

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44383; File Nos. SR-Amex-2001-18; SR-CBOE-2001-15; SR-ISE-2001-07; SR-PCX-2001-18; and SR-Phlx-2001-37]

### Self-Regulatory Organizations: Order Approving Proposed Rule Changes, as Amended, and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 3 to Proposed Rule Changes by the American Stock Exchange LLC, Amendment Nos. 2 and 3 by the Chicago Board Options Exchange, Inc., Amendment No. 2 by the International Securities Exchange LLC, Amendment No. 2 by the Pacific Exchange, Inc., and Amendments Nos. 3, 4, and 5 by the Philadelphia Stock Exchange, Inc. Relating to the Application of the Quote Rule to Options Trading

June 1, 2001.

On March 15, 2001, the American Stock Exchange LLC ("Amex"); on March 30, 2001, the Chicago Board Options Exchange, Inc. ("CBOE"); on February 28, 2001, the International Securities Exchange LLC ("ISE"); on March 29, 2001, the Pacific Exchange, Inc. ("PCX"); and on March 12, 2001, the Philadelphia Stock Exchange, Inc. ("Phlx") (referred to collectively as "Exchanges") filed with the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> proposed rule changes relating to the implementation of sixty-day pilot programs to conform the Exchanges' rules to Rule 11Ac1-1 under the Exchange Act ("Quote Rule")<sup>3</sup> by the compliance date of April 1, 2001.<sup>4</sup>

Amex submitted to the Commission Amex Amendment No. 1 to its proposed rule change on March 21, 2001<sup>5</sup> and Amex Amendment No. 2 on March 28, 2001.<sup>6</sup> CBOE filed CBOE Amendment No. 1 to its proposed rule change on

March 30, 2001.<sup>7</sup> ISE submitted ISE Amendment No. 1 to its proposal on March 30, 2001.<sup>8</sup> The PCX submitted PCX Amendment No. 1 on March 29, 2001.<sup>9</sup> The Phlx submitted Phlx Amendment No. 1 to its proposal on March 16, 2001<sup>10</sup> and Phlx Amendment No. 2 on March 29, 2001.<sup>11</sup> Notice of the Exchanges' proposed rule changes, as amended, and an order granting partial accelerated approval of the proposed rule changes on a sixty-day basis ("Pilot Programs") was published in the *Federal Register* on April 10, 2001.<sup>12</sup> The Commission received two comment letters regarding the Exchanges' proposed rule changes, as amended.<sup>13</sup>

On May 30, 2001, the Amex submitted Amex Amendment No. 3 to its pilot program;<sup>14</sup> on June 1, 2001, the CBOE submitted CBOE Amendment No. 2 to its pilot program;<sup>15</sup> on June 1, 2001, the CBOE submitted CBOE Amendment No. 3 to its pilot program;<sup>16</sup> on May 30,

2001, the ISE submitted ISE Amendment No. 2 to its pilot program;<sup>17</sup> on May 23, 2001, the PCX submitted PCX Amendment No. 2 to its pilot program,<sup>18</sup> on May 11, 2001, the Phlx submitted Phlx Amendment No. 3 to its pilot program;<sup>19</sup> on May 21, 2001, Phlx submitted Phlx Amendment No. 4;<sup>20</sup> and on May 29, 2001, the Phlx submitted Phlx Amendment No. 5 to its pilot program.<sup>21</sup> The Commission is approving the Pilot Program on a permanent basis, as amended, and publishing this notice to solicit comments on Amex Amendment No. 3, CBOE Amendment Nos. 2 and 3, ISE Amendment No. 2, PCX, Amendment No. 2, and Phlx Amendment Nos. 3, 4, and 5 from interested persons.<sup>22</sup> As discussed below, the Commission also

Director, Division, Commission, dated June 1, 2001 ("CBOE Amendment No. 3"). In CBOE Amendment No. 3, CBOE clarified that it is requesting accelerated approval of CBOE Amendment No. 2, pursuant Section 19(b)(2) of the Exchange Act.

<sup>17</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to John Roeser, Attorney, Division, Commission, dated May 29, 2001 ("ISE Amendment No. 2"). In ISE Amendment No. 2, ISE requested permanent approval of its pilot rules and deleted its provision relating to obvious errors.

<sup>18</sup> See letter from Michael D. Pierson, Senior Vice President Regulatory Policy, PCX, to John Roeser, Attorney, Division, Commission, dated May 23, 2001 ("PCX Amendment No. 2"). In PCX Amendment No. 2, PCX requested permanent approval of its pilot rules and made a technical change to its rule text regarding unusual market conditions.

<sup>19</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 11, 2001 ("Phlx Amendment No. 3"). In Phlx Amendment No. 3, Phlx requested permanent approval of its pilot rules, provided more detailed procedures for determining and monitoring when quotes are not firm, clarified in its rule text that Phlx will notify specified persons when quotes are not firm through the Options Price Reporting Authority ("OPRA") using an agreed upon indicator, clarified that it will publish size for customer orders through OPRA and on its website, and specified that the designee of the Director of Surveillance may be any person employed by the Phlx in the Options Surveillance Department.

<sup>20</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 21, 2001 ("Phlx Amendment No. 4"). Phlx Amendment No. 5 supersedes and replaces Phlx Amendment No. 4.

<sup>21</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 29, 2001 ("Phlx Amendment No. 5"). In Phlx Amendment No. 5, Phlx made conforming changes to its floor procedure advices to reflect Phlx Amendment No. 3 and deleted a provision proposed in its initial filing that had not been approved as part of the Pilot Approval Order regarding the unbundling of orders for the primary purpose of availing upon the execution guarantee requirement.

<sup>22</sup> For ease of comparison and review, the Commission has consolidated the Exchanges' proposed amendments into one notice, which combines and summarizes the main provisions of such amendments.

<sup>7</sup> See letter from Madge M. Hamilton, Legal Division, CBOE, to Nancy Sanow, Assistant Director, Division, Commission, dated March 30, 2001 ("CBOE Amendment No. 1").

<sup>8</sup> See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division, Commission, dated March 29, 2001 (replacing Form 19b-4 in its entirety) ("ISE Amendment No. 1").

<sup>9</sup> See letter from Michael D. Pierson, Senior Vice President Regulatory Policy, PCX, to John Roeser, Attorney, Division, Commission, dated March 29, 2001 ("PCX Amendment No. 1").

<sup>10</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 15, 2001 ("Phlx Amendment No. 1").

<sup>11</sup> See letter from Richard S. Rudolph, Counsel, Phlx, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 28, 2001 ("Phlx Amendment No. 2").

<sup>12</sup> Securities Exchange Act Release No. 44145 (April 2, 2001), 66 FR 18662 (April 10, 2001) ("Pilot Approval Order").

<sup>13</sup> See letter from Meyer S. Frucher, Chairman and Chief Executive Officer, Phlx, to Jonathan G. Katz, Secretary, Commission, dated May 2, 2001 ("Phlx Letter") and electronic mail message from Mike Ianni, sent May 17, 2001 ("Ianni Letter").

<sup>14</sup> See letter from Claire P. McGrath, Vice President and Special Counsel, Derivative Securities, Amex, to Nancy J. Sanow, Assistant Director, Division, Commission, dated May 30, 2001 ("Amex Amendment No. 3"). In Amex Amendment No. 3, Amex requested permanent approval of its pilot rules, codified an exemption granted by the Commission regarding the treatment of foreign broker-dealers, made conforming changes to better reference the Quote Rule, and clarified that when there is an error in size, the responsible broker or dealer is obligated for ten contracts.

