reviews have led to some trading crowds being restricted in new product allocations and have led to referrals to the Department of Market Regulation for appropriate action when it appears that individual market makers are performing below standard.

The Exchange also stated that it evaluates the performance of individual market makers. The Exchange reviews, on a quarterly basis, whether a market maker is complying with the trading volume requirements of Interpretation .03 of CBOE Rule 8.7.[24] The Exchange stated that the MPC takes progressive remedial actions against market makers for violations of these provisions. In conjunction with the MPC's review, the Department of Market Regulation reviews the 80 percent in-person requirement.[25] According to the Exchange, these reviews seek to ensure that market makers trade in the appointed options. If a market maker is not performing, remedial actions may be taken.

Moreover, according to the Exchange, applications of potential market makers are reviewed. The Exchange's Membership Committee reviews all market maker applications, pursuant to CBOE Rule 8.2(a) and Chapter III of the Exchange's rules. All market maker applicants must successfully complete an examination that measures competence and qualifications. Further, all applicants must attend educational training.

In response to Mr. Gelbort's assertion that the proposal may be inequitably administered because of the broad authority of the MPC to set applicable percentages, the Exchange stated that this flexibility was necessary because the MPC does not yet have experience with setting such limitations. Further, the Exchange believes that the flexibility will enable the MPC to apply appropriate to each class and to exempt trading days as necessary. The Exchange stated that the administration of the rule would not be arbitrary because the same percentages for a particular class will apply to all market makers. Moreover, members economically aggrieved by any MPC decision will be able to appeal such decision pursuant to Chapter XIX of the Exchange's rules.

The Exchange disagreed with Mr. Gelbort's assertion that market makers will be unable to effectively regulate their percentage of RAES trades. While it is true that a market maker is obligated to log on to RAES in specified circumstances, which prevents the market maker from regulating the number of his or her RAES trades, the Exchange believes that a market maker can regulate the number of non-RAES trades by making competitive markets and aggressively competing for order flow. Thus, the Exchange believes that market makers can regulate the percentage of his or her RAES trades by monitoring his or her non-RAES trades. Moreover, the Exchange states that the MPC's authority to exempt certain

[21] As discussed above, DPMs have been specifically exempted from operation of the rule. *See* Amendment No. 3.

[22] *See* CBOE Rule 8.16(b).

[23] *See supra* note 19.

[24] Interpretation .03A of CBOE Rule 8.7 requires a market maker to transact 75 percent of his or her total contract volume in options classes to which he or she has been appointed. Interpretation .03B of CBOE Rule 8.7 requires a market maker to execute at least 25 percent of his or her total transactions in person, and not through the use of orders, provided, however, that for any calendar quarter in which a market maker receives market maker treatment of off-floor orders, the market maker must execute in person, and not through the use of orders, 80 percent of his or her total transactions.

[25] *Id.*

trading days should prevent market makers from failing to satisfy the tests due to unusual market conditions.

In response to Mr. Gelbort's assertion that the proposal would not encourage compliance with the obligation imposed on market makers to make markets in all series of options classes at the trading station, the Exchange states the proposal was not intended for such a purpose. According to the Exchange, the proposed rule change was not meant to encourage compliance with this market maker obligation and that other Exchange rule serve this purpose.

Regarding the proposed change in language from ''in the trading crowd'' to ''at the trading station,'' the Exchange states the terms ''station'' and ''trading crowd'' are synonymous, pursuant to Interpretation .01 to CBOE Rule 8.8. Thus, a future MPC could not change this Interpretation without first submitting a proposed rule change to the Commission for approval.

The Exchange believes that the proposal should provide market makers with an incentive to compete when they are signed onto RAES because failure to actively fulfill their market obligations under CBOE Rule 8.7 could lead to sanctions. The Exchange believes that the proposal complements the other objectives tests to ensure that a market maker fulfills his Rule 8.7 obligations. Further, the Exchange does not believe that the proposal will limit the number of market makers who will be able to actively engage in making markets in their appointed classes. Rather, the Exchange believes that the proposal encourages compliance with CBOE Rule 8.7 and promotes active competition among market makers.

Finally, the Exchange agrees with Mr. Gelbort's observation that persistent non-compliance with the proposal should be met with a stronger sanction than expulsion from RAES. According to the Exchange, suspension from RAES is only one of the alternative sanctions that may be imposed pursuant to proposed paragraph (d) of CBOE Rule 8.16. Specifically, if a member repeatedly violates the proposed rule, the MPC may refer the violations to the Department of Market Regulation for an investigation of the market maker's compliance with CBOE Rule 8.7 generally.

