

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release 34-43182; File No. 600-23;
International Series Release No. 1230]

Self-Regulatory Organizations; Emerging Markets Clearing Corporation; Notice of Filing and Order Approving a Request for an Extension of Temporary Registration as a Clearing Agency

August 18, 2000.

Notice is hereby given that on July 10, 2000, the Emerging Markets Clearing Corporation ("EMCC") filed with the Securities and Exchange Commission ("Commission") an application pursuant to Section 19(a) of the Securities Exchange Act of 1934 ("Act")¹ requesting that the Commission extend EMCC's temporary registration as a clearing agency.² The Commission is publishing this notice and order to solicit comments from interested persons and to extend EMCC's temporary registration as a clearing agency through August 31, 2001.

On February 13, 1998, pursuant to Sections 17A(b) and 19(a)(1) of the Act³ and Rule 17Ab2-1 promulgated thereunder,⁴ the Commission granted EMCC's application for registration as a clearing agency until August 20, 1999.⁵ The Commission subsequently extended EMCC's registration as a clearing agency until August 20, 2000.⁶ EMCC was created to facilitate the clearance and settlement of transactions in U.S. dollar denominated Brady Bonds.⁷ Since that time, EMCC has added certain sovereign

debt to the list of eligible securities that may be cleared and settled at EMCC.⁸

EMCC began operating on April 6, 1998, with ten dealer members. EMCC currently has 21 members. During 1999, EMCC's members achieved an average trade-date matching rate of 89 percent and an average settlement-date success rate of over 92 percent.⁹

As part of EMCC's initial temporary registration, the Commission granted EMCC temporary exemption from Section 17A(b)(3)(B) of the Act because EMCC did not provide for the admission of some of the categories of members required by that section.¹⁰ To date, EMCC continues to limit the categories of entities eligible for membership to U.S. broker-dealers, United Kingdom broker-dealers, U.S. banks, and non-U.S. banks. As the Commission noted in the Registration Order, the Commission believes that providing for limited categories of members is appropriate at least during a clearing agencies initial phases of operations especially when no one in a category not covered by EMCC desires to be a member. Accordingly, the Commission is extending EMCC's temporary exemption from Section 17A(b)(3)(B).

The Commission also granted EMCC a temporary exemption from Sections 17A(b)(3)(A) and 17A(b)(3)(F) of the Act to permit EMCC to use, subject to certain limitations, ten percent of its clearing fund to collateralize a line of credit at Euroclear to finance on an intraday basis the receipt by EMCC of eligible instruments from one member that EMCC will redeliver to another member.¹¹ The Registration Order limited EMCC's use of clearing fund deposits for this intraday financing to the earlier of one year after EMCC commenced operations or the date on which EMCC begins its netting service. On April 2, and May 17, 1999, the Commission approved rule changes that permitted EMCC to implement a netting service and that extended EMCC's ability to use clearing fund deposits for intraday financing at Euroclear until all EMCC members are netting members (as opposed to the date on which netting services were made available or EMCC's first anniversary).¹² Accordingly, the Commission is extending EMCC's

temporary exemption from Section 17A(b)(3) (A) and (F).

Interested persons are invited to submit written data, views, and arguments concerning the foregoing application. Such written data, views, and arguments will be considered by the Commission in granting registration or instituting proceedings to determine whether registration should be denied in accordance with Section 19(a)(1) of the Act.¹³ 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 amended application for registration and all written comments will be available for inspection at the Commission's Public Reference Room, 450 Fifth Street, NW, Washington, DC 20549. All submissions should refer to File No. 600-30 and should be submitted by September 15, 2000.

It Is Therefore Ordered, pursuant to Section 19(a) of the Act, that EMCC's registration as a clearing agency (File No. 600-30) be and hereby is temporarily approved through August 31, 2001.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43186; File No. SR-CBOE-99-37]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 2 and 3 to the Proposed Rule Change Establishing a Membership Ownership Requirement and a Capitalization Transfer Fee Applicable to Designated Primary Market Makers

August 21, 2000.

I. Introduction

On July 9, 1999, 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

¹² 17 CFR 200.30-3(a)(29).

