

19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to rescind Exchange Rule 106. The proposed rule change was published for comment in the **Federal Register** on October 22, 1999.<sup>3</sup> The Commission did not receive any comment letters with respect to the proposal. This order approves the Exchange's proposal.

## II. Description of the Proposal

The Amex proposes to delete Exchange Rule 106, "Substitute Principals." Exchange rule 106 currently provides that: "No party to a contract shall be compelled to accept a substitute principal unless the name proposed to be substituted was declared in, and as part of, the bid or offer giving rise to the contract." Rule 106 dates back to the 1921 Constitution of the New York Curb market,<sup>4</sup> a predecessor of the Exchange. The Rule's original purpose appears to be related to the clearance and settlement of trades, specifically, the terms of contracts and the creditworthiness of counterparties. The proposed rule change was filed in response to a recent dispute where an Exchange member invoked Rule 106 in an attempt to renege on a contract. Apparently, the Exchange member's counterparty provided an incorrect give-up at the time of the trade, and later sought to correct the error by substituting the correct clearing member.

## III. Discussion

For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to national securities exchange. In particular, the Commission believes the proposed rule change is consistent with the Section 6(b)(5)<sup>5</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and protect investors and the public interest.<sup>6</sup> The Commission also finds that the proposal

may serve to remove impediments to and perfect the mechanism of a free and open market by rescinding Rule 106, which provides a potential basis for parties to Exchange contracts to break trades without appropriate justification.

Since Exchange Rule 106 was adopted in 1921 the process of clearance and settlement has evolved. Broker-dealers no longer compare individual trades as was the case at the time of the inception of Exchange Rule 106. Today, trades executed on the Amex are required to be cleared and settled through a registered clearing agency.<sup>7</sup> Typically, clearing agencies guarantee the completion of a transaction by becoming the counterparty to each side of the transaction. This has substantially reduced the risk of trade default and made concerns about counterparty identity largely irrelevant.

Clearing agencies perform comparison, clearance, and settlement of trades. Clearance activities confirm the identity and quantity of the security being bought or sold, the transaction price and date, and the identity of the buyer and the seller. Settlement is the fulfillment, by the parties to the transaction, of the obligations of the trade.

The largest clearing agency is the National Securities Clearing Corporation ("NSCC"), which acts as the contrasider to every trade it processes. The NSCC guarantees the trades of its member participants and incurs the risk of default from the time of the guarantee until the settlement of obligations and payments. Thus, it is the NSCC and not the Exchange member—as was the case in 1921—who assumes counterparty risk. When the NSCC guarantees a trade, it becomes the buyer to every seller and the seller to every buyer. As a result, the clearing corporation incurs the risk that a counterparty to a transaction might default on its obligations.

Rule 106 was adopted in another era, prior to the utilization of modern clearing practices. The total assumption of default risk by clearing agencies has obviated the need for Exchange members to maintain strict control over the identify of trading counterparties. Because clearing corporations like NSCC eliminate the risk of trade default, trades are guaranteed irrespective of the identity of a counterparty. Thus, in light of clearance corporations and modern clearance and settlement practices, Rule 106 no longer serves the purpose of protecting a counterparty from the default risks associated with a trade.

Furthermore, Rule 106 may have the disruptive effect of permitting parties to Exchange contracts to break trades without appropriate justification. This kind of action is contrary to the goals of preserving the public's interest and protecting investors. The Commission therefore believes it is appropriate for the Exchange to rescind Rule 106.

## IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-Amex-99-35) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42379; File No. SR-CBOE-98-27]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 6 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Enhancements to the Exchange's Processing of Live Ammo Orders

February 2, 2000.

#### I. Introduction

On June 16, 1998, 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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change amending its rule governing the execution of orders on the "live ammo" screen. On June 23, 1998, the CBOE submitted Amendment No. 1 to the proposed rule change to the Commission.<sup>3</sup> On July 15, 1998, the CBOE submitted Amendment No. 2 to the proposed rule change to the

<sup>1</sup> 15 U.S.C. 78s(b)(2).

<sup>2</sup> 17 CFR 200.30-3(a)(12).

<sup>3</sup> 15 U.S.C. 78s(b)(1).

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

<sup>5</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), SEC, dated June 23, 1998 ("Amendment No. 1").

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

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

<sup>3</sup> Securities Exchange Act Release No. 42010 (Oct. 14, 1999), 64 FR 57167.

<sup>4</sup> Section 7 of the Article XXIV of the 1921 Constitution of the New York Curb Market stated: "No party to a contract shall be compelled to accept a substitute principal, unless the name proposed to be substituted shall be declared in marking the offer and as a party thereof."