<sup>15</sup> See letter from Madge M. Hamilton, Legal Division, CBOE, to Nancy Sanow, Assistant Director, Division, Commission, dated May 31, 2001 ("CBOE Amendment No. 2"). In CBOE Amendment No. 2, CBOE requested permanent approval of its pilot rules, implemented non-substantive reorganization to the rule text, and deleted a provision proposed in its initial filing that had not been approved as part of the Pilot Approval Order relating to multiple orders from the same beneficial owner.

<sup>16</sup> See letter from Madge M. Hamilton, Legal Division, CBOE, to Nancy Sanow, Assistant

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

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

<sup>3</sup> 17 CFR 240.11Ac1-1.

<sup>4</sup> Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000) ("Adopting Release").

<sup>5</sup> See letter from Claire P. McGrath, Vice President and Special Counsel, Derivative Securities, Amex, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 20, 2001 ("Amex Amendment No. 1").

<sup>6</sup> See letter from Claire P. McGrath, Vice President and Special Counsel, Derivative Securities, Amex, to Nancy Sanow, Assistant Director, Division, Commission, dated March 27, 2001 ("Amex Amendment No. 2").

is granting accelerated approval to the amended proposals.

### I. Text of the Proposed Amendments to the Pilot Program

The Exchange propose to amend their Pilot Programs to conform to the requirements of the Quote Rule. The text of the proposed rule changes follows. Text added by amendments since the publication of the Exchanges' proposals is italicized and deleted text is bracketed.

#### A. Amex Proposed Rule Text

##### Rule 958A. Application of the Firm Quote Rule

(a) Definitions—(i) For purposes of this rule the terms “aggregated quotation size”, “best bid and best offer”, “bid and offer”, “quotation size”, “quotation vendor”, “reported security”, “listed option”, “option class”, “option series”, and “trading rotation” shall have the meanings set forth in SEC Rule 11Ac1-1.

(ii) For purposes of this rule and SEC Rule 11Ac1-1 as applied to the Exchange and its members, the term “responsible broker or dealer” shall mean, with respect to any bid or offer for any listed option made available by the Exchange to quotation vendors, the specialist and any registered options traders constituting the trading crowd in such option series shall collectively be the responsible broker or dealer to the extent of the aggregate quotation size specified.

(b) Dissemination Requirements of the Exchange—(i) With respect to paragraph (b) of SEC Rule 11Ac1-1 [and except as set forth in Commentary .01 of this rule], the Exchange shall, at all times it is open for trading:

(A) Collect, process and make available to quotation vendors the best bid, the best offer, quotation sizes and aggregate quotation sizes associated therewith for each option series that is a reported security and for which a responsible broker or dealer is obligated to execute any customer order as set forth in paragraph (c)(1)(A) below; and

(B) Shall for each listed option class, establish [by rule] and periodically published the quotation size for which the responsible broker or dealer is obligated to execute an order for the account of a *U.S. registered or foreign registered* broker or dealer to buy or sell an option series that is a reported security at its published bid or offer as set forth in paragraph (c)[(ii)] (i)(B) below. The exchange may collect, process and make available to quotation vendors a best bid or best offer determined by an automated quotation system.

(ii) The Exchange's obligations to collect, process and make available data as set forth above shall not include:

(A) collecting, processing or making available any such bid or offer which is executed immediately after being made in the crowd and any such bid or offer which is cancelled or withdrawn if not executed immediately after being made; or

(B) data communicated during any period when trading in such reported security has been suspended or halted; prior to the commencement of trading in such reported security on any trading day; or during a trading rotation.

[The minimum quotation size made available to quotation vendors established by rule and published by the Exchange shall be ten contracts for each option series.]

(c) Obligations of a Responsible Broker or Dealer—(i) Pursuant to SEC Rule 11Ac1-1 each responsible broker or dealer for each series of each listed option class shall promptly communicate to the Exchange its best bid, best offer, quotation size and aggregate quotation size. No responsible broker or dealer shall communicate a quotation size or aggregate quotation size for less than ten contracts. This obligation may be fulfilled by the use of an automated quotation system.

[i](A) Subject to the provisions of paragraph (d) of this rule, each responsible broker or dealer shall be obligated to execute any customer order in an option series in an amount up to its published quotation size.

[ii](B) Subject to the provisions of paragraph (d) of this rule, each responsible broker or dealer shall be obligated to execute any order for the account of a *U.S. registered or foreign* broker or dealer in a listed option in an amount up to the quotation size established [by rule] and periodically published by the Exchange *which quotation size shall be for at least one contract.*

[iii](C) Subject to the provisions of paragraph (d) of this Rule, each responsible broker or dealer shall comply with the Thirty Second Response provisions set forth in paragraph (d)(3) of SEC Rule 11Ac1-1.

(ii) *Non responsible broker or dealer shall be obligated to execute a transaction for any listed option as provided in paragraph (c)(i) when:*

(A)(1) *Prior to the presentation of an order to sell (buy), a responsible broker or dealer has communicated to the exchange, a revised quotation size;*

(2) *At the time an order to sell (buy) is presented, a responsible broker or dealer is in the process of effecting a transaction in such class and/or series*

*of option, and immediately after the completion of such transaction it communicates to the Exchange a revised quotation size, such responsible broker or dealer shall not be obligated by paragraph (c)(i) of this Rule to sell (buy) that option in an amount greater than such revised quotation size.*

(3) *Before the order sought to be executed is presented, a responsible broker or dealer has communicated to the Exchange a revised bid or offer; or*

(4) *At the time the order sought to be executed is presented, a broker or dealer is in the process of effecting a transaction in such class and/or series of option, and, immediately after the completion of such transaction, a responsible broker or dealer*

*communicates to the exchange a revised bid or offer; provided, however, that the responsible broker or dealer shall nonetheless be obligated to execute any such order as provided in paragraph (c)(i) at its revised bid or offer in any amount up to its published quotation size or revised quotation size; or*

(B) *The order for the purchase or sale of a listed option is presented during a trading rotation in that listed option.*

(d) Use of Unusual Market Exception—Notwithstanding paragraphs (b) and (c) above and pursuant to paragraph (b)(3) of SEC Rule 11Ac1-1, if the Exchange determines, in accordance with the procedures set forth below, that the level of trading activity or the existence of unusual market conditions is such that the Exchange [cannot] *is incapable of* collecting, processing and making available to quotation vendors quotation data in a manner which accurately reflects the current state of the market at the Exchange, the Exchange shall immediately notify the persons specified in paragraph (b)(3) of SEC Rule 11Ac1-1 [below] and, upon such notification, the obligation imposed upon Exchange members under paragraph (c)(2) of SEC Rule 11Ac1-1 and the Exchange under paragraphs (b)(1) and (2) of SEC Rule 11Ac1-1 shall be suspended, until a determination by the Exchange that the unusual market activity or condition has terminated and the specified persons have been notified that the usual market activity or condition has terminated:

(i) If a responsible broker or dealer is unable to update his quotations on a timely basis due to the high level of trading activity or the existence of an unusual market conditions, he shall promptly notify a Floor Official.

(ii) Upon notification by a responsible broker or dealer, the Floor Official shall promptly verify the existence of the unusual market activity or condition

and if, in his judgment, the responsible broker or dealer is unable to update his quotations on a timely basis, the Floor Official shall promptly notify the Market Operations Division of the Exchange. If a Floor Official, independent of notification by a responsible broker or dealer, becomes aware of any unusual market activity or condition which adversely affects a responsible broker or dealer's ability to promptly communicate quotation data, he shall likewise promptly advise the Market Operations Division.

(iii) If the Exchange is unable to accurately collect, process, and/or disseminate quotation data owing to the high level of trading activity or the existence of unusual market conditions, the Market Operations Division of the Exchange, after consultation with a Floor Official, shall make a determination that this is the case.

