

implement its proposed improvement to its market to encourage greater competition among trading crowd participants.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁸ that the Exchange's proposed rule change, as amended, (File No. SR-CBOE-2002-07) is approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁹

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45676; File No. SR-CBOE-2001-70]

Self-Regulatory Organizations; Order Granting Accelerated Approval of a Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Dissemination of Options Quotations With Size

March 29, 2002.

I. Introduction

On December 28, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission" or "SEC"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend CBOE Rules 6.8 and 8.51 to accommodate the introduction of an options quotation with size ("quotes with size" or "QWS") system with an automatic decrementation feature ("AutoDec"). On January 14, February 27, and March 1, 2002, respectively, the Exchange submitted Amendment Nos. 1, 2, and 3 to the proposal.³ Notice of the proposed rule change, as amended, appeared in the **Federal Register** on March 8, 2002.⁴ The Commission received no comments on the proposal. This order approves the proposed rule

change, as amended, on an accelerated basis.

II. Description of the Proposal

The CBOE proposes to implement a QWS system with an AutoDec feature that would enable the Exchange to disseminate options quotations with a size that reflects previous executions. The Exchange proposes to implement the QWS system gradually on a series-by-series basis.⁵

AutoDec

For those series in which the exchange disseminates options quotations with size, the QWS system would automatically decrement all executions for each individual series calculated by Autoquote⁶ that execute automatically. For example, if the Exchange disseminates a size of 100 contracts, the trading crowd would be firm for 100 non-broker-dealer contracts executed automatically or via open outcry⁷ at the disseminated price, until that size was exhausted or until the quote was refreshed. Under the proposal, the appropriate Floor Procedure Committee ("FPC") would retain its authority to establish the eligible order size permitted to be sent to RAES for a particular series at a number less than the disseminated size. Therefore, for classes in which the Exchange does not disseminate options quotations with size, CBOE Rule 6.8(c)(v) would remain in effect.⁸

While the disseminated size would reflect the number of contracts that may be executed automatically or via open outcry at a particular price, trades executed in open outcry would *not* cause the disseminated size to decrement automatically. Under these circumstances, the Exchange would be firm for executions that in the aggregate sum up to more than its disseminated size. The number of contracts in a particular series that may receive automatic execution at the disseminated price, however, may not exceed the disseminated size.⁹

⁵ For those series in which the Exchange does not implement the QWS system, the Exchange would continue to publish firm quote sizes on its website. See CBOE Rule 8.51(c)(2).

⁶ For purposes of this rule filing, Autoquote shall refer to any automated quotation updating system, whether Exchange-owned or proprietary.

⁷ The Commission's Quote Rule obligates the responsible broker or dealer to also be firm for the disseminated size for orders executed in open outcry. Rule 11Ac1-1 under the Act, 17 CFR 240.11Ac1-1.

⁸ CBOE Rule 6.8(c)(v) provides that the appropriate FPC shall determine the size of orders eligible for entry into RAES. The eligible order size for non-QWS series must be 100 contracts or less.

⁹ See proposed CBOE Rule 6.8.09(a)(1). Notwithstanding this provision, all orders rerouted

Consistent with the current provisions of CBOE Rule 6.8, orders eligible for automatic execution would not be executed automatically at prices inferior to the national best bid or offer. If an incoming electronic order exceeds the disseminated size, that order would receive a partial automatic execution for up to the disseminated size at the disseminated price. The balance of the order would be automatically routed away from RAES to the Exchange's Public Automated Routing System ("PAR"), the Exchange's Booth Automated Routing Terminal ("BART"), or Live Ammo¹⁰ and thus may receive a dual-price execution.¹¹

30-Second Reroute Period

When the disseminated size is decremented to zero by automatic executions, for a period not to exceed 30-seconds ("reroute period"), all subsequent orders in that series that are otherwise eligible for RAES would be automatically routed away from RAES to either PAR, BART, or Live Ammo.¹² During the reroute period, the Exchange would disseminate a size of "1" with the same price. Upon expiration of the reroute period timer, new electronic orders would be eligible for automatic execution up to the refreshed disseminated size. The duration of the reroute period would be configurable by the DPM on a class basis and may not exceed 30-seconds. The appropriate FPC may, however, establish a ceiling on that duration not to exceed thirty seconds. The DPM may manually override the reroute period timer by submitting a new quote prior to the expiration of the reroute period. For example, if the reroute period timer is established at 15-seconds, the DPM may manually send a new quote at any time prior to the expiration of the 15-second reroute period, thereby allowing orders to be eligible for automatic execution at the refreshed price.

Upon expiration of the reroute period, subsequent incoming orders that are eligible for automatic execution would

from Live Ammo back to RAES would receive an automatic execution at the disseminated price even if the cumulative size of such rerouted orders exceeds the disseminated size. See proposed CBOE Rule 6.8.09(a)(2). See also *infra* note 13.