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

<sup>6</sup> In approving this proposed rule change, the Commission has considered the proposal's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> See American Stock Exchange Constitution, Article X, Section 2.

Commission.<sup>4</sup> On July 21, 1998, the CBOE submitted Amendment No. 3 to the proposed rule change to the Commission.<sup>5</sup> On August 6, 1998, the proposal was published in the **Federal Register**.<sup>6</sup> On August 11, 1998, the CBOE submitted Amendment No. 4 to the proposed rule change to the Commission.<sup>7</sup> On August 18, 1998, the CBOE submitted Amendment No. 5 to the proposed rule change to the Commission.<sup>8</sup> On January 21, 2000, the CBOE submitted Amendment No. 6 to the proposed rule change to the Commission.<sup>9</sup>

<sup>4</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Richard Strasser, Assistant Director, Division, SEC, dated July 10, 1998 ("Amendment No. 2").

<sup>5</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Richard Strasser, Assistant Director, Division, SEC, dated July 20, 1998 ("Amendment No. 3").

<sup>6</sup> Exchange Act Release No. 40283 (July 30, 1998), 63 FR 42085.

<sup>7</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Michael Walinskas, Associate Director, Division, SEC, dated August 7, 1998 ("Amendment No. 4"). In Amendment No. 4, the Exchange proposed to implement the proposed rule change on a pilot basis for 90 days and requested accelerated approval of the proposed rule change, as amended. In addition, the Exchange supplemented the record with data to demonstrate the purpose of the proposed rule change.

<sup>8</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Michael Walinskas, Associate Director, Division, SEC, dated August 17, 1998 ("Amendment No. 5"). In Amendment No. 5, the Exchange proposed that the proposed rule change be approved on a pilot basis for six months during which time the Exchange would submit a monthly report on the progress of the implementation of the proposal. The Exchange further proposed to distribute a Regulatory Circular to its members describing the parameters of the live ammo to Retail Automatic Execution System ("RAES") system.

<sup>9</sup> Letter from Timothy H. Thompson, Director, Regulatory Affairs, Legal Department, CBOE, to Richard Strasser, Assistant Director, Division, SEC, dated January 20, 2000 ("Amendment No. 6"). In Amendment No. 6, the CBOE proposed a nine-month pilot. In addition, the CBOE committed to submit a report to the SEC by August 31, 2000, analyzing the degree to which orders accumulate on the live ammo screen during the pilot period. During the pilot period, the Exchange will work on a further systems change that will route live ammo orders directly to RAES without manual intervention. The CBOE further committed to distribute a Regulatory Circular to its members describing the parameters of the "Live Ammo to RAES" system and how the proposed changes will be implemented on the floor. The Exchange amended the proposed rule by deleting the phrase that stated that the system may only be used "when the OBO or the DPM believes that there are unusual market conditions or when there is a large influx of orders to the electronic book screen" and replaced it with the statement that the system should be used "when the OBO or the DPM believes there are more orders on the live ammo screen than can be expeditiously handled in open outcry." In Amendment No. 6, the Exchange also described its plan to roll out the proposed change over a period of a few weeks to ensure that there are no unforeseen capacity or operational problems. Finally, the CBOE withdrew Amendment Nos. 4 and 5 to the proposed rule change.

The Commission received two comments on the proposed rule change.<sup>10</sup> This notice and order solicits comments from interested persons on Amendment No. 6 and approves the proposal, as amended, on a pilot basis until October 31, 2000.

## II. Description of the Proposal

The CBOE proposes to amend its rule governing the execution of orders by order book officials ("OBO") or designated primary market makers' ("DPM") book staff to provide for the electronic execution of certain orders on the "live ammo" screen. The proposal will allow an OBO or a DPM to designate orders to be electronically executed against market makers standing in the crowd.

Currently, an OBO or a DPM, acting in his or her capacity as an OBO,<sup>11</sup> represents in the trading crowd the orders that have been placed in the customer limit order book (also known as the Electronic Book or the EBook), which displays all pre-open market orders<sup>12</sup> and customer limit orders. Orders placed in the EBook are represented individually when they become marketable and are traded with the market makers standing in the crowd.