(iv) The Market Operations Division, after receiving notification from a Floor Official pursuant to either subparagraphs (i) and (iii) above, shall notify the persons specified in paragraph (b)(3) of SEC Rule 11Ac1-1 regarding the Exchange's inability to accurately collect, process, and make available the quotation data required by SEC Rule 11Ac1-1. The Exchange shall append to each quotation made available to a quotation vendor an identifier which will indicate that the obligation imposed upon Exchange members and the Exchange by SEC Rule 11Ac1-1 has been suspended.

(v) The Floor Official or the Market Operations Division (as the case may be) shall monitor the unusual market activity or condition until it has terminated. Thereupon, the Market Operations Division shall immediately notify the persons specified in paragraph (b)(3) of SEC Rule 11Ac1-1 that the Exchange is once again capable of disseminating the quotation data required by Rule SEC 11Ac1-1 and responsible brokers or dealers shall be once again obligated under SEC Rule 11Ac1-1 as made applicable to Exchange members pursuant to this Rule 958A.

\* \* \* \* \*

#### \* \* \* Commentary

[.01 As of April 1, 2001, the compliance date for application of SEC Rule 11Ac1-1 to the trading of options, the Exchange is able to disseminate to quotation vendors the quotation size or aggregate quotation size of the best bid or best offer in most, but not all, option classes. This is not expected to be a permanent condition and it is anticipated that quotation sizes will be available for all option classes shortly

after the compliance date. However, until such time as the Exchange is able to disseminate quotation size for all option classes, for those option classes for which it is unable to do so, it will collect, process and disseminate the best bid and best offer, and establish by rule and periodically publish the quotation size for which the responsible broker or dealer is obligated to execute a customer order to buy or sell an option series in that class.]

[.02].01 No specialist shall be deemed to be a responsible broker or dealer with respect to a published bid or offer that is erroneous as a result of an error or omission made by the Exchange or any quotation vendor. If a published bid or published offer is accurate but the published quotation size (or published aggregate quotation size, as the case may be) associated with it is erroneous as a result of an error or omission made by the Exchange or any quotation vendor, then the specialist who is responsible for the published bid or published offer shall be obligated to the extent set forth in paragraph (c) of Rule 11Ac1-1 but only to the extent of [one unit of trading in the reported security in question] *ten contracts*.

[.03].02 Absent unusual market conditions, the responsible broker or dealer shall honor any bid or offer then being displayed by quotation vendors which is erroneous, up to the quotation size then being so displayed, which has been displayed for six minutes or more. Provided, however, that the specialist shall not be required to honor such a bid or offer which is erroneous as to either price or size or both if:

(i) As a matter of record, an execution, cancellation or update of such bid or offer was in effect or in process;

(ii) In honoring such a bid or offer, the resulting transaction would violate applicable Exchange rules or federal regulations;

(iii) Equipment failure prevents the specialist from monitoring such bid or offer; or

(iv) The price sought upon such quotation is above the current bid or below the current offer, on the Floor, by (a) \$.25 or more in the case of a reported security trading at \$3 or less or (b) \$.50 or more in the case of a reported security trading at more than \$3.

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#### Rule 590—Minor Rule Violation Fine System

##### Part 1 General Rule Violations

(a) through (g) No change.

(h) The following is a list of the rule violations and applicable fines that may

be imposed by the Exchange's Minor Floor Violation Disciplinary Committee pursuant to Part 1 of this Rule.

1. Failure to comply with the SEC firm quote rule (and honoring 10-up market for customer option orders). (SEC Rule 11Ac1-1 and Rule 958A.)

#### B. CBOE Propose Rule Text

##### Rule 8.51.—Firm Disseminated Market Quotes

(a) Definitions.

(1) For the purposes of this rule, and SEC Rule 11Ac1-1 as applied to the Exchange and members on the floor, the term "responsible broker or dealer" shall mean, with respect to any bid or offer for any reported security made available by the Exchange to quotation vendors, the trading crowd in a series or class of option, which shall be the responsible broker or dealer to the extent of the quotation size specified in [(b) or] (c) of this rule.

(2) For purposes of this rule, the term "reported security" means any security or class of securities for which transactions reports are collected, processed and made available pursuant to an effective national market system plan for reporting transactions in listed options.

(b) Firm Quote Requirement [for Non-broker-dealer Orders]. [All classes and series shall be subject to the requirements of this rule.

(1) The appropriate Floor Procedure Committee may establish the firm quote requirement for each series of option, which shall be for at least one contract, for non-broker-dealer orders. The Exchange will periodically publish the firm quote requirement for each series of option. In the event the Exchange disseminates quotation size, the firm quote requirement would be for up to the disseminated size.]

(1[2]) The firm quote requirement obligates the responsible broker or dealer to sell (buy) at least the established number of contracts at the offer (bid) which is displayed when the responsible broker or dealer receives a buy (sell) order at the trading station where the *reported security* [particular option class] is located for trading.

[(3) When orders for the same class (whether for the same series or different series) from the same beneficial owner are represented at the trading station at approximately the same time, then only the first of such orders that cumulatively equal or add up to less than the firm quote requirement shall be entitled to an execution pursuant to paragraphs (b) and (c) above.]

(c) Firm Quote *Size* [Requirement for Broker-Dealer Orders].

(1) The appropriate Floor Procedure Committee may establish *separate* [the] firm quote requirements for each series of option, which shall be for at least one contract, for (i) *non-broker-dealer orders* and (ii) *broker-dealer orders*. [The Exchange will periodically publish the firm quote requirement for each series of option. In the event the Exchange disseminates quotation size, if the disseminated quotation size is for a lesser amount than the firm quote requirement, then the broker-dealer firm quote requirement would be for the disseminated size.] For purposes of this Rule, the term broker-dealer includes foreign broker-dealers as defined in Rule 1.1(xx). *The Exchange will periodically publish the firm quote size requirement for each series of option for both order types.*

(2) *The firm quote requirement size for non-broker-dealer orders shall be the size that the Exchange periodically publishes along with the quotes disseminated to vendors. In the event the Exchange has not published a size along with its quotes for a particular series, then the firm quote requirement size for non-broker-dealer orders shall be that size published by the Exchange in a different manner (e.g., on its website). The Exchange also publish separately the firm quote requirement size for broker-dealer orders. In the case of broker-dealer orders, it the size for a particular series disseminated along with the quotes is less than the size published for broker-dealer orders, then the firm quote requirement for broker-dealer orders shall be the size published along with the quotes.*

(d) *Thirty Seconds Rule.* Each responsible broker or dealer within thirty seconds from receiving an order that is greater than the quotation size established by paragraph [(b) or] (c) of the rule must:

(1) Execute the entire order; or  
(2) [(i)A] Executive that portion of the order equal to at least the quotation size established by paragraph[s] (b) or] (c) of this rule; and

[(ii)B] Revise its bid or offer.

(e) *Exemptions to Firm Quote Requirement. Non-Firm Mode.*

(1) *The responsible broker or dealer shall be relieved of its obligations under this Rule 8.51 [with respect to such reported security] and with[With] respect to paragraph (b)(3) of SEC Rule 11Ac1-1:*

(i) *When[Any] two Floor Officials, on a case by case basis, for either a class or series within a class, [may] make a determination[, ] that the level of trading activity or the existence of unusual market conditions are such that the Exchange is incapable of collecting,*

*processing and making available to quotation vendors bids, offers and quotation sizes with respect to one or more class or series within a class of option in a manner which accurately reflects the current state of the market on the floor[.]; [During any period that the market in a reported security is in a non-firm mode, the responsible broker or dealer shall be relieved of their obligations under SEC Rule 11Ac1-1 as applicable to such members under this Rule 8.51 with respect to such reported security, but the responsible broker or dealer shall report bids and offers or revised bids and offers in such reported security, for publication, on a "best efforts" basis; or]*

(ii) *When the [The] senior person, then in charge of the Exchange's Control Room, suspends the firm quote requirements of paragraph[s] (b) [or] (c)] with respect to a class of options if he or she determines that the level of trading activity or the existence of unusual market conditions are such that the Exchange is incapable of collecting, processing and making available to quotation vendors bids, offers and quotation sizes with respect to one or more class or series of option in a manner which accurately reflects the current state of the market on the floor. After exercising such authority, that senior person shall immediately seek approval by two Floor Officials, who may confirm or overrule the decision; or [.* During any period that the market in a reported security is in a non-firm mode, the responsible broker dealer shall be relieved on their obligations under SEC Rule 11Ac1-1 as applicable to such members under this Rule 8.51 with respect to such reported security, but the responsible broker or dealer shall report bids and offers or revised bids and offers in such reported security, for publication, on a "best efforts" basis.]