¹⁰ The Live Ammo electronic screen displays market orders or limit orders that improve the market. See CBOE Rule 7.4(g).

¹¹ Orders would route to BART only if a firm so chooses.

¹² Orders received during the reroute period would not be held for the duration of the reroute period. Rather, as incoming electronic orders are received during the reroute period they would be sent upon receipt either to PAR, BART, or Live Ammo. The appropriate FPC shall determine by class the location to which to route those RAES orders that are submitted during the reroute period.

¹⁸ 15 U.S.C. 78s(b)(2).

¹⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letters from Edward J. Joyce, President and Chief Operating Officer, CBOE, to Deborah Flynn, Division of Market Regulation ("Division"), SEC, dated January 11, 2002 ("Amendment No. 1"); Steve Youhn, CBOE, to Deborah Flynn, Division, SEC, dated February 13, 2002 ("Amendment No. 2"); and Steve Youhn, CBOE, to Deborah Flynn, Division, SEC, dated February 28, 2002 ("Amendment No. 3").

⁴ See Securities Exchange Act Release No. 45490 (March 1, 2002), 64 FR 25091.

be eligible to receive automatic execution at the refreshed price.¹³

RAES Operation

To facilitate the introduction of QWS, the Exchange proposes to make a corresponding change to CBOE Rule 6.8(c)(v) regarding the maximum eligible order size for RAES orders. Currently, the maximum allowable RAES size is 100 contracts. The Exchange proposes to retain this upper limit, however, it would only apply to those series in which the Exchange does not disseminate options quotations with size (as defined in Proposed CBOE Rule 6.8(b)(iv)). For those series in which the Exchange disseminates options quotations with size, the eligible order size would be established by the appropriate FPC.

Determination of Disseminated Size

The CBOE proposes that the entity that has responsibility under Exchange Rules to determine a formula for generating automatically updated market quotations would also be responsible for determining the size of the undecremented disseminated quote. According to the CBOE, this entity, in most instances, would either be the DPM, Lead Market-Maker ("LMM"), or Supplemental Market-Maker ("SMM") or Appointed Market-Maker ("Appointed Market-Maker") for the class.¹⁴

While DPMs, LMMs, SMMs, and Appointed Market-Makers have the responsibility to determine the size of the undecremented disseminated quote, the proposed amendment to Interpretation and Policy .09(c) of CBOE Rule 6.8 expressly provides that the DPM, LMM, SMM, or Appointed Market-Maker may, but is not required to, consult with and/or agree with other market makers in the trading crowd in determining the size of the undecremented disseminated quote. The CBOE further proposes that the members of the trading crowd, however, may, but are not required to, provide the DPM, LMM, SMM, or Appointed

Market-Maker with any input regarding the size of the undecremented disseminated quote. In those classes in which a DPM, LMM, SMM, or Appointed Market-Maker does not have responsibility to determine the Autoquote variables, the trading crowd as a whole shall determine the size of the undecremented disseminated quote.

Replenishment Timer

According to the Exchange, because of the preponderance of series for which each DPM is responsible for maintaining quotes, the CBOE proposes to introduce a replenishment timer to automatically update the dissemination of size values. The replenishment timer, which would be configurable by class by the DPM, would be a feature that automatically increases the disseminated size for a particular series back to the original Autoquote volume parameter after a set time-period when no further decrementation has occurred.¹⁵

III. Commission's Findings and Order Granting Accelerated Approval of the Proposed Rule Change

After careful review, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.¹⁶ In particular, the Commission believes that the proposal to allow automatic decrementation of disseminated size to reflect automatic executions at the disseminated price is consistent with Section 6(b)(5),¹⁷ in that it is designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system. Specifically, the Exchange's ability to automatically decrement its disseminated size based on automatic executions through RAES should enable CBOE members to more accurately reflect their liquidity and provide all market participants, including investors,

with a more accurate measure of the liquidity available in CBOE's market at the disseminated price.

While DPMs, LMMs, SMMs, and Appointed Market-Makers have the responsibility to determine the size of the undecremented disseminated quote, the proposal would permit the DPM, LMM, SMM, or Appointed Market-Maker to consult with and/or agree with other market makers in the trading crowd in determining the size of the undecremented disseminated quote. The proposal would further allow that the members of the trading crowd may, but are not required to, provide the DPM, LMM, SMM, or Appointed Market-Maker with any input regarding the size of the undecremented disseminated quote. At this time, the Commission believes it is reasonable for the Exchange's rules to permit the members of the crowd to be given a voice in setting the size associated with the Autoquote price because, pursuant to the Exchange's rules, they will be obligated to execute orders at that size.

