

of the two markets' automatic execution size for customer orders. The Exchange expects that the interim linkage may expand to include limited access for pure principal orders, for orders of no more than 10 contracts.

All interim linkage orders must be "immediate or cancel" (that is, they cannot be placed on an exchange's limit order book), and a market-maker may send a linkage order only when the other (receiving) market is displaying the best national bid or offer and the sending market is displaying an inferior price. This will allow a market-maker to access the better price for its customer. In addition, if the interim linkage includes principal orders, it would allow market-makers to attempt to "clear" another market displaying a superior quote. Any exchange participating in the interim linkage will implement heightened surveillance procedures to help ensure that their market-makers send only properly-qualified orders through the linkage.

DPM participation in the interim linkage will be voluntary. Only when a DPM and its equivalent on another exchange believe that this form of mutual access would be advantageous will the exchanges employ the interim linkage procedures. The CBOE believes that the interim linkage will benefit investors and will provide useful experience that will help the exchanges in implementing the full linkage.

## 2. Statutory Basis

The proposed rule change meets the requirement of Section 6(b)(5) under the Act<sup>6</sup> in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transaction in securities, to remove impediments to and perfect the mechanism for a free and open market and a national market system, and, in general, 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 will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-00-58 and should be submitted by January 18, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>6</sup>

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

[FR Doc. 00-33119 Filed 12-27-00; 8:45 am]

**BILLING CODE 8010-01-M**

## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-43750; File No. SR-CBOE-00-52]

### **Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Participation Entitlements of Designated Primary Market Makers and Time and Priority Rules**

December 20, 2000.

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 November 7, 2000, 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 Exchange. The proposed rule change has been filed by the CBOE as a "non-controversial" rule change pursuant to Rule 19b-4(f)(6)<sup>3</sup> under the Act. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The CBOE is proposing to increase the participation entitlements of Designated Primary Market Makers ("DPMs") when only one or two market makers are at parity with the DPM, and to clarify the operation of various CBOE rules concerning participation entitlements, time and priority rules, and orders represented by a DPM as agent. The text of the proposed rule change is available at the Office of the Secretary, CBOE, and at the Commission.

#### **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 these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in

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

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

<sup>3</sup> 17 CFR 240.19b-4(f)(6).

<sup>6</sup> 15 U.S.C. 78f(b)(5).

<sup>6</sup> 17 CFR 200.30-3(a)(12).

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

A DPM's right to participate as principal in a transaction is generally governed by the principles of time and price priority set forth in CBOE Rule 6.45 and applicable in general to all bids and offers made on the Exchange.<sup>4</sup> Under these principles, if a DPM is first to respond with the best bid (offer) in response to a request for a market from a member not acting on behalf of the DPM, the DPM is entitled to participate up to 100% in any resulting transaction.<sup>5</sup>

In addition to this right, CBOE Rule 8.87 authorizes the Modified Trading System Appointments Committee ("MTS Committee") to establish from time to time a participation entitlement formula for all DPMs in the securities allocated to them, to apply even when the DPM's bid or offer is not otherwise entitled to priority in accordance with CBOE Rule 6.45. Rule 8.87 grants any DPM trading for its own account a right to participate with the market makers in the trading crowd—up to the percentage established by the MTS Committee<sup>6</sup>—in transactions that occur at the DPM's previously established principal bid or offer.<sup>7</sup>

<sup>4</sup> Certain exceptions apply, as provided in Rule 6.45.

<sup>5</sup> Similarly, by the principles set forth in Rule 6.45, if a market maker is first to respond with the best bid (offer) in response to a request for a market, the market maker is entitled to participate up to 100% in any resulting transaction. However, this entitlement applies only if the market maker's bid (offer) is better than the DPM's previously established principal bid (offer). If the DPM had previously established its principal bid (offer) at the price at which the transaction is to take place, the DPM entitlement provisions of CBOE Rule 8.87 apply, as explained below. It should be noted further that, by the terms of Rule 6.45, if the best bid (offer) is also represented by an order in the customer limit order book, that order will have priority over any other bid (offer) at the trading post.

<sup>6</sup> As specified in rule 8.87, the extent of the entitlement is subject to the review of the CBOE Board of Directors.