(iii) *When the order for the purchase or sale of a reported security is presented during a trading rotation in that reported security.*

(2) *When it has been relieved of its firm quote obligation, the responsible broker or dealer shall report bids and offers or revised bids and offers in a reported security, for publication, on a "best effort" basis.*

(3)[(iii)] *Whenever two Floor Officials or the senior person then in charge of the Exchange's Control Room make a determination under subparagraphs (i) or (ii) above with respect to any reported security, the Exchange's Control Room will disseminate a message notifying the specified persons that the displayed quotes are not firm.*

(4)[(iv)] *During any period that the market in a reported security is in a non-firm mode, the Floor Officials shall monitor the activity or condition, which formed the basis for [his or]their determination. No more than 30 minutes after such market has been designated to be in a non-firm mode, the DPM shall review the condition of such market with the Floor Officials. Continuation of the non-firm mode for longer than 30 minutes shall require the reaffirmation of the reviewing Floor Officials. Such review and reaffirmation shall occur not less frequently than every 30 minutes thereafter while the non-firm mode is effect.*

(5)[(v)] *When the Exchange is once again capable of collecting, processing and making available to quotation vendors bids and offers with respect to a reported security that is in non-firm mode in a manner which accurately reflects the current state of the market on the floor then the senior person then in charge of the Exchange's Control Room, or two Floor Officials shall lift the non-firm mode designation. Once the non-firm mode designation has been lifted, the responsible broker or dealer[s] shall be obligated for the firm quote requirements as stated in paragraph[s] (b) [or] (c)].*

(6)[(2)] *No responsible broker or dealer shall be obligated to execute a transaction for any listed option as provided in paragraph[s] (b) [and] (c)] of this rule<sup>23</sup> when:*

*(i) Revised Quotation Size*

(A) *Prior to the presentation of an order to sell(buy), a responsible broker or dealer has communicated to the exchange, a revised quotation size; or*

(B) *At the time an order to sell(buy) is presented, responsible broker or dealer is in the process of effecting a transaction in such class and/or series of option, and immediately after the completion of such transaction, it communicates to the exchange a revised quotation size, such responsible broker or dealer shall not be obligated by paragraph (b), [(c)] or (d) of this Rule to sell(buy) that option in an amount greater than such revised quotation size.*

*(ii) Revised Bid or Offer*

(A)[C] *Before the order sought to be executed is presented, a responsible broker or dealer has communicated to the exchange, a revise bid or offer; or*

(B)[D] *At the time order sought to be executed is presented, a responsible broker or dealer is in the process of*

<sup>23</sup>This section is pursuant to SEC Rule 11Ac1-1(d)(4). The responsible broker or dealer shall also be relieved of its [their] obligations under SEC Rule 11 Ac1-1(c)(2).

effecting a transaction in such class or series of option, and, immediately after the completion of such transaction, a responsible broker or dealer communicates to the exchange, a revised bid or offer; provided, however, that the responsible broker or dealer shall nonetheless be obligated to execute any such order as provided in paragraph[s] (b) [or (c)] of this rule at its revised bid or offer in any amount up to its published quotation size or revised quotation size.]; or]

[(ii) The order for the purchase or sale of a listed option is presented during a trading rotation in that listed option.]

(f) Each member on the floor shall abide by such rules and procedures adopted by the Exchange, in order to enable the Exchange to meet its quotation dissemination requirements.<sup>24</sup>

\* \* \* Interpretations and Policies.

.01 With respect to subsection (b) of this Rule, if the disseminated bid (offer) is on behalf of an order represented by a Floor Broker, DPM, or OBO and is for less than the firm quote requirement applicable for that class of options, a responsible broker or dealer is obligated to buy or sell the necessary number of contracts needed to make the disseminated quote firm for the firm quote requirement for that class of options.

.02 Where a Floor Broker, DPM, or OBO has caused a bid or offer to be disseminated and the order is subsequently filled or canceled, the Floor Broker, DPM, or OBO will be responsible for causing such disseminated bid or offer to be removed. Failure to do so will result in the Floor Broker, DPM, or OBO being responsible for satisfying the firm disseminated quote commitment pursuant to subsection (b) [or (c)] of this Rule. Any member who has caused a bid or offer to be disseminated is equally responsible for removing such bid or offer when he leaves the trading crowd.

.03 Where a disseminated market quote is revised, as provided for in paragraph (e) of this Rule, it shall be considered conduct inconsistent with just and equitable principles of trade for a responsible broker or dealer immediately to re-display the previously disseminated market quote, unless such action is warranted by a change in market conditions.

.04 Floor Officials may, as provided for under Rules 6.20(c) and 17.50(g)(6), impose a fine on members of the trading crowd for violations of this Rule and its Interpretations and Policies.

.05 The requirement of paragraph[s] (b) [and (c)] of this Rule that the responsible broker or dealer must honor displayed quotations up to the firm quote requirement subject to the conditions of the Rule applies not only to orders to buy or to sell options, but also to two-part spread or straddle for all options orders which may be executed at displayed quotations for both parts of the order. This obligation of a responsible broker or dealer applies to two-part orders where the two sides are on opposite sides of the market in a one-to-one ratio, and extends to the amount of the firm quote requirement on each side of the order.

.06 Pursuant to Rule 6.20 Interpretation .09, the reference to any two Floor Officials in Rule 8.51 and its Interpretations and Policies includes, but is not limited to, members of the appropriate Market Performance Committee.

.07 Under paragraph (e) of this Rule, when two Floor Officials [may] determine that a market in a class of series of option is fast pursuant to Rule 6.6, the Floor Officials may determine the market constitutes a level of trading activity or such unusual market conditions that the Exchange is incapable of collecting, processing and making available to quotation vendors bids, offers and quotation sizes in a manner that accurately reflects the current state of the market on the floor, and thus, suspend the firm quote requirement.

.08 The trading crowd shall not be deemed to be a responsible broker or dealer with respect to a published bid or offer that is erroneous as a result of an error or omission made by the Exchange or any quotation vendor. If a published bid or published offer is accurate but the published quotation size (or published aggregate quotation size, as the case may be) associated with it is erroneous as a result of an error or omission made by the Exchange or any quotation vendor, then the [trading crowd] responsible broker or dealer is responsible for the published bid or published offer shall be obligated to the extent set forth in paragraph (c) of Rule 11Ac1-1 but only to the extent of one contract of the listed option in question.

#### C. ISE Proposed Rule Text

##### Rule 804. Market Maker Quotations

\* \* \*

(d) Firm Quotes. Market maker bids and offers are firm for Public Customer Orders and Non-Customer Orders Both under this Rule and Rule 11Ac1-1 under the Exchange Act ("Rule 11Ac1-1") for the number of contracts specified

for each according to the requirements of paragraph (b) above. Market Maker bids and offers are not firm under this Rule and Rule 11Ac1-1 if:

[(i) the Exchange determines that an exception is warranted, on a case by case basis, because of an obvious error;]

[(ii) (i) a system malfunction or other circumstance impairs the Exchange's ability to disseminate or update market quotes in a timely and accurate manner;

[(iii) (ii) The level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors the data for the option in a manner that accurately reflects the current state of the market on the Exchange, and as a result, the market in the option is declared to be "fast" pursuant to Rule 704;

[(iv) (iii) during trading rotations; or

[(v) (iv) any of the circumstances provided in paragraph (c)(3) of Rule 11Ac1-1 exist.