¹³ 15 U.S.C. 78s(a).

² Letter from Merrie Faye Witkin, Assistant Secretary, EMCC (July 7, 2000).

³ 15 U.S.C. 78q-1(b) and 78s(a)(1).

⁴ 17 CFR 240.17Ab2-1.

⁵ Securities Exchange Act Release No. 39661 (February 13, 1998), 63 FR 8711 ("Registration Order").

⁶ Securities Exchange Act Release No. 41733 (August 12, 1999), 64 FR 44982.

⁷ Brady bonds are restructured bank loans. They were first issued pursuant to a plan developed by then U.S. Treasury Secretary Nicholas Brady to assist debt-ridden countries restructure their sovereign debt into commercially marketable securities. The plan provided for the exchange of bank loans for collateralized debt securities as part of an internationally supported sovereign debt restructuring. Typically, the collateral would be U.S. Treasury securities.

⁸ Securities Exchange Act Release Nos. 41618 (July 14, 1999), 64 FR 39181 and 40363 (August 25, 1999), 63 FR 46263.

⁹ EMCC 1999 Annual Report.

¹⁰ Registration Order at 8716.

¹¹ Registration Order at 8720.

¹² Securities Exchange Act Release Nos. 41247 (April 2, 1999), 64 FR 17705 (April 12, 1999) and 41415 (May 17, 1999), 64 FR 27841 (May 21, 1999).

¹³ 15 U.S.C. 78s(a)(1).

¹⁴ 17 CFR 200.30-3(a)(16).

of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change adding provisions to the designated primary market maker ("DPM") program. On July 13, 1999, the Exchange submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change was published in the **Federal Register** on September 21, 1999.⁴ The Commission received 19 comment letters on the proposed rule change.⁵ On December 20, 1999, the CBOE submitted Amendment No. 2 to the proposed rule change.⁶ On August 9, 2000, the CBOE submitted Amendment No. 3 to the proposed rule change.⁷ This order approves the proposed rule change and approves Amendment Nos. 2 and 3 to the proposed rule change on an accelerated basis. The Commission is also soliciting comment on Amendment Nos. 2 and 3 to the proposed rule change.

II. Description of the Proposed Rule Change

The CBOE proposes two new requirements for DPMs. The first will require that each DPM own at least one Exchange membership. The second will assess a transfer fee on a DPM that undergoes a change in its capitalization during a set period of time.

A. Requirement That a DPM Own an Exchange Membership

The Exchange proposes to add paragraph (e) to CBOE Rule 8.85, which is the current rule governing the Modified Trading System. This new proposal would require DPMs to own at least one Exchange membership. Each

current DPM would have 18 months from the proposal's effective date to satisfy the ownership requirement. The ownership requirement may be satisfied either by owning a transferable regular CBOE membership, or a Chicago Board of Trade full membership that is effectively exercised pursuant to Article Fifth of the CBOE's Certificate of Incorporation. A single membership, however, may not be used to satisfy the ownership requirement for more than one DPM. The ownership requirement would be satisfied if a senior principal of a DPM owns the membership.

B. Assessment of Transfer Fee

The proposal also adds Interpretation and Policy .02 to CBOE Rule 8.89. Under this Interpretation, the Exchange proposes to assess a transfer fee on DPMs that undergo changes in its capitalization during a determined five-year period. The transfer fee would only be assessed on those DPMs that have been allocated one or more options classes that have traded on the CBOE prior to June 29, 1999. Furthermore, the transfer fee would only be imposed on those DPMs that have been allocated on pre-June 29, 1999 options class after June 29, 1999. The five-year period would begin as of the date of allocation to the DPM of the first pre-June 29, 1999 option class.

The Exchange proposes to define a change in capitalization to include any sale, transfer, or assignment of any ownership interest in the DPM or any change in the DPM's capital structure, voting authority, or distribution of profits or losses.

