

strike price of the long put/buy stock).² A collar strategy provides downside protection by the use of put option contracts and finances the purchase of the puts through the sale of short call option contracts. The goal of this strategy is to bracket the price of the underlying security at the time the position is established. For example, assume that the price of an underlying equity, XYZ, is \$53 and account ABC is long 5000 shares of XYZ at \$53. Account ABC sells 50 XYZ April 55 calls and purchases 50 XYZ April 50 puts. Under the collar exemption, one collar (*i.e.*, one short call, and one long put) must be hedged with 100 shares of the underlying security to remain exempt.

Additionally, neither side of the short call, long put position can be in-the-money at the time the position is established.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45633; File No. SR-CBOE-2002-09]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Allocation of Orders for Appointed Market-Makers in Index FLEX Options

March 22, 2002.

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 February 19, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 18, 2002, 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, as amended, from interested persons.

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

The CBOE proposes to amend CBOE Rule 24A.5 relating to allocation of orders for Appointed Market Makers in Index Flex Options ("AMMs").

Below is the text of the proposed rule change. Deleted language is in brackets. Proposed new language is *italicized*.

* * * * *

Chicago Board Options Exchange, Inc.

Rules

CHAPTER XXIVA

Flexible Exchange Options

* * * * *

FLEX Trading Procedures and Principles

* * * * *

Rule 24A.5

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(e) Priority of Bids and Offers. (no change)

(i) Bids. (no change)

(ii) Offers. (no change)

(iii) Notwithstanding the foregoing subparagraphs (i) and (ii) of this paragraph (e), whenever the Submitting Member has indicated an intention to cross or act as principal on the trade and has matched or improved the BBO during the BBO Improvement Interval, the following priority principles will apply:

(A) (no change)

(B) In the case of Index FLEX Options, where the Submitting Member has matched the BBO or in the event the Submitting Member has improved the BBO and any other FLEX participating member matched the improved BBO, the Submitting Member will have priority to execute the contra side of the trade that is the subject of the Request for Quotes, but only to the extent of the largest of [25%] 20% of the trade, a proportional share of the trade, \$1 million Underlying Equivalent Value, or the remaining Underlying Equivalent Value on a closing transaction valued at less than \$1 million.

(iv) *Notwithstanding subparagraphs (i), (ii) and (iii), subject to the review of the Board of Directors, the appropriate Floor Procedure Committee may establish from time to time a participation entitlement formula that is applicable to all FLEX Appointed Market-Makers.*

* * * * *

The CBOE has also submitted as part of its proposed rule change the draft text of a proposed Regulatory Circular that would establish a participation entitlement formula pursuant to the above proposed CBOE Rule 24A.5(e)(iv) and would further describe its application, as discussed in Section II.A. below. The text of this proposed Regulatory Circular is available at the 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 Exchange 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 Exchange 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

CBOE is submitting the proposed change to amend CBOE Rule 24A.5 pursuant to subparagraph IV.B.j. of the Commission's Order of September 11, 2000,⁴ which requires that respondent options exchanges adopt new, or amend existing, rules to make express any practice or procedure "whereby market makers trading any particular option class determine by agreement * * * the allocation of orders in that option class." The proposed rule change addresses the allocation of orders for FLEX Index Options.

The proposed rule change would add CBOE Rule 24A.5(e)(iv), which would permit the appropriate Floor Procedure Committee to establish a participation entitlement formula that is applicable to all AMMs in FLEX Index Options. In addition, the proposed rule change would amend the participation entitlement of the Submitting Member⁵ by deleting "25%" in CBOE Rule

⁴ Order Instituting Public Administrative Proceedings Pursuant to section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000).

⁵ A "Submitting Member" is defined in CBOE Rule 24A.1(q) as an Exchange member that initiates FLEX bidding and offering by submitting a FLEX Request for Quotes.

² *Id.*

³ 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 Jaime Galvan, Attorney, CBOE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 15, 2002 ("Amendment No. 1"). The changes made by Amendment No. 1 have been incorporated into this notice.