2. Letco Letters

Letco submitted two letters to the Commission in response to the proposed rule change.[26] In both letters, Letco expressed concern about some of the administrative applications of the proposal. Specifically, the commenter questioned the application of the proposal with respect to DPMs. As discussed above, subsequent to these comment letters, the Exchange amended the proposal to exempt DPMs from the proposal rule.[27] Thus, the commenter's concerns regarding DPMs are moot.

IV. 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.[28] In particular, the Commission finds that the proposal is consistent with the requirements of Section 6(b)(5) [29] of the Act, which requires, among other things, that the rules of an exchange be designed to promote just and equitable principals of trade, 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.

Currently, CBOE Rule 8.16 does not contain any eligibility requirements for participating on RAES that is related to a market maker's trading activity. The Exchange stated that it had learned that some market makers on the floor have relied on their RAES participation to derive a large percentage of their profits and have not been affirmatively fulfilling their market making obligations as set forth in CBOE Rule 8.7. The Exchange explained that RAES was never intended to be a substitute to the normal operation of a traditional market making business. However, it became apparent to the Exchange that participation on RAES had led some market makers to cease to perform their obligations under CBOE 8.7.

To address these problems, the Exchange developed the proposed eligibility requirements. With these requirements, the Exchange seeks to ensure that market makers affirmatively make markets in their allocated classes. The proposal seeks to prevent market makers from relying on order flow from RAES without actively seeking order flow on the floor of the Exchange.

Pursuant to CBOE Rule 8.7, market makers have specified obligations that must be fulfilled. Generally, market makers are required to enter into transactions that constitute a course of dealings ''reasonably calculated to contribute to the maintenance of a fair and orderly market.'' Further, market makers are obligated to continuously engage in dealing for their own accounts when a lack of price continuity exists or when there is a temporary disparity between supply and demand for a particular contract, or when a temporary distortion of the price relationships exists between options contracts of the same class. In addition, market makers are specifically required to: (i) complete with other market makers to improve markets; (ii) make markets, which will be honored to a reasonable number of contracts in all series of options classes at the trading post; (iii) update market quotations in response to changed market conditions; and (iv) price options contracts fairly, within certain perimeters.

As described above, market makers have many important obligations that create a viable marketplace for options contracts, and perform functions that contribute to fair and orderly markets, as well as to liquidity. If market makers are not actively performing these obligations, the integrity of the marketplace is compromised. Customers expect that when they send an order to the CBOE floor that it will be treated in a manner consistent with the requirements of the CBOE rules, and when market makers fail to fulfill their obligations, customers can be negatively impacted.

If market makers are failing to fulfill their obligations as the Exchange described, the market for those securities can be adversely affected because there is not competition from all of the market makers in the trading crowd. This lack of total involvement by the crowd could lead to inferior pricing of customer orders, and could affect liquidity. Moreover, customer orders may be executed in a less timely manner.

Thus, the Commission is satisfied that the proposal addresses these concerns in a manner that is consistent with the Act. Under the proposal, in a particular calendar quarter market makers will be limited in the proportion of RAES transactions that may make up their total transactions and total contract volume. As proposed, the MPC may determine for a particular options class to limit each market maker's transactions and contract volume attributed to trades on RAES to a maximum percentage of each market maker's total transactions and contract volume. The MPC will determine two percentages, one will establish a maximum percentage of a market maker's total transactions for the quarter that may be derived from RAES transactions; the other will establish the

[26] *See* Letco Letter Nos. 1 and 2, *supra* note 4.

[27] *See* Amendment No. 3.

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

[29] 15 U.S.C. 78f(b)(5).

maximum contract volume that may be derived from a market maker's RAES transactions. Neither of these percentages may be less than 15 percent.

The Commission believes that these percentages should encourage market makers to actively fulfill their market making obligations. A market maker allocated options that are subject to these percentages requirements is more likely to participate in the floor market because its passive participation by signing onto RAES will be limited based on the market maker's non-RAES transactions. In this way, the proposed rule should act as an incentive to market makers to fulfill their obligations because those who fail to keep their RAES percentage within the maximum percentages will be subject to sanctions, including suspension of RAES participation.

The Commission is satisfied with the 15 percent floor that has been established in the rule. This provision limits the discretion of the MPC by preventing the MPC from establishing percentages that may be too low, and recognizes the importance of technology in Exchange operations. Today, a large amount of orders are routed to RAES for automatic execution.[30] Thus, an unduly restrictive percentage may have unintended consequences that compromise order flow and trading operations. This floor percentage is intended to strike a balance between establishing reasonable percentages to encourage market-makers to fulfill their obligations on the floor while also recognizing the amount of order flow that is routed to the RAES system for execution. The Commission expects that the Exchange will monitor the percentages established by the MPC to ensure that this balance is preserved.

