

(ii) as to which the Exchange 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 the filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to the File No. SR-Amex-00-04 and should be submitted by June 16, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42799; File No. SR-CBOE-99-20]

#### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 1 to Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Exchange's Rapid Opening System

May 19, 2000.

#### I. Introduction

On May 21, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities

and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act") and Rule 19b-4<sup>2</sup> thereunder, a proposed rule change. In its proposal, the CBOE seeks to amend its Rapid Opening System ("ROS") rule to permit two Floor Officials to adjust affected trades in cases where an underlying stock has been opened at an erroneous price and later corrected on the underlying market. The proposed rule change was published for comment in the *Federal Register* on July 14, 1999.<sup>3</sup> On March 22, 2000, the CBOE filed Amendment No. 1 to the proposed rule change.<sup>4</sup> The Commission received no comments on the proposal. This order approves the proposal, as amended. In addition, the Commission is publishing this notice to solicit comments on Amendment No. 1 to the proposed rule change and is simultaneously approving Amendment No. 1 on an accelerated basis.

#### II. Description of the Proposal

In 1999, the Commission approved ROS on a pilot basis.<sup>5</sup> CBOE represents that ROS enables the Exchange to open classes of options within seconds of the opening of the underlying security, which in turn enables firms and customers to enter orders in open trading almost immediately after the opening bell. In addition, CBOE believes that in those classes where it has been employed, ROS has prevented backlogs of orders from developing during the opening. However, according to the Exchange, there have been a few instances where ROS has opened an option class at a price based upon an erroneous opening price of the underlying security disseminated by the primary market which is later corrected by the primary market only after ROS had opened the option class.<sup>6</sup>

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

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

<sup>3</sup> See Securities Exchange Act Release No. 41599 (July 6, 1999), 64 FR 38058.

<sup>4</sup> In Amendment No. 1, the CBOE amended the text of the rule language to provide notification of trade adjustments, clarify the trades that can be adjusted, and limit the time period that trades can be adjusted to the day when the correction of the erroneous print occurs. See letter from Timothy Thompson, Director, Regulatory Affairs, CBOE, to Terri Evans, Special Counsel, Division of Market Regulation ("Division"), Commission, dated March 2, 2000 ("Amendment No. 1").

<sup>5</sup> See Securities Exchange Act Release No. 41033 (February 9, 1999), 64 FR 8156 (February 18, 1999) (The pilot was initially approved through March 30, 2000. The termination of the pilot was subsequently extended to September 30, 2000. See Securities Exchange Act Release No. 42596 (March 30, 2000), 65 FR 18397 (April 7, 2000).

<sup>6</sup> Because ROS employs the Exchange's AutoQuote system and the Exchange's AutoQuote system relies on a data feed of the price of the

In those instances when ROS opened on an erroneous print, the Exchange represents that it had to expend a substantial amount of time working with the participants in the trades to get their agreement to adjust the trades and to determine which customer orders should have been filled at the opening. According to the Exchange, market makers in classes where ROS is employed have suffered significant deleterious financial consequences from these openings on an erroneous print because only those market maker trades that occurred at a price that disfavored a customer were adjusted. As a result, the Exchange believes market makers may become discouraged from participating in ROS because, even though the incidences where an erroneous print occur are rare, the financial consequences to a particular market maker can be substantial.

The Exchange also notes that when ROS opens based upon an incorrect price of the underlying security, certain customer orders can be adversely affected. In particular, customer orders that would have been executed had ROS opened based on a correct price may not be executed. Further, certain customer-to-customer trades may be executed at an erroneous price.

After these problems first occurred, the Exchange represents that it tried to educate trading crowds about ways to avoid them. For example, the trading crowds may wait to send their AutoQuote values until after the initial bid/ask quotes on the underlying are disseminated to ensure that the initial disseminated opening price for the underlying security is in line with the bid/ask quotes. Also, a system enhancement was put in place that provides as indication to crowds when ROS is being opened at a price that appears erroneous. The Exchange believes, however, that there is no guarantee that these methods can prevent every occurrence of an opening on ROS based on an erroneous underlying price.

The Exchange believes, therefore, that it is necessary to grant Floor Officials the authority to adjust opening trades in the event that the class is opened at an erroneous price.<sup>7</sup> The Exchange represents that this authority is similar to the authority Floor Officials currently

underlying security to determine the option's price, an inaccurate underlying price can lead to an inaccurate ROS opening price.