24A.5(e)(iii)(B) and replacing it with "20%."⁶

CBOE is also submitting as part of the proposed rule change a draft Regulatory Circular in which the SPX Floor Procedure Committee⁷ would exercise its authority under the proposed CBOE Rule 24A.5(e)(iv) to set the participation entitlement formula for AMMs.⁸ Specifically, the Regulatory Circular would state that the Submitting Member is entitled to cross up to 20% of the contracts in an order that occurs as a result of the Submitting Member's Request for Quotes ("RFQ"). The Regulatory Circular would stipulate that to receive this participation entitlement, the Submitting Member must indicate an intention to cross or act as principal with respect to the FLEX trade. The Regulatory Circular would also state that the AMM(s) is (are) entitled to the contracts remaining in the order up to an aggregate of 40% of the order, but that a Submitting Member and the AMM(s) could not receive an entitlement that collectively equals more than 40% of the order. The remaining contracts in the order would then be allocated according to the relevant Exchange rules.⁹

2. Statutory Basis

The CBOE believes that the proposed rule change is designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, to protect investors and the public interest, and is not designed to permit unfair discrimination between customers, issuers, brokers or dealers, pursuant to section 6(b)(5) of the

⁶ CBOE Rule 24A.5(e)(iii)(B) currently permits a Submitting Member who has matched or improved the BBO to have priority to execute the contra side of the trade that is the subject of the Request for Quotes ("RFQ"), but only to the extent of the largest of 25% of the trade, a proportional share of the trade, \$1 million Underlying Equivalent Value, or the remaining Underlying Equivalent Value on a closing transaction valued at less than \$1 million.

⁷ The SPX Floor Procedure Committee would be the appropriate Floor Procedure Committee pursuant to proposed Rule CBOE Rule 24A.5(e)(iv) to establish the participation entitlement formula. Telephone conversation between Madge Hamilton and Jaime Galvan, Attorneys, the CBOE; and Nancy Sanow, Assistant Director, Ira Brandriss, Special Counsel, and Frank N. Genco, Attorney-Advisor, Division, Commission, on March 4, 2002.

⁸ The Exchange states that changes to this Regulatory Circular, including changes to a participation entitlement formula, will be submitted to the Commission pursuant to section 19(b) of the Act.

⁹ The AMM(s) would not be entitled to a share in these remaining contracts unless all other participants have been satisfied. Telephone conversation between Jaime Galvan, Attorney, CBOE, and Ira Brandriss, Special Counsel, and Frank N. Genco, Attorney-Advisor, Division, Commission, March 19, 2002.

Exchange Act.¹⁰ The CBOE believes that, through the AMMs' obligation to respond to all RFQs, liquidity is provided to the FLEX Index Options market. In return for the obligations that are imposed on AMMs in FLEX Index Options, the CBOE believes it is just and equitable that the AMMs receive a participation entitlement, which may be up to 40% of an order.

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

The Exchange does not believe that the proposed rule change, as amended, will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants or Others

The Exchange has neither solicited nor received written comments on the proposed rule change, as amended.

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 reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) By order approve such proposed rule change, as amended, or
- (B) Institute proceedings to determine whether the proposed rule change, as amended, 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, as amended, is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549-0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change, as amended, that are filed with the Commission, and all written communications relating to the proposed rule change, as amended, 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

¹⁰ 15 U.S.C. 78f(b)(5).

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 number SR-CBOE-2002-09 and should be submitted by April 23, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45640; File No. SR-CBOE-2002-10]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Allocation of Orders for Lead Market-Makers and Supplemental Market-Makers Logged On to the Exchange's Rapid Opening System

March 25, 2002.

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 February 19, 2002 the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On March 18, 2002, the CBOE submitted Amendment No. 1 to the proposed rule change.³ On March 22, 2002, the CBOE submitted Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The CBOE proposes to amend Interpretation and Policies .01 of CBOE

¹¹ 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 Jaime Galvan, Attorney, CBOE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 15, 2002. The changes made by Amendment No. 1 have been incorporated into this notice.

⁴ See letter from Madge M. Hamilton, Attorney, CBOE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 22, 2002. The changes made by Amendment No. 2 have been incorporated into this notice.