The "live ammo" screen, which is an undisplayed portion of the EBook, receives for further processing orders that are market orders or limit orders that improve the market. An order may be routed to the live ammo screen under a number of circumstances. First, if a customer submits a cancel/replace market order to cancel and replace an order already displayed by the Book, the replacement market order will automatically be routed to the live ammo screen rather than returning directly to the displayed portion of the EBook. Second, if a customer submits a cancel/replace limit order and the replacement order has a limit price that betters the same-side market quote for an order displayed on the EBook, the replacement order will automatically be routed to the live ammo screen. Third, market orders received through the Exchange's "order shoe" that are

manually booked are automatically routed to the live ammo screen. Fourth, limit orders that better the same-side market quote that are received through the order shoe and that are manually booked are automatically routed to the live ammo screen. Fifth, limit orders that better the same-side market quote and that are routed directly to the book when the routing parameters have been set at "O" are automatically sent to the live ammo screen.<sup>13</sup> Finally, marketable limit order that are electronically booked from a floor broker's PAR workstation are automatically routed to the live ammo screen.<sup>14</sup>

Orders sent to the live ammo screen are either traded manually in open outcry or sent to the EBook if book eligible, by either the OBO or the DPM, as the case may be.<sup>15</sup> When the live ammo screen experiences a large influx of orders it becomes difficult, according to the Exchange, for the OBO (or the DPM) to represent and execute these orders in a timely fashion, which can cause orders on the live ammo screen to queue. According to the Exchange, these backlogs usually had occurred during the opening rotations when a large number of orders can build up on the live ammo screen,<sup>16</sup> but they also can occur throughout the day during busy trading times.

To address this problem and accelerate the process of executing orders that are on the live ammo screen, the Exchange proposes to implement a new feature created for the live ammo screen, which will allow the OBO (or DPM) to send RAES-eligible orders on the live ammo screen to RAES for automatic execution. Under the proposal, the OBO (or DPM) may select all or any portion of the orders displayed on a live ammo page to be routed to RAES.<sup>17</sup> If fewer than all orders are selected, those orders will be routed based on time priority, pursuant to CBOE Rule 6.45. Orders selected for automatic execution must satisfy RAES requirements. Currently, RAES accepts market and marketable limit orders that meet the applicable size

<sup>13</sup> The "O" parameter is an order routing parameter that may be implemented under high volume situations to route all limit orders to the EBook.

<sup>14</sup> According to the Exchange, approximately 90 percent of orders routed to the live ammo screen are cancel/replacement orders.

<sup>15</sup> A "book all" button is currently available to send book eligible orders on the live ammo screen to the EBook.

<sup>16</sup> Since submitting this filing, the Exchange has implemented the Rapid Opening System ("ROS"), which has significantly reduced the opening rotation time period.

<sup>17</sup> A live ammo screen page may contain up to thirteen orders.

<sup>10</sup> Letter from David Miller, Managing Director, Salomon Smith Barney, Chairman, CBOE Member Firm Committee, to Michael Walinskas, Associate Director, Division, SEC, dated August 7, 1998; and letter from Jim Brophy, A.G. Edwards, *et al.* to Michael Walinskas, Associate Director, Division, SEC, dated August 13, 1998.

<sup>11</sup> Pursuant to CBOE Rule 8.80, a DPM acts as a market maker, floor broker and OBO in its allocated options classes. Currently, equity options on the CBOE floor have been allocated to DPMs. Index options still utilize OBOs.

<sup>12</sup> After the Exchange opens, the EBook does not display market orders.

requirements.<sup>18</sup> Any market maker who is signed on to RAES at the time the OBO (or DPM) routes the order or orders to RAES for automatic execution will be eligible to be electronically assigned as the contra-party on the trade. Orders on the live ammo screen that are not RAES-eligible will be manually represented.

As proposed, there may be instances when a RAES-eligible live ammo order may be executed before a non-RAES-eligible live ammo order that was received earlier. Therefore, the Exchange proposes to implement this live ammo to RAES feature notwithstanding the provisions of CBOE Rule 6.45. CBOE Rule 6.45 gives priority to some bids and offers, because they were made earlier in time, over other bids and offers.<sup>19</sup> In addition, if CBOE's best bid or offer on the limit order book equals the prevailing market quote, orders on the live ammo screen will be crossed with the orders in the EBook.<sup>20</sup>

### III. Summary of Comments

The Commission received two comments on the proposal both of which expressed their support.<sup>21</sup> The comment letter from the CBOE Member Firm Committee described the problems caused by backlogs of orders accumulating on the live ammo screen. The comment letter described how it could take the book staff up to 30 minutes to trade orders on the live ammo screen. The commenter detailed how many live ammo backlogs occur during the opening rotation and their belief that the ROS would alleviate

some of the problems.<sup>22</sup> The commenter believed that the proposal would be an interim fix until the implementation of ROS. The comment letter from the CBOE member firm community also expressed its strong support for the proposal. The commenter believed that the proposal would be in their best interests as well as the best interests of their customers, who they believed, would receive better service than was currently available.