<sup>7</sup> The concurrent approval of two Floor Officials would be needed before a trade could be adjusted. Telephone conversation between Timothy Thompson, Director, Regulatory Affairs, CBOE, and Terri Evans, Special Counsel, Division, Commission, on May 17, 2000.

<sup>8</sup> 17 CFR 200.30-3(a)(12).

have with respect to RAES trades.<sup>8</sup> The Exchange believes this change will prevent market makers from becoming discouraged from participating on ROS and will save time spent by Exchange staff negotiating with participants on trades that occur on erroneous prints. At the same time, the Exchange believes the rule change will give Floor Officials the authority to determine which trades should be adjusted so that a fair and equitable result is achieved for all market participants, including those customers that might not have been filled on the opening but otherwise would have been filled had the class opened at the correct price.

Under the proposed rule change, the Exchange will notify its members as soon as practicable after the correction of an erroneous print on the underlying.<sup>9</sup> In addition, the Exchange will indicate that this may result in the adjustment of opening trades that were either executed on ROS or should have been executed on ROS. Further, all adjustments will be made the day of the erroneous print correction.<sup>10</sup>

### III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1, including whether the amendment is consistent with the Act. Persons making written submissions should file six

<sup>8</sup> CBOE Rule 6.8(a)(ii) states in part; "A trade execute on RAES at an erroneous quote should be treated as a trade reported at an erroneous price and adjusted to reflect the accurate market after receiving a Floor Official's approval."

<sup>9</sup> According to the Exchange, either Exchange staff or the traders in the crowd where the particular options class is traded will know that the conditions have been met just as soon as the underlying market disseminates a corrected opening price, which usually occurs within a few minutes of the erroneous print's dissemination. The traders who trade the options have access to the underlying market's quotes and will receive a message that the opening print has been corrected. See Amendment No. 1, *supra* note 4.

<sup>10</sup> According to the Exchange, it does not have an automated system to handle the adjusting of these trades so it could require a significant amount of staff time to determine exactly which trades may need to be adjusted. Where there have been only a very few affected trades, the Exchange represents that its staff may be able to provide Floor Officials with the necessary information to adjust the trades within a few minutes. In an opening where a large number of trades are affected, the Exchange believes that it may take a number of hours to sift through the various trades and determine how each should be adjusted. As a result, the Exchange proposes to provide prompt notice that the situation has occurred and that trades may be adjusted. In this way, any trader or customer that may be affected by the adjustment can take any appropriate action to adjust his or her position. Because the opening print and its correction will be known as soon as any notice is disseminated, traders and customers should be able to determine the likelihood of their trade being adjusted and what the adjustment is likely to be. See Amendment No. 1, *supra* note 4.

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-99-20 and should be submitted by June 16, 2000.

### IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act.<sup>11</sup> In particular, the Commission finds the proposal is consistent with Section 6(b)(5)<sup>12</sup> of the Act. Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade and to protect investors and the public interest.

The Commission believes that the proposed rule change promotes just and equitable principles of trade. In particular, the proposal allows two Floor Officials to adjust trades when ROS opens a class based on an erroneous opening print disseminated by the underlying market.<sup>13</sup> In addition, the proposal would not only affect market makers, but also customers whose orders should or should not have been executed at opening. The Commission believes that procedures to correct erroneous trades in a timely manner are in the interest of all parties.

The Commission also believes the proposal includes adequate Exchange oversight and review procedures by requiring the concurrent approval of two Floor Officials before a trade can be adjusted. In addition, CBOE amended the proposal with Amendment No. 1 to include certain other procedural protections that limit the Exchange's and Floor Officials' discretion in adjusting trades. In particular,

<sup>11</sup> In addition, pursuant to Section 3(f) of the Act, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> Concurrent approval of both Floor Officials is necessary before a trade can be adjusted. See *supra* note 7.

Amendment No. 1 requires the Exchange to notify its members as soon as practicable about the possibility of a trade adjustment, limits the adjustment of trades to those that were or should have been executed at the opening, and requires that the Exchange make the adjustments on the day when the correction of the erroneous print occurred. The Commission believes these requirements should help protect investors who execute trades at the opening that are later adjusted.

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission believes that Amendment No. 1 strikes a reasonable balance between the need to correct erroneous trades and the need for adequate Exchange oversight over the process. Further, the Commission did not receive any comments on the original proposal, which did not contain the protections that were incorporated into the proposal through Amendment No. 1.

### V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-CBOE-99-20), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Jonathan G. Katz,**  
*Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42798; File No. SR-CBOE-00-19]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated To Make Certain Changes to Its Fee Schedule

May 18, 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 April 26, 2000, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</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.