\* \* \* \* \*

#### D. PCX Proposed Rule Text

¶ 5221—Firm Quotes.

Rule 6.86(a)–(c)—No change.

(d) Exception for Unusual Market Conditions

(1) If the Exchange determinations, in accordance with the procedures set forth below, that the level of trading activity or the existence of unusual market conditions is such that the Exchange *is incapable of collecting, processing and making* [cannot collect, process and make] available to quotation vendors quotation data in a manner that accurately reflects the current state of the market at the Exchange, the Exchange will immediately notify the persons specified in SEC Rule 11Ac1-1(b)(3) and, upon such notification, the obligation imposed upon Exchange members under SEC Rule 11Ac1-1(c)(2) and the Exchange under subsection (b), above, will be suspended, until the Exchange determines that the unusual market activity or condition has terminated and the specified persons have been notified that the unusual market activity or condition has terminated.

\* \* \*

#### E. Phlx Proposed Rule Text

Rule 1082 Firm Quotations.

(a) Definitions.

(i) The term "disseminated price" shall mean the bid (or offer) price for an options series that is made available by the Exchange and displayed by a quotation vendor on a terminal or other display device.

<sup>24</sup> See SEC Rule 11Ac1-1.

(ii) The term "disseminated size" shall mean with respect to the disseminated price for any quoted options series, the AUTO-X guarantee for the quoted option, except that the disseminated size of bids and offers of limit orders on the book shall be ten (10) contracts.

(iii) The term "SEC Quote Rule" shall mean Rule 11Ac1-1 under the Securities Exchange Act of 1934, as amended.

(iv) The terms "customer," "responsible broker or dealer," and "specified persons" shall have the meaning set forth in the SEC Quote Rule.

(b) Except as provided in paragraph (c) of this Rule, all quotations made available by the Exchange and displayed by quotation vendors shall be firm for customer orders at the disseminated price in an amount up to the disseminated size. Responsible brokers or dealers bidding (or offering) at the disseminated price shall be collectively required to execute orders presented to them at such price up to the disseminated size in accordance with Rule 1015, or, if the responsible broker or dealer is representing (as agent) a limit order, such responsible broker or dealer shall be responsible (as agent) up to the size of such limit order, but may be responsible as principal for all or a portion of the excess of the disseminated size over the size of such limit order to the extent provided in Rule 1015.

(c) The requirements of paragraph (b) or (d) of this Rule shall not apply to displayed quotations: (i) When the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors the data for a subject security required to be made available pursuant to the SEC Quote Rule in a manner that accurately reflects the current market on the Exchange as determined in accordance with paragraph (f) of this Rule; [by two Floor Officials, with the concurrence of the Director of Surveillance, or his designee] (ii) during a trading rotation; (iii) if any of the circumstances provided in paragraph (c)(3) of the SEC Quote Rule exist; or (iv) on a case by case basis where it is determined that an exemption is warranted for an obvious error in the posting of the disseminated price or disseminated size due to reporter error or system malfunction. [The Exchange shall immediately notify all specified persons of such a determination. Regular trading procedures shall be resumed when two Floor Officials determine that the

conditions supporting that determination no longer exist. The Exchange shall immediately notify all specified persons of such a determination.] Any exemption granted pursuant to paragraph (c)(iv) shall be in writing and shall set forth the basis upon which the exemption is granted.

(d) In accordance with paragraph (d)(1)(ii) of the SEC Quote Rule, the quotation size for a disseminated price with respect to an order for the account of a broker or dealer ("broker-dealer order") shall be one (1) contract ("quotation size"), and all quotations made available by the Exchange and displayed by quotation vendors shall be firm for broker-dealer orders at the disseminated price in an amount up to the quotation size. The quotation size for broker-dealer orders provided in this paragraph (d) shall be periodically published by the Exchange. Responsible brokers or dealers bidding (or offering) at the disseminated price shall be collectively required to execute broker-dealer orders at such price up to the quotation size.

(e) If responsible brokers or dealers receive an order to buy or sell a listed option at the disseminated price in an amount greater than the disseminated size (for customer orders) or the quotation size (for broker-dealer orders), such responsible broker or dealer shall, within thirty (30) seconds of receipt of the order, (i) execute the entire order at the disseminated price (or better), or (ii) execute that portion of the order equal to the disseminated size (in the case of a customer order) or the quotation size (in the case of a broker-dealer order) at the disseminated price (or better), and revise its bid or offer.

(f) *With respect to subparagraph (c)(i) of this Rule, two Floor Officials ("Initiating Officials"), with the concurrence of the Director of Surveillance (or his designee), may determine (either on their own motion or at the request of a responsible broker or dealer) that the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing and making available to quotation vendors the data for a subject security required to be made available pursuant to the SEC Quote Rule in a manner that accurately reflects the current market on the Exchange. Upon the making of such a determination, the Exchange shall designate the market in such security to be "non-firm," and shall immediately notify all specified persons of that determination through the Options Price Reporting Authority, using the industry agreed-upon indicator for "non-firm" status. Upon*

*such notification, responsible brokers or dealers shall be relieved of their obligations under paragraph (c)(2) the SEC Quote Rule and this Rule 1082 with respect to such security until a determination by the Exchange that the unusual market conditions have terminated and the specified persons have been notified that the unusual market conditions have terminated. During any period that the market for a subject security is "non-firm," the Exchange shall continue to the maximum extent practicable under the circumstances, to collect, process, and make available to quotation vendors data for that security as required under the SEC Quote Rule.*

*During any period that the market in a subject security is "non-firm," the Exchange shall monitor the activity or condition which formed the basis for such determination. Continuation of the "non-firm" designation for longer than 15 minutes shall require the reaffirmation of two floor officials (the "Reviewing Floor Officials"), with the concurrence of the Director of Surveillance (or his designee). Such review and reaffirmation shall occur not less frequently than every 15 minutes thereafter while the quotations in the subject security are deemed "non-firm."*

*When the Exchange determines that the unusual market conditions have terminated, the Exchange shall immediately notify all specified persons that the Exchange is once again capable of collecting, processing and making available to quotation vendors the quotation data required by the SEC Quote Rule, and responsible brokers and dealers shall once again be obligated under the SEC Quote Rule and this Rule 1082 with respect to the subject security.*

#### F-10 Unusual Market Conditions

In the interest of maintaining a fair and orderly market under unusual market conditions for one or more classes of options, [two Floor Officials, with the concurrence of the Director of Surveillance or his designee, may determine that the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors the data for a subject security required to be made available pursuant to the SEC Quote Rule in a manner that accurately reflects the current market on the Exchange. The Exchange shall immediately notify all specified persons of such a determination. Regular trading procedures shall be resumed when two Floor Officials determine that the

conditions supporting that declaration no longer exist.] two Floor Officials ("Initiating Officials"), with the concurrence of the Director of Surveillance (or his designee), may determine (either on their own motion or at the request of a responsible broker or dealer) that the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing and making available to quotation vendors the data for a subject security required to be made available pursuant to the SEC Quote Rule in a manner that accurately reflects the current market on the Exchange.

