

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43646; File No. SR-CBOE-00-53]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by Chicago Board Options Exchange, Inc. Relating to Permanent Approval of Live Ammo to RAES

November 30, 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 8, 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. 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 adopt on a permanent basis the system that allows an Order Book Official ("OBO") or Designated Primary Market Maker ("DPM") to designate certain booked orders to be electronically executed against market makers standing in the crowd. 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, 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, the Proposed Rule Change

##### 1. Purpose

On February 2, 2000, the Commission approved, on a pilot basis, a systems change that allows an OBO or a DPM to reroute orders on the electronic book screen that displays market orders and limit orders that improve the market ("Live Ammo") to the Retail Automatic Execution System ("RAES").<sup>3</sup> On October 31, 2000, the pilot was extended through December 15, 2000.<sup>4</sup>

The Exchange now proposes to make permanent the pilot program with respect to the processing of Live Ammo orders.<sup>5</sup> The Commission recently approved a system enhancement to the Exchange's Order Routing System ("ORS"), which provided for the automatic rerouting of cancel/replace orders.<sup>6</sup> The Exchange believes that this systems change addresses the Commission's expectation that the Exchange develop a system enhancement to ensure that RAES-eligible orders will be routed directly to RAES without the interim step of first appearing on the Live Ammo screen.<sup>7</sup> The Exchange expects that the enhancement to ORS will be implemented in December 2000.

Although the number of Live Ammo orders should be substantially reduced by the planned enhancement to ORS, there occasionally may still be circumstances when the OBO or DPM may have reason to reroute Live Ammo orders manually. For example, in the event that a Floor Broker becomes so busy during heavy trading conditions that he is unable to represent and execute orders in a timely manner, the Floor Broker can electronically book all non-market, non-contingency orders he holds by hitting the "book all" button on his PAR workstation. Those orders that are marketable will route to the Live Ammo screen while those that are not marketable will stay in the book. Those orders that route to the Live Ammo screen will still require an OBO or DPM to manually reroute the orders to RAES. Therefore, the Exchange proposes that the Live Ammo to RAES

functionality be approved on a permanent basis to deal with such limited circumstances.

##### 2. Basis

The Exchange believes that because the Live Ammo to RAES processing system has provided for the more timely execution of marketable orders, the proposed rule change is consistent with Section 6(b) of the Act,<sup>8</sup> in general, and furthers the objectives of Section 6(b)(5),<sup>9</sup> in particular, because it is designed 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 a national market system, and, in general, to protect investors and the public interest.

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

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

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 reason 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

<sup>3</sup> Securities Exchange Act Release No. 42379, 65 FR 6665 (February 10, 2000) (approving SR-CBOE-98-27 on a pilot basis until October 31, 2000) ("Pilot Order").

<sup>4</sup> Securities Exchange Act Release No. 43499, 65 FR 67023 (November 8, 2000).

<sup>5</sup> The Exchange rule pertaining to the processing of Live Ammo orders is CBOE Rule 7.4(g).

<sup>6</sup> Securities Exchange Act Release No. 43185 (August 21, 2000), 65 FR 51884 (August 25, 2000).

<sup>7</sup> See Pilot Order, note 3 *supra*.

<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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

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

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 CBOE. All submissions should refer to File No. SR-CBOE-00-53 and should be submitted by January 2, 2001.

For the Commission, by the Division of Market Regulations, pursuant to delegated authority.<sup>10</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43638; File No. SR-CBOE-00-57]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to the Prohibition Against Electronically Generated and Communicated Orders

November 29, 2000.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934,<sup>1</sup> ("Act") and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 13, 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 CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

<sup>10</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.

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

The Exchange proposes to amend CBOE Rule 6.8A, which governs the entry of electronically generated and communicated orders. Pursuant to the proposed amendment, an order would be deemed electronically generated and communicated for purposes of the Rule even if a practice requiring minimal human intervention has been added to the process of electronically generating and communicating the order.

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 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, the Proposed Rule Change

##### 1. Purpose

On September 12, 2000, the Commission approved a proposed rule change filed by the Exchange that prohibits the entry of certain options orders that are created and communicated electronically, without manual input, into the CBOE's Order Routing System ("ORS").<sup>3</sup> Specifically, the new Rule (CBOE Rule 6.8A) provides that members may not enter nor permit the entry of, orders into ORS if those orders are created and communicated electronically without manual input and if such orders are eligible for execution on Retail Automatic Execution System ("RAES") at the time they are sent.<sup>4</sup> To be

<sup>3</sup> See Securities Exchange Act Release No. 43285 (September 12, 2000), 65 FR 56972 (September 20, 2000) (SR-CBOE-00-01). The Exchange's rule is similar to a rule of the International Securities Exchange ("ISE") that the Commission approved earlier. When the Commission approved ISE's application for Exchange registration, it also approved several ISE rules, including ISE Rule 717(f) regarding the entry of computer-generated orders. See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11401 (March 2, 2000).

<sup>4</sup> CBOE Rule 6.8A clarifies that an order is eligible for execution on RAES if: (1) Its size is equal to or

permitted under the Rule, order entry by public customers or associated persons of members must involve manual input, such as entering the terms of an order into an order-entry screen or manually selecting a displayed order against which an off-setting order should be sent.

In its Order approving CBOE Rule 6.8A,<sup>5</sup> the Commission noted that allowing the entry of electronically generated and communicated orders could undercut CBOE's business model.<sup>6</sup> As CBOE Rule 6.8A is currently drafted, however, it is the Exchange's view that the Rule is capable of being easily undermined. Professional traders that have developed or purchased software to electronically generate and communicate orders can easily install a simple manual step into the process in order to avoid a violation of the Rule. In fact, the Exchange has learned that professional traders have had persons enter a keystroke to electronically generate and communicate orders to an exchange's order routing system in order to circumvent the prohibition against such orders that have been adopted by other exchanges.

The one comment letter submitted to the Commission on the Exchange's proposed rule change adopting the CBOE Rule 6.8A made this same point.<sup>7</sup> The commenter noted, "[t]he CBOE should be free to interpret its prohibition against electronically generated and submitted orders to include orders with nominal or minimal human intervention. Otherwise, CBOE's proposal could be completely undermined."<sup>8</sup>

The Exchange believes that its proposed new interpretation to Rule 6.8A is an appropriate response to the potential harm that could result to its business model from those persons who can easily avoid violations of the Rule as it currently stands. The Exchange does not believe it is enough to simply prohibit orders that are sent by the entry of a single keystroke because those

less than the maximum RAES order size for the particular option series; (2) the order is marketable or is tradable pursuant to the RAES auto step-up feature at the time it is sent; and (3) the order has either no contingency or has a contingency that is accepted for execution by RAES.

<sup>5</sup> See note 3, *supra*.

<sup>6</sup> Specifically, the Commission noted: " \* \* \* the Commission recognizes that the CBOE's business model depends on market makers for competition and liquidity. Allowing electronic order entry into ORS could give automated customers a significant advantage over market makers. This could undercut CBOE's business model." *Id.* at 56973.

<sup>7</sup> Letter from Joel Greenberg, Managing Director, Susquehanna Investment Group, to Jonathan G. Katz, Secretary, Commission, dated August 29, 2000.

<sup>8</sup> *Id.* at p. 3.