The proposal will only be implemented in those options classes that the Exchange has identified as having market makers that are not actively fulfilling their market making obligations. The Commission believes that this limitation is appropriate and consistent with the Act. There would not be any reason to impose such limitations on market makers who are already actively making markets in their allocated options classes. This proposal provides the MPC with a remedial measure that can be imposed when a problem is identified.

The MPC will have the authority to determine the options classes in which market makers will be subject to the percentage limitations. In determining whether to impose the percentage requirements on a particular options classes, the MPC will consider factors such as complaints from floor brokers or other market makers that certain market makers performance surveys, data concerning the percentage of RAES trades performed by particular market makers, and other relevant factors. The Commission believes that these factors provide the MPC with the appropriate amount of discretion. Because the MPC will consider only relevant data, the limitations on the proportion of RAES trades to a market maker's total trades should only be applied to those options classes that are experiencing market maker problems. The Commission believes that this discretion should provide the MPC with flexibility to implement the eligibility requirements where needed, while also preventing the implementation of these requirements in classes that do not have such a need.

The MPC, at the end of each quarter, will have the authority to exclude from the percentage calculations trading days that may have experienced an unusually high percentage of RAES transactions when compared to normal trading days. In making this decision, the MPC, however, will not be able to identify individual market makers. Thus, the MPC will not be able to make these decisions based on any market maker's identity or volume. This anonymity should help to ensure that the process of excluding days is fair.

As described above, the Commission received three comment letters from two commenters regarding the proposal. The Commission believes that the Exchange adequately addressed the commenters concerns. Specifically, the Commission believes that the proposal does not reflect upon the Exchange's ability to enforce its market making obligations. Rather, the Commission believes that the proposal should enhance the existing regulatory structure of the Exchange. In addition, the Commission is satisfied with the Exchange's assertion that its rules already specifically define the terms ''in that trading crowd'' and ''at the trading station'' as synonymous, and the Commission further agrees that such definitions could only be amended by a rule change approved by the Commission.

The Commission disagrees with Mr. Gelbort's assertion that the proposal is anticompetitive because it condones disregard for affirmative market making obligations and because it arbitrarily restricts the number of market makers that may interact with RAES–eligible orders. On the contrary, the Commission believes that the proposal should encourage market makers to vigorously make markets in their appointed classes. Moreover, the Commission does not believe that the proposal arbitrarily restricts the number of RAES-eligible market makers that may interact with RAES transactions because all market makers will be able to continue to interact with RAES orders so long as their businesses do not place an over-reliance on RAES transactions to the detriment of the business on the floor. Market makers that fulfill their market making obligations on the floor, as well as in RAES, should not be prevented from participating in either trading forum.

Finally, as discussed above both commenters expressed concerns about how the proposal would apply to DPMs. The Exchange has addressed these concerns by exempting DPMs from operation of the rule. DPMs have additional responsibilities along with making markets, such as maintaining the book, participating at all times in automated execution and order handling systems, and responding to competitive developments in areas of market quality and customer service.[31] Thus, a DPM is unable to rely primarily on RAES trades to operate profitably. Therefore, imposing the eligibility requirements on DPMs would be unwarranted.

The Commission finds good cause to accelerate approval of Amendment Nos. 1, 2, 3, 4 and 5 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**.

In Amendment No. 1, the Exchange proposed to prohibit the MPC from requiring that market makers' transaction or contract volume from RAES executions be less than 15 percent of their total transaction or contract volume. By placing a floor on the percentage of a market maker's total transaction and contract volume that it must execute otherwise than on RAES, the Commission believes that the changes proposed in Amendment No. 1 preclude the MPC from establishing eligibility requirements that could actually harm the operations of the floor and the business of the market makers. The Exchange also proposed to apply these market makers eligibility requirements on a quarterly basis. Finally, the Exchange proposed two sets of guidelines for the MPC. The first set of guidelines will be used by the MPC to determine which days to exclude from the eligibility calculations. The Commission believes that these proposed guidelines strengthen the proposal by preventing the MPC from

[30] According to the Exchange, approximately 34% of its order executions take place in RAES.