As proposed, the transfer fee would generally be equivalent to an applicable percentage of the larger of: (1) The dollar amount of the change in a DPM's capitalization attributable to pre-June 29, 1999 option classes allocated to the DPM after June 29, 1999, or (2) the value of the change in the DPM's capitalization attributable to the business gained because of the pre-June 29, 1999 options class that was allocated to the DPM after June 29, 1999, as determined by a formula for ascertaining an approximate value of that portion of the transaction. The applicable percentage to be applied in determining the transfer fee will be: 50% in the first year of the five-year period during which the DPM is subject to this transfer fee, 40% in the second year, 30% in the third year, 20% in the fourth year, and 10% in the fifth year.

III. Summary of Comments

The Commission received nineteen comment letters opposing the proposed rule change. Eighteen were submitted by

DPMs, and one by members of the Board of the DPM Members Association of the CBOE.⁸ The Exchange submitted one letter in response.⁹

Three of the commenters stated that the proposed rule change had not been adequately explained by the CBOE staff, and that it was broader in its scope than they had previously understood.¹⁰ Five commenters argued that the rule change was actually meant to mollify or protect certain members of the Exchange at the expense of newer or smaller DPMs, and not simply to ensure a long-term commitment to the CBOE.¹¹

In response to these objections, the Exchange stated that the proposed rule change was developed as part of an initiative to expand its DPM system, after substantial input from the Exchange membership, including meetings of each CBOE trading crowd

⁸ See letters to Kelly Riley, Attorney, Division, SEC, from Lee E. Tenzer, Chairman, Lee E. Tenzer Trading Company, dated January 20, 2000 ("Tenzer Letter"); Thomas Bartlett, Managing Partner, Trade Mark Financial Group, dated February 11, 2000 ("Bartlett Letter"); Jack Callahan, Callahan DPM, LLC, dated February 12, 2000 ("Callahan Letter"); John M. Saliba, Managing Member, Saliba Partners DPM, dated February 14, 2000 ("Saliba Letter"); Ethan Schwartz, Schwartz Trading Group LLC, dated February 16, 2000 ("Schwartz Letter"); Keith Heglund, General Partner, Rathunas Trading, L.L.C., dated February 26, 2000 ("Heglund Letter"); Thomas M. O'Donnell, Member, Specialist DPM, LLC, dated February 17, 2000 ("O'Donnell Letter"); Ed Zareck and Michael Hoban, General Partners, ZH Partners, JV, dated February 27, 2000 ("ZH Partners Letter"); Joseph Feldman, Partner, Bridgeport Securities and Bridgeport DPM, L.L.C., dated February 17, 2000 ("Feldman Letter"); Michael R. Benson and Edward V. Dolinar, Managing Members, Big Blue Trading LLC, dated February 17, 2000 ("Big Blue Letter"); Randy Emer, Managing Partner, Eclipse JV, dated February 17, 2000 ("Emer Letter"); Jeff Cesarone, Terry Herlihy, Robert Maine, Robert Murphy, John Witten and Scott Witten, Members, Hiland Capital I, LLC/DPM, dated February 17, 2000 ("Hiland Letter"); Daniel F. O'Neill and Peter J. Gancer, Managing Members, Midway Securities, L.L.C., dated February 17, 2000 ("Midway Letter"); Timothy J. Werner, Member, RTB Derivates L.L.C., undated, received February 18, 2000 ("Werner Letter"); William J. Gorman and Orlando Alfonso, Partners, Copper Trading J.V., and William Johnson, Partner, Johnson Trading, J.V., dated February 18, 2000 ("Cooper-Johnson Letter"); Jim Murphy, Managing Partner, Option Funding Group, LP, dated February 18, 2000 ("Murphy Letter"); Jeff Melgard, Prime Markets Group, LLC, dated February 18, 2000 ("Melgard Letter"); Jesse Stamer, TradeNet, LLC, dated February 18, 2000 ("Stamer Letter"); and Daniel Koutris, Managing Member, KFT DPM, LLC, *et al.*, Members of the Board of the DPM Members Association of the CBOE, dated February 15, 2000 ("DPM Board Members Letter"); Copies of the comment letters are available in the Commission's Public Reference Room in File No. SR-CBOE-99-37.