Upon the making of such a determination, the Exchange shall designate the market in such security to be "non-firm," and shall immediately notify all specified persons of that determination, the Exchange will notify specified persons through the Options Price Reporting Authority, using the agreed-upon indicator. Upon such notification, responsible brokers or dealers shall be relieved of their obligations under paragraph (c)(2) the SEC Quote Rule and Exchange Rule 1082 with respect to such security until a determination by the Exchange that the unusual market conditions have terminated and the specified persons have been notified that the unusual market conditions have terminated. During any period that the market for a subject security is "non-firm," the Exchange shall continue, to the maximum extent practicable under the circumstances, to collect, process, and make available to quotation vendors data for that security as required under the SEC Quote Rule.

During any period that the market in a subject security is "non-firm," the Exchange shall monitor the activity or condition which formed the basis for such determination. Continuation of the "non-firm" designation for longer than 15 minutes shall require the reaffirmation of two floor officials (the "Reviewing Floor Officials"), with the concurrence of the Director of Surveillance (or his designee). Such review and reaffirmation shall occur not less frequently than every 15 minutes thereafter while the quotations in the subject security are deemed "non-firm."

When the Exchange determines that the unusual market conditions have terminated, the Exchange shall immediately notify all specified persons that the Exchange is once again capable of collecting, processing and making available to quotation vendors the quotation data required by the SEC Quote Rule, and responsible brokers and dealers shall once again be

*obligated under the SEC Quote Rule and this Advice with respect to the subject security.*

During the period for which such a determination has been made, displayed quotes for the respective options are not firm (as required by Rule 1082) and volume guarantees of Advice A-11 and Rule 1015 are not applicable, but the respective specialists and trading crowds are required to use best efforts to update quotes and fill incoming orders in accordance with Advice A-11 and Rule 1015.

#### **Fine Schedule—F-10**

Fine Not Applicable

\* \* \* \* \*

#### **Rule 1015. Execution Guarantees**

(a) Execution Guarantees—Customer market or marketable limit orders in any options series on the Exchange are to be filled at the best market, in accordance with Rule 1082, to a minimum of the disseminated size by floor traders (i.e., Specialists and ROTs) in the crowd as follows:

(i) If only one floor trader is quoting the availed upon best bid (or offer), that floor trader is responsible for providing a fill for the disseminated size.

(ii) If more than one floor trader is quoting the availed upon best bid (or offer), and their combined quote size is less than the disseminated size, participation for the additional contracts needed to meet the disseminated size requirement shall be decided upon agreement by those floor traders or otherwise divided proportionately among them.

(iii) If the availed upon best bid (or offer) is established by someone other than a floor trader and is not for at least the disseminated size, participation for the additional contracts needed to meet the disseminated size requirement shall be supplied at that same price by the floor trader with the immediately prior best bid (or offer). If more than one floor trader was on the prior bid (or offer), participation for the additional contracts shall be decided upon agreement by those floor traders or otherwise divided proportionately among them. For example, if a 2¼ or 2.25 bid by an ROT is followed by a 2½ or 2.50 bid for five contracts by a customer, the ROT who was bidding 2¼ or 2.25 will be responsible for buying the other five contracts at 2½ or 2.50.

(iv) The "availed upon best bid (or offer)" for purposes of this Rule shall be the disseminated price (as defined in Rule 1082).

[(v) Orders received by a member from a customer may not be unbundled

for the primary purpose of availing upon the execution guarantee requirement, nor may a Firm solicit a customer to unbundle an order for the primary purpose of availing upon the execution guarantee.]

(v[i]) Floor Brokers must make reasonable efforts to ascertain whether each order entrusted to them is for the account of a customer or a broker-dealer. If it is ascertained that the order is for the account of a broker-dealer, the responsible Floor Broker must advise the crowd of that fact prior to bidding/offering on behalf of the order or executing the order. The responsible floor agent must legibly mark the floor ticket as "B/D" when it has been determined that the order is for an account of a broker/dealer.

(vi[i]) The disseminated size requirement shall not apply when Exchange quotations are not required to be firm pursuant to paragraph (c) of Rule 1082.

(b) Trade or Fade—When paragraph (e) of Rule 1082 is applicable to an order received by a responsible broker or dealer, participation by Specialists or ROTs above their stated size to fill the order completely or meet the disseminated size requirement (for customer orders) or the quotation size requirement (for broker-dealer orders) shall be decided upon agreement by such Specialists or ROTs or otherwise divided proportionately among them. Where the disseminated market quote of a responsible broker or dealer is revised, as provided for in Rule 1082, it shall be considered conduct inconsistent with just and equitable principles of trade for such responsible broker or dealer to immediately re-display its previously disseminated market quote, unless such action is warranted by a change in market conditions.

\* \* \* \* \*

#### **A-11 Responsibility To Fill Customer Orders**

(a) Execution Guarantees—Customer market or marketable limit orders in any options series on the Exchange are to be filled at the best market, in accordance with Rule 1082, to a minimum of the disseminated size by floor traders (i.e., Specialists and ROTs) in the crowd as follows:

(i) If only one floor trader is quoting the availed upon best bid (or offer), that floor trader is responsible for providing a fill for the disseminated size.

(ii) If more than one floor trader is quoting the availed upon best bid (or offer), and their combined quote size is less than the disseminated size, participation for the additional contracts needed to meet the disseminated size

requirement shall be decided upon agreement by those floor traders or otherwise divided proportionately among them.

(iii) If the availed upon best bid (or offer) is established by someone other than a floor trader and is not for at least the disseminated size, participation for the additional contracts needed to meet the disseminated size requirement shall be supplied at that same price by the floor trader with the immediately prior best bid (or offer). If more than one floor trader was on the prior bid (or offer), participation for the additional contracts shall be decided upon agreement by those floor traders or otherwise divided proportionately among them. For example, if a 2¼ or 2.25 bid by an ROT is followed by a 2½ or 2.50 bid for five contracts by a customer, the ROT who was bidding 2¼ or 2.25 will be responsible for buying the other five contracts at 2½ or 2.50.

(iv) The "availed upon best bid (or offer)" for purposes of this Advice shall be the disseminated price (as defined in Rule 1082).

[(iv) Orders received by a member from a customer may not be unbundled for the primary purpose of availing upon the execution guarantee requirement, nor may a Firm solicit a customer to unbundle an order for the primary purpose of availing upon the execution guarantee.]

(v[i]) Floor Brokers must make reasonable efforts to ascertain whether each order entrusted to them is for the account of a customer or a broker-dealer. If it is ascertained that the order is for the account of a broker-dealer, the responsible Floor Broker must advise the crowd of that fact prior to bidding/offering on behalf of the order or executing the order. The responsible floor agent must legibly mark the floor ticket as "B/D" when it has been determined that the order is for an account of a broker/dealer.

(vi[i]) The disseminated size requirement shall not apply when Exchange quotations are not required to be firm pursuant to paragraph (c) of Rule 1082.

(b) Trade or Fade—When paragraph (e) of Rule 1082 is applicable to an order received by a responsible broker or dealer, participation by Specialists or ROTs above their stated size to fill the order completely or meet the disseminated size requirement (for customer orders) or the quotation size requirement (for broker-dealer orders) shall be decided upon agreement by such Specialists or ROTs or otherwise divided proportionately among them. Where the disseminated market quote of a responsible broker or dealer is revised,

as provided for in Rule 1082, it shall be considered conduct inconsistent with just and equitable principles of trade for such responsible broker or dealer to immediately re-display its previously disseminated market quote, unless such action is warranted by a change in market conditions.

#### Fine Schedule—A-11

Fine Not Applicable

### II. Description of the Proposals

#### A. Background

On November 17, 2000, the Commission adopted amendments to its Quote<sup>25</sup> to require options exchanges and options market makers to publish firm quotes beginning on April 1, 2001.<sup>26</sup> As a result of the amendments to the Quote Rule, the Exchanges needed to make conforming amendments to their rules. Accordingly, the Exchanges submitted proposals to the Commission to conform their rules to the provisions of the Quote Rule. On April 2, 2001, the Commission approved portions of the Exchange's proposed rule changes for a 60-day pilot period expiring on June 1, 2001.<sup>27</sup> The Exchanges now seek permanent approval of their respective Pilot Programs. In addition, the Exchanges seek to make additional modifications to their proposals to conform their respective rules to the requirements of the Quote Rule.