<sup>7</sup> On the other hand, when a DPM and one or more market makers all announce bids (offers) that establish the best bid (offer) at a price at which the DPM was *not* previously bidding, the priority rules apply as set forth in Rule 6.45. As such, the member who was first to respond at the best price (be it the DPM, a market-maker, or a floor broker) is entitled to participate up to the full amount of the order. As further provided by Rule 6.45, after the member with time priority has been satisfied, all other members bidding (offering) at the best price are entitled to participate based upon the sequence of their bids (offers). Concerning the application of the DPM entitlement when a customer order is at the best bid (offer), see further below.

The CBOE's current DPM participation entitlement is 30% for all transactions occurring at the DPM's previously established bid or offer.<sup>8</sup> The 30% entitlement is a flat rate and applies regardless of the volume in a particular class and the number of market makers present in the trading crowd, and regardless of whether the class is multiply listed. The CBOE is proposing to increase its DPM participation entitlements when there are one or two market makers at parity with the DPM<sup>9</sup> as follows:

- 50% when there is one market maker bidding (offering) at the DPM's previously established bid (offer); and
- 40% when there are two market makers at parity with the DPM.

When there are three or more market makers at parity with the DPM, the DPM's participation entitlement will remain unchanged at 30%. Accordingly, the changes would only occur in those limited instances where there are just one or two market makers at parity with the DPM, as the case may be. As discussed in more detail below, the CBOE proposes to issue a regulatory circular ("Regulatory Circular") to establish these changes.

The proposed changes will enable the CBOE to conform its participation entitlement percentages to the entitlements established by the rules and/or practices of the other exchanges. For example, on the Philadelphia Stock Exchange ("Phlx"), a specialist is currently allocated 60% of an order when one "controlled account" is on parity, 40% when two are on parity, and 30% when three or more are on parity.<sup>10</sup> Similarly, on the International Securities Exchange ("ISE"), after all public customer orders have been filled, a Primary Market Maker ("PMM") is allocated 60% of an order if only one other participant is quoting at the best price, 40% if two other participants are at the best price, and 30% if more than two other participants are at the best

<sup>8</sup> See Securities Exchange Act Release No. 42190 (Dec. 1, 1999), 64 FR 68706 (Dec. 8, 1999).

<sup>9</sup> According to the CBOE, market makers are deemed to be "at parity" with the DPM when they are bidding or offering at the DPM's previously established bid or offer; and "at parity" with each other when it is impossible to determine, in the open outcry of the auction floor, which market maker responded first with the best bid (offer) in response to the request for a market. Telephone conversation between Arthur B. Reinstein and Steve Youhn, CBOE, and Ira L. Brandriss, Division of Market Regulation, Commission, on December 4, 2000.

<sup>10</sup> See Phlx Rule 1014(g)(ii). A "controlled account," for the purposes of the referenced rule, includes any account controlled by or under common control with a member broker-dealer of the Phlx. See also Phlx Rule 1014(g)(i), which incorporates additional provisions for situations when a customer order is on parity.

price.<sup>11</sup> The American Stock Exchange ("Amex") and Pacific Exchange ("PCX") have similar practices and provisions.<sup>12</sup>

The primary purpose of the DPM participation right is to provide Exchange members with an incentive to become and remain DPMs and to assume the additional affirmative obligations imposed on DPMs that other members do not have. These obligations include the obligation to be present at the trading post throughout every business day, the obligation to participate at all times in automated execution and order handling systems such as the Exchange's Retail Automatic Execution System (RAES), the obligation to act as an Order Book Official and to maintain the public order book, and the obligation to provide high quality markets and services and to promote the Exchange as a marketplace to customers and other market participants.

In this respect, lower DPM participation entitlements on the CBOE make it more difficult to attract and retain qualified DPMs. This puts the CBOE at a competitive disadvantage to those exchanges that provide for higher guarantees. Thus, the Exchange believes that the proposed changes to its DPM participation entitlements are necessary to promote the CBOE's competitiveness within the exchange-traded options marketplace.<sup>13</sup>

The CBOE notes that the proposed changes will not affect the priority currently afforded to public customers in the execution of their option orders. The Exchange will continue to apply the DPM participation entitlement only to that portion of the order that remains

<sup>11</sup> See Supplementary Material .01 to ISE Rule 713. ISE rules also state that a PMM has precedence to execute orders of five contracts or fewer.

<sup>12</sup> On the Amex, a specialist is not currently entitled by rule to a participation guarantee. However, the Amex recently filed a proposal to codify the specialist allocation practices that have developed on its trading floor. The proposal would guarantee the specialist approximately 60% of an order when one registered trader is on parity, 40% when two to four are on parity, 30% when five to seven are on parity, 25% when eight to fifteen are on parity, and 20% when 16 or more are on parity. See Securities Exchange Act Release No. 42964 (June 20, 2000), 65 FR 39972 (June 28, 2000). On the PCX, after all public customer orders in the book have been filled, an LMM is generally guaranteed the right to participate in 50% of each transaction occurring at its disseminated quote. See PCX Rule 6.82(d).