⁹ See letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Kelly Riley, Attorney, Division, SEC, dated April 18, 2000 ("CBOE Response").

¹⁰ See Heglund Letter; Feldman Letter; and DPM Board Members Letter.

¹¹ See Tenzer Letter; Schwartz Letter; Murphy Letter; Stamer Letter; and DPM Board Members Letter.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Kelly Riley, Attorney, Division, SEC, dated December 17, 1999 ("Amendment No. 1").

⁴ Securities Exchange Act Release No. 41872 (September 13, 1999), 64 FR 51158.

⁵ See note 8 *infra*.

⁶ Letter from Arthur B. Reinstein, Assistant General Counsel, CBOE, to Kelly Riley, Attorney, Division, SEC, dated December 17, 1999 ("Amendment No. 2"). In Amendment No. 2, the Exchange amended the proposed transfer fee to provide that options traded on other exchanges before June 29, 1999 that have been allocated to DPMs will not be considered when determining whether the proposed transfer fee applies to a capitalization transfer. In addition, the Exchange clarified its use of the multiplier of two in one of the proposed transfer fee formulas. Finally, the CBOE committed that it would not consider financial information that relates to a DPM's non-DPM business activities in the calculation of the capitalization transfer fee.

⁷ See letter from Arthur B. Reinstein, Associate General Counsel, CBOE, to Kelly Riley, Division, SEC, dated August 8, 2000 ("Amendment No. 3"). In Amendment No. 3, the CBOE proposed to renumber the proposed rules so that they are consistent with the current CBOE rules.

and general open membership meetings. The CBOE stated that the initiative included work by a task force of seventeen members, four of whom were among the commenters now opposing the rule. Finally, the CBOE noted that the rule change had been approved by its Board of Directors, and by its membership by a vote of 654 for, 372 against, and 4 abstentions. The CBOE further noted that the proposed rule change was approved by a vote of its membership before any allocation of the subject option classes. The CBOE therefore argued that DPMs that accepted such allocations knew or should have known of the rule.¹²

In response to the argument that the rule had not been adequately explained, the CBOE noted that a circular describing the rule was distributed, which clearly stated that the fee would be imposed for "any change in capitalization," and that the text of the proposed rule itself defined what would constitute such a change.¹³

Finally, the Exchange submitted that the rule was not meant to disadvantage any particular DPMs. The Exchange stressed that the proposed rule was meant to serve three purposes: (1) To provide an incentive for owners to sufficiently capitalize their DPMs; (2) to ensure a long-term commitment to the CBOE; and (3) to return value to the CBOE for any sale of a valuable asset which the DPM received at no cost.¹⁴

Five commenters argued that the proposed rule change was poorly drafted and vague. They stated that these deficiencies could lead to subjective interpretation, and uneven application of the proposed rule.¹⁵ One letter argued, for example, that it was not clear whether a change in capital structure would include, or how the proposed fee formula would assess, the conversion of subordinated debt to equity, or a change of structure from a partnership to a limited liability corporation.¹⁶

In response, the Exchange stated that the proposed rule, by its own terms, was clear that it would apply to any change in a firm's capitalization, including any sale, transfer, or assignment of ownership, or any change in its capital structure, voting authority, or distribution of its profits or losses. The Exchange specified that the proposed rule would, therefore, apply to the conversion of consolidated debt to

equity, since this would involve a change in ownership. On the other hand, so long as the DPM's capital structure, voting, and profit and loss distribution remained otherwise the same, the conversion of a partnership to a limited liability corporation would not implicate the fee, because there would be not be a change in ownership. Finally, the Exchange asserted that the methods of calculation of the fee were also clear, and noted that a DPM may appeal an assessment of the fee to the Exchange's Appeals Committee, and from there to the CBOE's Board of Directors.¹⁷

All the commenters asserted that the proposed rule change hindered DPMs from changing their business structures in order to remain competitive. They argued that the proposed rule would, for example, prevent a DPM from acquiring a strategic partner, or from rewarding an employee with a share of ownership. Five of the commenters asserted that the rule would disadvantage new DPMs relative to older firms, and would disadvantage DPMs at the CBOE relative to specialists on other Exchanges, which do not have such rules.¹⁸ Four commenters also argued that the proposed rule change would disadvantage the CBOE as well, because fewer firms would be willing to become, or could effectively complete as, DPMs.¹⁹