### IV. Discussion

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>23</sup> In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>24</sup> which provides, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and processing information with respect to, and facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market, and in general to protect investors and the public interest.

The Commission believes that the proposed rule change should help in providing timely executions of orders on the live ammo screens of the CBOE's EBook. Currently, the OBO (or DPM) must individually represent orders that are displayed on the live ammo screen in the crowd. In periods of high volume or volatility, the OBO (or DPM) may not be able to manually represent these live ammo orders in a timely fashion. According to the Exchange, these marketable orders may stay on the live ammo screen for up to 30 minutes, during which time the market could move significantly away from the market that was quoted at the time the

order was routed to the live ammo screen. Thus, investors currently may not be receiving the best price on the CBOE floor when their orders are placed on the live ammo screen.<sup>25</sup>

To address this problem, the Exchange is proposed to implement a new mechanism of the live ammo screen, which will allow the OBO (or DPM) to send RAES-eligible orders to RAES for automatic execution. This feature should help to address the problem of orders being left on the live ammo screen for long periods of time when the OBO (or DPM) is unable to manually represent the live ammo orders in a timely fashion. As a result, customer orders routed to the live ammo screen should receive more timely executions during periods of high volume or volatility on the Exchange. Although non-RAES eligible orders may be executed out of time priority under the proposal, the Commission is hopeful that the proposed rule change will enhance the timely processing of all live ammo orders. That having been said, however, the Commission is concerned that the continued use of the live ammo screen may unfairly disadvantage customer orders. As a result, the Commission is approving this proposal as an interim measure to provide the Exchange with the time to make modifications to its order processing systems to improve the handling of customer orders that currently are routed to the live ammo screen. In particular, the Commission expects that the Exchange will make the necessary systems enhancements to ensure that a maximum number of customer orders in the CBOE system are matched against one another.

Moreover, the Commission expects that the Exchange will develop the necessary systems enhancements to ensure that when there are no opportunities for matching customer orders in the CBOE system, RAES-eligible orders will be routed directly to RAES without the interim step of appearing first on the live ammo screen. The Commission requests that the Exchange submit any proposed rule changes to implement these enhancements by August 31, 2000. The Commission also notes that the Exchange has agreed to provide the Commission with an analysis of the

<sup>18</sup> Most equity option classes have an eligible order size for RAES of 50 contracts. See Exchange Act Release No. 41821 (September 1, 1999), 64 FR 50313 (September 16, 1999).

<sup>19</sup> For the reasons discussed below, the Exchange believes that instances where the priority of orders would be executed out of sequence would be infrequent. First, the non-RAES-eligible order must be for the same series as the RAES-eligible order that is traded for there to be an interruption of the normal priority principles. Second, for the RAES-eligible order to trade ahead of the non-RAES-eligible order, the limit price of the non-RAES-eligible order must be at the CBOE's quoted market because that is the price at which the RAES-eligible order will be executed. When the limit price for the larger non-RAES-eligible order is at the market, the CBOE book staff will act to execute the order promptly. See Amendment No. 3.

<sup>20</sup> The CBOE's Automated Book Priority ("ABP") system allows orders in live ammo to cross with orders held in the EBook. If the live ammo order is for a size greater than the limit order size displayed on the EBook, the ABP will cross the live ammo order with the EBook and any balance will be routed to RAES (provided it is RAES-eligible) for execution against the market makers signed on to RAES at the book price. Telephone call between Timothy Thompson and Anthony Montesano, CBOE and Kelly Riley and Heather Traeger, SEC, dated January 14, 2000.

<sup>21</sup> See note 10.

<sup>22</sup> The Commission notes that since this proposal was filed the ROS has been implemented on the Exchange. ROS provides for the automated opening of options classes on the Exchange and has significantly shortened the length of time needed for opening each option class. While ROS has mitigated the problems during the opening rotations, it has not had an impact on intraday trading volatility. See Exchange Act Release No. 41033 (February 9, 1999), 64 FR 8156 (February 18, 1999.) Telephone call between Timothy Thompson and Anthony Montesano, CBOE and Kelly Riley and Heather Traeger, SEC, on January 14, 2000.

<sup>23</sup> 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).

<sup>24</sup> 15 U.S.C. 78f(b)(5).