<sup>13</sup> When it first proposed the current DPM participation right, the CBOE stated that the MTS Committee would continue to periodically review the entitlement "to ensure that it remains at an appropriate level given the market environment that prevails at the time," and that accordingly, the Exchange might propose further changes to the DPM participation entitlement in the future. See Securities Exchange Act Release No. 41904 (Sept. 22, 1999), 64 FR 52813 (Sept. 30, 1999).

after all public customer orders have been filled. This applies to customer orders in the book as well as those represented in the crowd. Thus, CBOE's DPM participation entitlement will continue to benefit customers by allowing them to receive full executions of their orders before a DPM can assert its participation entitlement.

As mentioned above, to effect the changes to the DPM participation entitlement level, the CBOE proposes to issue a new regulatory circular. The CBOE further believes that it would be beneficial to its membership if, for ease of access, the Exchange were to combine a discussion of the provisions referencing priority and DPM participation entitlements into one circular. Currently, in order to determine whether and to what extent a DPM is entitled to participate in a transaction, market participants must first reference Rule 6.45 and the corresponding, previously issued circulars to determine whether the principles of time and price priority are applicable. Next, they must refer to the most recent circular addressing DPM participation entitlements to determine whether these entitlements apply and at what level. By combining the relevant provisions of these previously issued circulars and the new changes into one comprehensive circular, CBOE believes that its membership will be in a better position to access this important information more quickly and efficiently.

The first section of the Regulatory Circular, "Price and Time Priority," contains a brief summary of the price and time priority principles contained in CBOE Rule 6.45. The second section of the Regulatory Circular, "DPM Participation Right," establishes and describes the participation percentages discussed in this proposal. As such, it explains when a DPM is entitled to a participation entitlement and, if so entitled, under what circumstances a 30%, 40%, or 50% participation entitlement is appropriate.

This section further clarifies a long-held CBOE interpretation that a DPM's participation entitlement is applicable to all securities traded by a DPM, which includes options as well as non-option securities traded pursuant to Chapter XXX of CBOE's Rules. Rule 8.87(b) states that, with respect to the DPM entitlement, a DPM has the right to participate for its own account "in securities allocated to the DPM." The circular makes clear that the term "securities" is not restricted to options only and, therefore, that the participation entitlement extends to

non-option securities traded on the CBOE.

The third section of Regulatory Circular, "Agency Orders," is an amplification of the principle that public customer orders, whether in the book or in the trading crowd, take priority over a DPM's participation right. As such, this section clearly states that a DPM's participation right is applicable only to that portion of an order that remains after public customer orders have been filled. The proposed circular also contains an example illustrating these principles:

Assume there is an order in the book to buy 150 contracts at \$3, a price that represents the national best bid. The DPM's previously established principal bid is \$3 and there are two market makers in the crowd each bidding at \$3. If a floor broker enters the crowd with a market order to sell 300 contracts, the order in the book receives full execution of 150 contracts at \$3. Thereafter, because the market makers' bids are at parity with the DPM's previously established principal bid, the DPM is entitled to a participation right of 40% with respect to the remaining 150 contracts of the market order. Therefore, the DPM receives 40% of the remaining 150 contracts at \$3, or 60 contracts. The two market makers in the crowd each receive 45 contracts at \$3.

The fourth section of the Regulatory Circular, "Orders in the Order Book," is primarily a restatement of time priority principles contained in CBOE Rule 6.45 as applied to the Order Book. The first sentence clarifies that because a DPM's previously established principal bid (offer) could not have been equal to the book, a DPM cannot participate with a market maker that was first to buy the book offer (sell to the book bid). The next sentence explains the operation of this principle in the context of crossed orders. Currently, when the AutoQuote system bid or offer would cross a booked order, AutoQuote will not adjust until the booked order trades. Thus, when a market maker trades with the booked order in this instance, a DPM is not entitled to participate because its previously established best bid or offer could not have matched the book. This section clarifies that this is the case even if the operation of AutoQuote may have prevented the DPM's quote from automatically adjusting to match the book offer (bid).