Finally, five commenters argued that the proposed rule change could be detrimental to customers. They asserted that DPMs that could not acquire capital without incurring the associated fee for a change in capital structure might not be able to compete effectively with other DPMs or specialists on other Exchanges. These commenters stated that this would lead to a reduction in competition, increasingly illiquid markets, and wider bid-ask spreads.²⁰

In response to these objections, the CBOE argued that differing rules among exchanges reflected competition and ongoing efforts by each exchange to better serve its customers. The CBOE stated that the proposed rule did not prevent DPMs from raising capital, but merely added to the cost of doing so. The Exchange stated that it had contemplated the effect of the proposed rule change on business at the CBOE,

but concluded that its benefits outweighed any potential costs.²¹

Finally the Exchange noted that changes to the proposed rule could be considered in the future, but asserted that it should be approved now. The Exchange argued that, with greater experience applying the rule, its staff and affected DPMs could later propose changes to the appropriate Exchange authorities, if necessary.²²

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.²³ In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,²⁴ which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest.

A. Membership Requirement

The proposed rule change will require DPMs to own an Exchange membership. The Commission believes that this ownership requirement should provide stability in the Exchange's options market. By requiring each DPM to own an Exchange membership, the Exchange is seeking to ensure that DPMs have a long-term commitment to the Exchange. The proposal should discourage entities from seeking short-term DPM appointments, which could be disruptive to the trading of allocated options classes, because DPMs will be required to make a substantial financial commitment to the Exchange. DPMs that own a membership in the Exchange should be more willing to invest the time, effort, and funding needed to build and foster a stable market place for the trading of their allocated options classes. This should provide enhanced trading benefits to investors by increasing liquidity and trading stability. Moreover, the proposal should help to preserve the integrity of the Exchange because DPMs will have a vested interest in ensuring that the Exchange maintains high standards.

¹⁷ See CBOE Response.

¹⁸ See Tenzer Letter, Hiland Letter; Copper-Johnson Letter, Bartlett Letter; and DPM Board Members Letter.

¹⁹ See Tenzer Letter; Saliba Letter; Murphy Letter; and DPM Board Members Letter.

²⁰ See Hiland Letter; ZH Partners Letter; Saliba Letter; Copper-Johnson Letter; and Stamer Letter.

²¹ See CBOE Response.

²² *Id.*

²³ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

²⁴ 15 U.S.C. 78f(b)(5).

¹² See CBOE Response.

¹³ *Id.*

¹⁴ *Id.*

¹⁵ See Tenzer Letter; Emer Letter; Hoglund Letter, Bartlett Letter; and DPM Board Members Letter.

¹⁶ See DPM Board Members Letter.

B. Capitalization Transfer Fee

The Commission finds that the proposed capitalization transfer fee is consistent with the requirements of the Act because it also seeks to provide stability to the DPM program on the CBOE. DPMs will be assessed a transfer fee if it seeks to change its capitalization during the initial five years after it has been allocated a pre-June 29, 1999 options class. The transfer fee will only apply to business attributable to options classes that have been trading on the CBOE before June 29, 1999 that have been allocated to a DPM after June 29, 1999.

This proposal should discourage DPMs from seeking allocations in established options classes and then quickly seeking to sell its interest to other parties. Allowing a DPM to sell the established business of an allocated options class may be inequitable to the Exchange. Many existing options classes have significant established order flow and contract volume that is not attributable to the newly appointed DPM's efforts. It may be inequitable to allow a newly appointed DPM to profit from this order flow and contract volume without having contributed to its development. Moreover, by discouraging DPMs from selling its interest in established options classes, the transfer fee should encourage long-term commitments to the Exchange, which should enhance stability in DPM allocated securities.