[31] *See* CBOE Rules 8.80 and 8.81.

considering inappropriate information that could lead to uneven or potentially discriminatory application of the eligibility requirements. The second set of guidelines set forth the factors to be considered by the MPC, pursuant to Interpretation .01, in determining whether to apply the eligibility requirements to fewer than all the option classes traded at a trading station. The second set of guidelines was eliminated by the CBOE in a subsequent amendment.[32]

The Commission believes that the proposals in Amendment No. 1 enhance the proposed rule change. For these reasons the Commission believes that good cause exists, consistent with Section 6(b)(5)[33] and Section 19(b)[34] of the Act, to accelerate approval of Amendment No. 1 to the proposed rule change.

In Amendment No. 2, the Exchange proposed to limit the application of the proposed rule to options classes identified as having market makers that trade an inordinate percentage of their trades on RAES. The Commission believes that allowing the Exchange to limit application of the proposal to only certain options classes will reduce the potential for undue burdens to be placed on those options classes that are trading without problems and that have market makers that are actively fulfilling their market making obligations. In addition, the Exchange further explained why it believes that its proposal sufficiently protects against the MPC discriminating against or in favor of any parties when exercising its discretion to exclude certain days from the percentage calculations. The Commission is satisfied that the proposal prevents the MPC from applying the eligibility requirements in a discriminatory fashion. In particular, the Commission believes that, because the data upon which the MPC will base its decision to exclude certain days from the calculation of the eligibility requirement will not identify individual market makers, the MPC will not be able to make such decisions based upon the businesses of the individual market makers on those days. For these reasons, the Commission believes that Amendment No. 2 is consistent with the Act and that good cause exists to accelerate its approval.

The Commission believes that good cause exists, pursuant to Section 6(b)(5)[35] and Section 19(b)[36] of the Act, to accelerate approval of Amendment No. 3 to the proposed rule change. In Amendment No. 3, the Exchange proposed to exempt DPMs from the eligibility requirements. The Commission believes that in light of the additional responsibilities that DPMs must fulfill and due to the fact that these additional responsibilities are required by specific CBOE rules, that it is reasonable to exempt DPMs from the eligibility requirements.

The Commission believes that good cause exists, pursuant to Section 6(b)(5)[37] and Section 19(b)[38] of the Act, to accelerate approval of Amendment No. 4 to the proposed rule change. Amendment No. 4 was technical in nature and only sought to correct the proposed rule language submitted in Amendment No. 3 to make it consistent with the proposed rule language submitted in Amendment No. 2.

Finally, in Amendment No. 5, the Exchange deleted proposed factors that were no longer applicable after the submission of Amendment No. 2. Specifically, in Amendment No. 2, the Exchange proposed to only apply the percentage requirements to those options classes that had a demonstrated need for the limitations. The factors the Exchange proposes to delete in Amendment No. 5 were to be used by the MPC to determine if options classes should be exempt from the percentage requirements. Because the proposal now only applies the percentage requirements to those options classes with a demonstrated need, these factors are no longer appropriate. In addition, the Exchange proposed to add factors to be used by the MPC to determine which options classes should be subject to the percentage requirements. The Commission believes that the factors, as described above, provide the Exchange with appropriate discretion to determine which options should be subject to the limitations. Therefore, the Commission believes that good cause exists, pursuant to Section 6(b)(5)[39] and Section 19(b)[40] of the Act, to accelerate approval of Amendment No. 5.

V. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning Amendment Nos. 1, 2, 3, 4, and 5, including whether Amendment Nos. 1, 2, 3, 4 and 5 are 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 No. SR–CBOE–97–37 and should be submitted by July 5, 2000.

VI. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,[41] that the amended proposed rule change (SR–CBOE–97–37) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[42]

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42900; File No. SR–OCC–00–03]

Self-Regulatory Organizations; The Options Clearing Corporation; Notice of Filing of Proposed Rule Change To Amend OCC's By-Laws Relating to Clearing Member Representatives

June 5, 2000.

Pursuant to Section 19(b)(1)[1] of the Securities Exchange Act of 1934 (''Act''), notice is hereby given that on April 6, 2000, The Options Clearing Corporation (''OCC'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change as described in Items I, II, and III below, which have been prepared primarily by OCC. The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change.

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[32] *See* Amendment No.5

[33] 15 U.S.C. 78f(b)(5).

[34] 15 U.S.C. 78s(b).

[35] 15 U.S.C. 78f(b)(5).

[36] 15 U.S.C. 78S(b).

[37] 15 U.S.C 78f(b)(5).

[38] 15 U.S.C. 78s.

[39] 15 U.S.C. 78f(b)(5).

[40] 15 U.S.C. 78s(b).

[41] 15 U.S.C. 78s(b)(2)

[42] 17 CFR 200.30–3(a)(12).

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