A brief summary of the additional modification to the proposed rule changes filed by each of the Exchanges is provided below.

#### B. Amex

The Amex proposes a number of non-substantive revisions to its Pilot Program. Specifically, Amex proposes to delete the last sentence of Amex Rule 958A(b) because it is already an obligation of the responsible broker or dealer to communicate a quotation size or aggregate quotation size of not less than ten contracts. Amex also proposes to revise Amex Rule 958A(c)(i)(B) to codify the Commission's grant of exemptive relief to permit responsible brokers or dealers to be firm for foreign broker-dealers to the same extent that the rules require their quotes to be firm for U.S. broker-dealers,<sup>28</sup> and to establish that the quotation size established by

the Amex would be at least one contract.

In addition, Amex proposes to codify in its rules the provisions found in paragraph (c)(3) of the Quote Rule and to delete Commentary .01 to Amex Rule 958A because the Amex is now able to disseminate quotations with size for all option classes it trades. Finally, the Amex proposes to revise Commentary .02 to Amex Rule 958A to be consistent with Amex's requirement that responsible brokers or dealers be firm to customers for at least ten contracts.

#### C. CBOE

CBOE proposes to amend CBOE Rule 8.51 to delete paragraph (b)(3), which it proposed in its initial filing but which was not approved by the Commission as part of the Pilot Approval Order.<sup>29</sup> This proposal states that "[w]hen orders for the same class (whether for the same series or different series) from the same beneficial owner are represented at the trading station at approximately the same time, then only the first of such orders that cumulatively equal or add up to less than the firm quote requirement shall be entitled to an execution pursuant to paragraphs (b) and (c) above." The Commission did not approve this proposed provision because it is not consistent with the Quote Rule. However, the CBOE, pursuant to paragraph (e) of Rule 11Ac1-1 under the Exchange Act, has submitted to the Commission a letter requesting on behalf of their members an exemption from the Quote Rule in such circumstances.<sup>30</sup>

#### D. ISE

ISE proposes to delete subparagraph (d)(i) from ISE Rule 804 to remove obvious errors from the circumstances under which market maker bids and offers are not firm under ISE Rule 804 and the Quote Rule. The Commission has separately approved ISE Rule 720 to address obvious errors and, therefore, reference to obvious errors under ISE Rule 804 is unnecessary.<sup>31</sup>

#### E. PCX

PCX proposes a non-substantive amendment to its rule text regarding an exception from its obligation to collect, process, and make available to quotation vendors quotation data. Specifically, the PCX proposes to amend PCX Rule 6.86(d)(1) by replacing the phrase

<sup>25</sup> Exchange Act Rule 11Ac1-1, 17 CFR 240.11Ac1-1.

<sup>26</sup> See Adopting Release, *supra* note 4.

<sup>27</sup> See Pilot Approval Order, *supra* note 12.

<sup>28</sup> See Letter from Annette L. Nazareth, Director, Division, Commission, to Timothy H. Thompson, Esq., Assistant General Counsel, CBOE, dated April 2, 2001.

<sup>29</sup> See Pilot Approval Order, *supra* note 12.

<sup>30</sup> See Letter to Annette L. Nazareth, Director, Division, Commission, from Timothy H. Thompson, Esq., Assistant General Counsel, CBOE, dated March 29, 2001.

<sup>31</sup> Securities Exchange Act Release No. 44376 (June 1, 2001).

“cannot collect, process, and make available” with the phrase “is incapable of collecting, processing, and making available.”

#### F. Phlx

In general, Phlx proposes two amendments to its rules. First, Phlx proposes to adopt Phlx Rule 1082(f) and to amend Options Floor Procedure Advice (“OFPA”) F-10 to: (1) Include procedures to be followed in making a determination that unusual market conditions exist with respect to an option; (2) grant relief from firm quote obligations during periods of unusual market conditions; (3) monitor the existence of unusual market conditions; and (4) provide notification to specified persons that unusual market conditions exist or that the conditions supporting that determination no longer exist. Second, Phlx proposes to amend Phlx Rule 1015 and OFPA A-11 by deleting Phlx Rule 1015(a)(v) and OFPA A-11(a)(v), relating to the unbundling of orders for the purpose of availing upon the execution guarantee requirement, and renumbering that subsequent sections of Phlx Rule 1015(a) and OFPA A-1(a).

#### III. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether Amex Amendment No. 3, CBOE Amendment Nos. 2 and 3, ISE Amendment No. 2, PCX Amendment No. 2, and Phlx Amendment Nos. 3, 4, and 5 are consistent with the Exchange 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 changes that are filed with the Commission, and all written communications relating to the proposed rule changes 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 Exchanges. All submissions should refer to the File Nos. SR-Amex-2001-18, SR-CBOE-2001-15, SR-ISE-2001-07, SR-PCX-2001-18, and SR-Phlx-2001-37 and should be submitted by June 29, 2001.

#### IV. Commission Findings and Order Granting Accelerated Approval of the Proposed Rule Changes on a Permanent Basis

After careful consideration, the Commission finds that the proposed rule changes, as amended, are consistent with the Exchange Act and the rules and regulations thereunder applicable to national securities exchanges,<sup>32</sup> and, in particular, Section 6(b)(5) of the Exchange Act.<sup>33</sup> As noted in the Adopting Release, the Commission believes that the application of the Quote Rule to the options market will provide significant and immediate benefits to investors. In particular, market participants, including customers and broker-dealers, will be able to rely on options quotes up to the published size when routing orders.

On April 2, 2001, the Commission granted accelerated approval to the Exchanges’ sixty-day pilot rule proposals. During the sixty-day pilot period, the Commission received two comment letters on the proposals<sup>34</sup> and, after considering the operating of the Pilot Programs during the sixty-day period, has determined to approve the Pilot Programs, as amended, on a permanent basis.

##### A. Rule 11Ac1-1(b)(3) and (c)(3) Under the Exchange Act

The Commission approved the Exchanges’ proposals to relieve responsible brokers or dealers from their obligations under the Quote Rule in unusual market conditions.<sup>35</sup> Paragraph (b)(3)(i) of the Quote Rule provides that responsible brokers or dealers on the Exchanges will be relieved of their obligations under their rules and the Quote Rule when the level of trading activities or the existence of unusual market conditions is such that the Exchange is incapable of collecting, processing, and making available to quotation vendors quotation data.<sup>36</sup> The

<sup>32</sup> In approving these proposals, the Commission has considered the proposals’ impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>33</sup> 15 U.S.C. 78f(b)(5).

<sup>34</sup> See *supra* note 13. One commenter raised concerns about the provisions of Amex, CBOE, and Phlx rules relating to when an order “reaches” the trading post. See Ianni Letter, *supra* note 13. The Commission notes that such provisions have been eliminated from the Amex, CBOE, and Phlx rules. See *supra* note 12.

<sup>35</sup> See Pilot Approval Order, *supra* note 12. The Commission notes that a determination that a market is “fast” does not necessarily indicate a level of trading activity or unusual market condition that would relieve an exchange’s or responsible broker or dealer’s obligation under the Quote Rule. See e.g., Proposed CBOE Rule 8.51 Interpretation and Policy .07.

<sup>36</sup> The Commission notes that CBOE, ISE, and Phlx proposed to establish specific time parameters

Phlx now proposes to modify its rules regarding unusual market conditions to provide more detailed procedures for determining and monitoring when quotes are not firm.<sup>37</sup> The Commission believes that such rules are consistent with the Exchange Act, and expects that the Phlx will ensure that sufficient monitoring procedures are in place to fully implement the requirements of the Quote Rule.