The transfer fee should also serve as an incentive to a DPM to ensure its financial well-being. The transfer fee should ensure that a DPM has sufficient capital before seeking an allocation of a pre-June 29, 1999 options class because during the first five years after allocation, it will be subject to a significant transfer fee if the DPM should require financial restructuring. This should help in providing investors with a stable, liquid market in options classes allocated to DPMs.

The Commission notes that the comment letters received regarding the transfer fee were all opposed to the proposed transfer fee. The Commission has carefully considered the issues raised by the commenters but finds that the proposed transfer fee is consistent with the requirements of the Act.

First, the Commission notes that the proposed transfer fee was approved by a majority of CBOE's members. The transfer fee was developed as a component of the CBOE's DPM expansion initiative. According to the CBOE, the transfer fee, as part of the DPM expansion initiative, was developed with extensive member

input. Member input was secured by way of the Floor Directors Committee, which developed the initiative to expand the DPM program, as well as general membership meetings. In addition, a member task force was convened to further consider the DPM expansion, including the transfer fee. Before the member vote, the CBOE distributed an Information Circular describing the expansion of the DPM program, which included a description of the proposed transfer fee and specifically set forth the two proposed formulas. Further, the Information Circular stated the proposed transfer fee would apply to "any change in capitalization of the firm." Therefore, the Commission believes that the members of the CBOE, which approved the proposal by a majority vote, were sufficiently informed of the proposal and its ramifications.

Second, the transfer fee will be applied only to options allocated to DPMs after June 1999 that have options traded on the CBOE before June 29, 1999. Thus, the CBOE has tailored this proposed fee to apply only to DPMs that are allocated options classes that have established order flow on the CBOE. Further, according to the CBOE, each DPM is notified before it is allocated an existing option class. Moreover, a DPM can choose not to apply to receive allocations of existing CBOE options classes and therefore, to not be subject to the transfer fee.

Finally, the Commission notes that the Act does not mandate that the SROs have the same rules. On the contrary, each SRO is free to tailor its own rules to meet the requirements of its individual marketplace, so long as its rules are consistent with the requirements of the Act. In fact, one of the ways the SROs compete with one another for listings and members is by way of their individual business structures, which includes trading and membership rules.

The Commission believes that the proposed transfer fee should provide incentives to DPMs that are allocated existing CBOE options to maintain sufficient capital to operate as a DPM, which should result in greater liquidity and investor protections in those options classes. Further, the CBOE has an interest in securing long-term commitments to the Exchange because members that are committed to the Exchange should have greater incentives to ensure the orderly and effective operation of the market. Finally, the Commission recognizes that the existing order flow in options classes that have traded on the Exchange for a period of time is a valuable commodity for which

the Exchange and its members are not compensated by the DPMS allocated such classes. Thus, the Commission finds that it is reasonable for the Exchange to limit the compensation that a DPM may receive by virtue of a capitalization change for those options classes that have business that was established by a person or entities other than the DPM.

C. Amendment Nos. 2 and 3

The Commission finds good cause for approving Amendment Nos. 2 and 3 to the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that in Amendment No. 2, the CBOE proposed to narrow the application of the transfer fee to apply to capitalization changes of DPMs that have been allocated options classes traded only on the CBOE before June 29, 1999. DPMs that have been allocated options classes traded on other options exchanges before June 29, 1999 will not be subject to a transfer fee on the business generated by such options.²⁵ The Commission believes that this amendment is reasonable because a DPM that has been allocated an options class that is new to the CBOE but that may have traded on another exchange may have to expend significant time and resources to establish order flow and contract volume on the CBOE. Therefore, applying the transfer fee to options classes that have traded on another options exchange does not raise the same inequitable concerns that maybe raised by a capitalization transfer after an allocation of an established CBOE options class.

Amendment No. 2 also clarifies that when calculating the transfer fee, the Exchange will not consider financial information that is reflected in the FOCUS Data Reports that does not relate to a DPM's business as such. The Commission believes that it is appropriate to exclude this financial information because it does not relate to the DPM's business in allocated options classes or its profitability per contract in an allocated options class.