The last section of the Regulatory Circular, "Orders Represented by a DPM as Agent," establishes that, because of its knowledge of orders it represents as agent, a DPM Designee acting on behalf of the DPM's market maker account cannot be deemed first to respond to the

request for a market from another person acting on behalf of the DPM in performing the DPM's agency function. This is designed to prevent a DPM from using knowledge of orders it represents as agent in order to trade ahead of other market participants. This section clarifies that other market participants must have the opportunity to act upon the order represented by the DPM as agent before the DPM's principal account can transact with that agency order.

However, a DPM Designee acting on behalf of the DPM's principal trading account may be the first to make a bid (offer) at a particular price with respect to a previously displayed resting order in the book or a previously represented resting order held by a DPM Designee acting as floor broker.

## 2. Statutory Basis

The CBOE believes that the proposed rule change will improve the operation of the DPM trading system by making the DPM participation entitlement more equitable for members while retaining the incentive for members to become and remain DPMs. Accordingly, the Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,<sup>14</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>15</sup> in particular, in that it is designed to remove impediments to and perfect the mechanism of a free and open market.

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

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

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

No written comments were solicited or received with respect to the proposed rule change.

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

The foregoing proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>16</sup> and Rule 19b-4(f)(6) thereunder<sup>17</sup> because the proposed rule change (1) does not significantly affect the protection of

<sup>14</sup> 15 U.S.C. 78f(b).

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

<sup>16</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>17</sup> 17 CFR 240.19b-4(f)(6).

investors or the public interest; (2) does not impose any significant burden on competition; and (3) by its terms does not become operative before 30 days from the date on which it was filed, and the CBOE provided the Commission with written notice of its intent to file the proposed rule change at least five days prior to the filing date.

At any time within 60 days of the filing of such 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 it is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR-CBOE-00-52 and should be submitted by January 18, 2001.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 00-33123 Filed 12-27-00; 8:45 am]

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43746; File No. SR-CBOE-00-62]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated to Limit the Meaning of "Public Customer" for Purposes of Determining Who May Use RAES

December 19, 2000.

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 28, 2000, the Chicago Board Options Exchange, Incorporated ("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 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 the provisions of CBOE Rule 6.8 (RAES Operations) that govern the eligibility of the owners of certain types of accounts to submit orders through the Exchange's Retail Automatic Execution System ("RAES").<sup>3</sup> The text of the proposed rule change is set forth below. Deleted text is in brackets; new text is in italics.

#### Rule 6.8 RAES Operations

(a)(i) Firms on the Exchange's Order Routing System ("ORS") will automatically be on the Exchange's Retail Automatic Execution System ("RAES") for purposes of routing small public customer market or marketable limit orders into the RAES system. Those orders which are eligible for routing to RAES may be subject to such contingencies as the appropriate Floor Procedure Committee ("FPC") shall approve. Public customer orders are orders for accounts other than accounts in which a member, non-member participant in a joint-venture with a member, [or ]any non-member broker-dealer (including a foreign broker-dealer as defined in Rule 1.1 (xx)), or member of a futures or securities exchange has an interest. The appropriate Floor

Procedure Committee ("FPC") shall determine the size of orders eligible for entry into RAES in accordance with paragraph (e) of this Rule. For purposes of determining what a small customer order is, a customer's order cannot be split up such that its parts are eligible for entry into RAES. Firms on ORS have the ability to go on and off ORS at will. Firms not on ORS that wish to participate will be given access to RAES from terminals at their booths on the floor.

\* \* \* \* \*

#### Interpretations and Policies

\* \* \* \* \*

.12 For purposes of this rule (or Rule 6.8(a)(i)), members, non-member participants in a joint venture with a member, non-member broker dealers, and members of a futures or securities exchange are deemed to have an interest in accounts held by the following:

1. Spouses of, or family members living in the same household with: CBOE members, non-member participants in a joint venture with a member, non-member broker dealers, or members of a futures or securities exchange.

2. (a) An affiliate that holds a 5% or more interest in the CBOE member, non-member participant in a joint venture with a member, non-member broker-dealer, or member of a futures or securities exchange; (b) Spouses of, or family members living in the same household with, any affiliate as defined in this rule.

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

In its filing with the Commission, CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. 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

CBOE proposes to amend its rule governing the eligibility of the owners of certain types of accounts to submit orders through the Exchange's RAES system by: (i) interpreting the term

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

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

<sup>3</sup> RAES is the Exchange's automatic execution system for public customer market or marketable limit orders of less than a certain size.

<sup>18</sup> 17 CFR 200.30-3(a)(12).