In addition, Amex proposes to incorporate into its own rules the exceptions from the Quote Rule under Rule 11AC1-1(c)(3) regarding revised bids, offers, and quotation sizes. The Commission notes that CBOE Rule 8.51 contains similar provisions that were approved by the Commission in connection with the Pilot Programs, and the ISE and Phlx proposals incorporate by reference these Quote Rule provisions.<sup>38</sup> The Commission believes that including such provisions in the exchanges’ rules is consistent with the Exchange Act, provided that the Exchanges interpret them in a manner consistent with paragraph (c)(3) of Rule 11AC1-1.

##### B. Proposed Deletion of CBOE Rule 8.51(b)(3), Phlx Rule 1015(a)(v) and Phlx Options Floor Procedure Advice A-11(a)(v)

As a part of its pilot program, the CBOE proposed to retain a provision of CBOE Rule 8.51 providing that when multiple orders for the same class from the beneficial owner are represented at the trading station approximately the same time, only the first of such orders that cumulatively equal or add up to less than the firm quote requirement would be entitled to an execution pursuant to CBOE’s rules. Similarly, Phlx initially proposed to retain a provision in its rules that would prohibit orders from being “unbundled” for the primary purpose of availing

for reviewing market conditions. See Proposed CBOE Rule 8.51(e)4 (requiring review no more than thirty minutes after the market has been designated non-firm); Proposed ISE Rule 704(c)(3) (requiring review at least every thirty minutes after the market has been designated non-firm); and Proposed Phlx Rule 1082(f) (requiring review at least every fifteen minutes after the market has been designated non-firm). Amex and PCX have, instead, proposed to continuously monitor their markets until the market condition or activity has terminated. See Proposed Amex Rule 958A(d)(v) (requiring the exchange to “monitor the unusual market activity or condition until it has terminated”) and Proposed PCX Rule 6.86(d)(1)(E) (requiring the exchange to “monitor the unusual market activity or condition until it has terminated”). The Commission believes that both approaches are consistent with the Exchange Act.

<sup>37</sup> See Phlx Amendment Nos. 3 and 5, *supra* notes 19 and 21, respectively.

<sup>38</sup> See Proposed ISE Rule 804(d)(iv) and Phlx Rule 1082(c).

upon the execution guarantee requirement provided by the Phlx.

In the Pilot Approval Order, the Commission stated its belief that rules such as CBOE Rule 8.51(b)(3) and Phlx Rule 1015(a)(v) are inconsistent with the Quote Rule and cannot be used to relieve exchange members from their obligations under the Quote Rule.<sup>39</sup> The Commission noted that those provisions had been approved prior to the adoption of amendments to the Quote Rule that extended its application to the options market. Generally, the Quote Rule requires each responsible broker or dealer to "execute *any* order to buy or sell a subject security \* \* \* at a price at least as favorable to such buyer or seller as the responsible broker's or dealer's published bid or offer \* \* \* in any amount up to its published quotation size."<sup>40</sup> Further, the Quote Rule does not expressly provide an exception for multiple orders submitted by the same beneficial owner. And, in fact, the Quote Rule requires, subject to certain limitations, a responsible broker or dealer to execute *any* up to its published size.

At the same time, the Commission specifically solicited comment on whether it would be appropriate for the Commission to grant an exception from the requirement of the Quote Rule for multiple orders submitted by the same beneficial owner at approximately the same time. One commenter addressed this issue, arguing that without providing an exemption from the Quote Rule, options market makers would be subject to unacceptable levels of risk.<sup>41</sup> In addition, CBOE submitted a letter to the Commission requesting exemptive relief from the requirements of the Quote Rule that, if granted, would relieve responsible brokers and dealers of their obligations under the Quote Rule in these circumstances.<sup>42</sup> The Commission has determined not to grant an exemption from the requirements of the Quote Rule at this time. Accordingly, the CBOE and Phlx now propose to eliminate these provisions from their rules.<sup>43</sup>

The Commission finds good cause, consistent with Section 19(b)(2) of the Exchange Act,<sup>44</sup> for granting the Exchanges' request for permanent approval of the Pilot Programs, as amended, prior to the thirtieth day after the day of publication of notice of filing

thereof in the **Federal Register**. The Commission notes that the Changes' Pilot Program expire on June 1, 2001. The Commission believes that granting accelerated approval to the proposed amendments will allow the Exchanges to permanently implement their rules in compliance with the Quote Rule without delay. In addition, the Commission notes that the Exchanges reported no complaints or problems with the operation of the rules during the 60-day pilot period. Finally, the Commission notes that the proposed amendments to the Pilot Programs generally include only non-substantive revisions and technical corrections to the Exchanges' rule text.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Exchange Act,<sup>45</sup> the Exchanges' proposed rule changes (File Nos. SR-Amex-2001-18, SR-CBOE-2001-15, SR-ISE-2001-07, SR-PCX-2001-18, and SR-Phlx-2001-37), as amended, are approved on a permanent basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>46</sup>

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

[FR Doc. 01-14463 Filed 6-7-01; 8:45 am]

**BILLING CODE 8080-01-M**

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-44385; File No. SR-CBOE-2001-17]

### Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated To Change the Voting Requirement for Approval of Membership Applications and to Clarify a Notice Requirement Relating to the Exercise of an Authorization To Sell a Membership

June 1, 2001.

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 5, 2001, 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 CBOE

submitted an amendment to the proposed rule change on May 22, 2001.<sup>3</sup> The Commission is publishing this notice to solicit comments from interested persons on the proposed rule change, as amended, and to approve the proposal, as amended, on an accelerated basis.

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

The CBOE proposes to change the voting requirement for approval of CBOE membership applications and to clarify a notice requirement relating to the exercise of an Authorization to Sell a membership. Below is the text of the proposed rule change. New language is italicized, and deletions are bracketed.

\* \* \* \* \*

#### Chicago Board Options Exchange, Incorporated Rules

\* \* \* \* \*

#### Chapter III—Membership

\* \* \* \* \*

#### Application Procedures and Approval or Disapproval

Rule 3.9.

(a)–(j) Unchanged.

(k) [Approval of an application requires a vote of the majority of the members of the Membership Committee then in office.] Any applicant that is approved to be a member by the Membership Committee must be approved by the Membership Committee to perform in at least one of the recognized capacities of a member as stated in Rule 3.1(b). Written notice of the action of the Membership Committee, specifying in the case of disapproval of an application the grounds therefore, shall be provided to the applicant.

\* \* \* \* \*

#### Sale and Transfer of Membership

Rule 3.14.

(a)–(c) Unchanged.

(d) Authorizations to Sell. The owner of a transferable membership may voluntarily grant to another Exchange member an Authorization to Sell the membership. Authorizations to Sell shall be subject to the following provisions:

<sup>3</sup> See letter from Arthur B. Reinstein, Deputy General Counsel, CBOE, to Sonia Patton, Attorney, Division of Market Regulation, Commission, dated May 22, 2001 ("Amendment No. 1"). Amendment No. 1 designated the proposed rule change for submission to the Commission under Section 19(b)(2) of the Act instead of under Section 19(b)(3)(A) of the Act.

<sup>39</sup> See Pilot Approval Order, *supra* note 12.

<sup>40</sup> 17 CFR 240.11Ac1-1(c)(2) (emphasis added).

<sup>41</sup> See Phlx Letter, *supra* note 13.

<sup>42</sup> See *supra* note 30.

<sup>43</sup> See CBOE Amendment No. 2 and Phlx Amendment No. 5.

<sup>44</sup> 15 U.S.C. 78s(b)(2).

<sup>45</sup> 15 U.S.C. 78s(b)(2).

<sup>46</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.