Finally, Amendment No. 2 clarifies the use of the multiplier of two in one of the transfer fee formulas. According to the Exchange, this type of multiplier is frequently used in the industry when determining the value of a DPM's business. The multiplier is, in essence, an multiple of earnings and is intended

²⁵ The Commission notes that a DPM may still be subject to a transfer fee if it also has been allocated an options class that traded on the CBOE before June 29, 1999.

to represent two calendar years of assumed DPM operation. The Commission finds that the use of this multiplier to determine the value of a DPM's business as such is reasonable because it seeks to approximate the multiple of earnings that parties utilize to value DPM units in the marketplace.

Since Amendment No. 2 only modifies that the scope and clarifies the application of the proposed rule change, but did not change the intent of the proposal, the Commission believes that good cause exists, consistent with Sections(b)(5)²⁶ and 19(b) of the Act²⁷ to accelerate approval of Amendment No. 2.

In Amendment No. 3, the CBOE proposed to renumber the proposed rules to make them consistent with recently approve changes to the CBOE's DPM rules.²⁸ The CBOE did not make substantive changes to the proposed rules in Amendment No. 3. Therefore, the Commission believes that good cause exists, consistent with Sections 6(b)(5)²⁹ and 19(b) of the Act,³⁰ to approve Amendment No. 3 on an accelerated basis.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 2 and 3, including whether the amendments are 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 submissions should refer to File No. SR-CBOE-99-37 and should be submitted by September 15, 2000.

VI. Conclusion

It Is Therefore Ordered, pursuant to Section 19(b)(2) of the Act,³¹ that the amended proposed rule change (SR-CBOE-99-37) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43185; File No. SR-CBOE-00-30]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to the Routing of Cancel Replace Orders

August 21, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 14, 2000, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. On August 10, 2000, the CBOE submitted Amendment No. 1 to the proposed rule change.³ 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 implement a systems change to its Order Routing System ("ORS") to provide for the automatic rerouting of cancel replace orders.

³¹ 15 U.S.C. 78s(b)(2).

³² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Timothy Thompson, Assistant General Counsel, Legal Department, CBOE, to Kelly Riley, Division of Market Regulation, SEC, dated August 9, 2000 ("Amendment No. 1"). In Amendment No. 1, the CBOE clarified the purpose section and set forth its anticipated implementation schedule.

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

The purpose of the proposed rule change is to implement a systems change to provide for the automatic rerouting of cancel replace orders.

a. *Background.* Currently, when orders residing on the Exchange's electronic book ("Ebook") are replaced at the market, the original order will be canceled and the marketable replace order will be placed on the "Live Ammo" trading screen. Previously, this marketable replace order has waited on the Live Ammo screen until, one by one, each order was traded. The replace order was not immediately displayed as part of the best book bid or ask, and was not reflected in the market quote until the order was individually addressed by either the designated primary market maker ("DPM") or order book official ("OBO") handling the Ebook.⁴

To provide for certain of these Live Ammo orders to be addressed in a more automated and expedited fashion, the Exchange developed a system⁵ that allows for a Live Ammo order (or a group of Live Ammo orders) to be manually selected by the DPM or OBO. Once selected, the system developed by the Exchange evaluates each selected order and routes it to one of three locations depending on the routing parameters then in place and the terms of the particular order. If the order is marketable and otherwise meets all of the eligibility criteria for execution on the Exchange's Retail Automatic Execution Systems ("RAES"), the order will be routed to RAES and executed

⁴ In most cases, staff of the DPM operates Ebook for the option classes assigned to them.

⁵ The Commission approved the Exchange's Live Ammo processing system on a pilot basis earlier this year. The pilot expires October 31, 2000. Securities Exchange Act Release No. 42379 (February 2, 2000), 65 FR 6665 (February 10, 2000) (File No. SR-CBOE-98-27).

²⁶ 15 U.S.C. 78f(b)(5).

²⁷ 15 U.S.C. 78s(b).

²⁸ See Securities Exchange Act Release No. 43004 (June 30, 2000), 65 FR 43060 (July 12, 2000).

²⁹ 15 U.S.C. 78f(b)(5).

³⁰ 15 U.S.C. 78s(b).