<sup>25</sup> Delayed execution of customer orders could implicate a broker-dealer's best execution responsibilities. See letter from Chairman Arthur Levitt to Michael Kelly, President, First Options of Chicago, Inc., dated April 13, 1999 ("While price is certainly a key element in a quality execution, other factors, such as the ability to obtain a complete and timely fill \* \* \* may also be considered in determining whether a customer is receiving best execution.")

degree to which live ammo orders accumulate on the live ammo screens during the pilot period.

The Commission finds good cause for approving Amendment No. 6 to the proposed rule change prior to the thirtieth day after the date of publication of notice in the **Federal Register**. In Amendment No. 6, CBOE requests that the proposal be approved on a pilot basis for a nine-month period. Amendment No. 6 also would remove the requirement that the live ammo to RAES feature may only be used in unusual market conditions or when there is a large influx of orders to the Book. As amended, the proposal would permit the OBO (or DPM) to employ the live ammo to RAES feature at any time when the OBO (or DPM) determines that there are more orders on the live ammo screen than can be expeditiously handled in open outcry.<sup>26</sup> The Commission finds good cause for accelerating approval of Amendment No. 6 to allow the Exchange to address immediately the order processing problems caused by the live ammo system while developing the needed systems enhancements to eliminate these problems in the future.

#### V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 6, including whether Amendment No. 6 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. 20549-0609. 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

<sup>26</sup> In Amendment No. 6, the Exchange committed to distribute a Regulatory Circular to announce the changes to its members. The Regulatory Circular will also remind members of the priority principles under CBOE Rule 6.45(a) and (b).

submissions should refer to File No. SR-CBOE-98-27 and should be submitted by March 2, 2000.

#### VI. Conclusion

*It Is Therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>27</sup> that the proposed rule change, as amended, (SR-CBOE-98-27) is approved on a pilot basis until October 31, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>28</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42382; File No. SR-CBOE-99-52]

#### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Amending Its Market-Maker Surcharge Fee Schedule

February 3, 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 September 2, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The Exchange filed Amendment No. 1<sup>3</sup> to the

<sup>27</sup> 15 U.S.C. 78s(b)(2).

<sup>28</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See Letter from Stephanie C. Mullins, Attorney, CBOE, to Sonia Patton, Attorney, Division of Market Regulation ("Division"), Commission, dated January 21, 2000 ("Amendment No. 1"). Amendment No. 1 states that all option classes on Friede Goldman International (FGI), Northwest Airlines Corporation (NAQ), Open Market, Inc. (OQM), Orbital Science Corp. (ORB), Onsale, Inc. (QOL), Prime Medical Services, Inc. (QSI), Synovus Financial Corp. (SNV), Wackenhut Corrections Corp. (WHC), and Zebra Technologies Corp. (ZBQ) were designated to Designated Primary Market-Makers ("DPMs") on September 7, 1999 and all option classes on The Boeing Company (BA) were designated to DPMs on September 13, 1999. Amendment No. 1 also states that no market-maker

proposed rule change on January 23, 2000. 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 make changes to its fee schedule pursuant to CBOE rule 2.40,<sup>4</sup> entitled "Market-Maker Surcharge for Brokerage."

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

In its filing with the Commission, the CBOE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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

###### 1. Purpose

Pursuant to CBOE Rule 2.40, on September 1, 1999, the Exchange's Equity Floor Procedure Committee ("EFPC") approved the following fees for the following option classes:

\_\_\_\_\_ surcharges were assessed on these options after their designation to DPMS.

<sup>4</sup> See Securities Exchange Act Release No. 41121 (Feb. 26, 1999), 64 FR 11523 (March 9, 1999) (order approving CBOE Rule 2.40). The Exchange imposes a market-maker surcharge to allow the Exchange and its member firms to better compete with other exchanges in floor brokerage and order book rates. The surcharge is used to (i) reimburse the Exchange to the extent that the order book official ("OBO") brokerage rate is reduced if the reduction is based upon a recommendation of resident market-makers, and (ii) pay stationary floor brokers ("SFBs") to induce them to reduce the brokerage rates they charge their customers. A resident market-maker is defined under CBOE Rule 2.40(a)(ii) as a market-maker who transacted at least 80% of his market-maker contracts in option classes traded in the trading crowd where the particular option class is traded in the prior calendar month. An SFB is defined under CBOE Rule 2.40(a)(i) as a floor broker who (i) has established a business in the trading crowd for an option class of accepting and executing orders for members or registered broker-dealers and (ii) transacted at least 80% of his orders for the previous month in the trading crowd at which a particular option class is traded.