The Commission notes that to the extent the CBOE no longer establishes by rule and periodically publishes quotation sizes pursuant to Rule 11Ac1-1(d)(1) under the Act, its members that are responsible broker or dealers, likewise, may no longer rely on the exception to the Quote Rule that currently relieves them of their obligation pursuant to paragraph (c)(1) to Rule 11Ac1-1 to communicate to the Exchange the sizes associated with their quotations. In addition, such responsible brokers or dealers may no longer comply with its obligations under paragraph (c)(2) to Rule 11Ac1-1 by executing orders up to the size established by Exchange rule and must, instead, execute any order in any amount up to its published quotation size.

Pursuant to Section 19(b)(2),¹⁸ the Commission finds good cause for approving the proposed rule change, as amended, prior to the 30th day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that the proposed rule change was published for comment and that no comment letters were received. The Commission believes that granting accelerated approval to the proposed rule change should allow the CBOE begin to implement, without delay, its QWS system with AutoDec, which should enhance the transparency of the CBOE market.

¹³ The Live Ammo terminals feature a "Live Ammo to RAES" switch that enables the DPM to automatically reroute orders back to RAES for automatic execution. If the DPM uses this function, all orders on Live Ammo would then immediately reroute for automatic execution, even if the cumulative size of these orders exceeds the disseminated size. Orders rerouted from Live Ammo to RAES would retain priority over subsequently received RAES orders. See proposed CBOE Rule 6.8.09(a)(2).

¹⁴ For those classes in which a DPM, LMM, SMM, or Appointed Market-Maker does not have responsibility to determine a formula for generating automatically updated market quotations, the obligation to update quotes is imposed upon the trading crowd as a whole.

¹⁵ For example, assume the replenishment timer is set for 240-seconds in a class with a disseminated size of 200 and that this particular series has been decremented to 40 contracts due to executions. In order to prevent the continued dissemination of 40 contracts for an extended period, the replenishment timer would, after 240-seconds from the last execution, increase the disseminated size back to 200 contracts. The firm quote size would once again be 200 contracts. The replenishment timer is incorporated in proposed CBOE Rule 8.51(c)(2)(b).

¹⁶ In approving this rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁷ 15 U.S.C. 78f(b)(5).

¹⁸ 15 U.S.C. 78s(b)(2).

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-2001-70) is approved, as amended, on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁰

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45675; File No. SR-CBOE-2002-13]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Rebate of Fees Assessed on Certain Trades Submitted for Matching and Clearing Solely To Correct Trades That Clear Incorrectly Due to Manual Data Entry Errors

March 29, 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 March 19, 2002, the Chicago Board of 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. 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 authorize a rebate of fees that are assessed on trades submitted for matching and clearing solely to correct trades that clear incorrectly due to manual data entry or "key punch" errors. The text of the proposed rule change appears below. New text is in italics; deletions are in brackets.

FEE SCHEDULE

MARCH 01, 2002

MEMBER TRANSACTION FEE POLICIES AND REBATE PROGRAMS

MEMBER TRANSACTION FEES— INDEX OPTIONS (Unchanged)

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MEMBER TRANSACTION FEES— EQUITY & INDEX OPTIONS (Unchanged)

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ERROR ACCOUNT TRANSACTIONS (Unchanged)

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MISCLEARED TRANSACTIONS

On occasion, options transactions are matched and cleared as a result of certain keypunch errors and members are forced to execute subsequent transactions to achieve the originally intended results. A qualifying keypunch error is any error that is inadvertent and creates a duplicate fee or fees to be charged in the matching and clearing of corrective options trades. The CBOE shall have the discretion to rebate any duplicate transaction and trade match fees incurred in the course of correcting such errors. Only those transactions that require a minimum of 500 contracts to correct the error or errors shall be eligible for this rebate.

A written request with all supporting documentation (trade date, options class, executing firm and broker, opposite firm and broker, premium, and quantity) and a summary of the reasons for the error must be submitted to the CBOE Accounting Department within 60 days after the last day of the month in which the error occurred. This rebate program shall apply to all applicable fees collected under Section 1 (Options Transaction Fees), Section 2 (Trade Match Fee), and Section 3 (Floor Brokerage Fee) of the Chicago Board Options Exchange, Inc. Fee Schedule, as amended from time to time.

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

The Exchange collects transaction fees and trade match fees for the many different types of equity and index option orders that are executed on the Exchange.³ In the course of collecting these fees, the Exchange has discovered that, in certain situations, these fees should be rebated to members. On rare occasions, the Exchange finds that an options trade will be matched and cleared inappropriately as a result of a manual data entry or "key punch" error. In order to put the parties in the originally desired position, another transaction (or transactions) must be submitted through the trade match and clearing process to accurately reflect the intended transactions on the Exchange in accordance with Exchange rules. The Exchange states that these corrective transactions, like any other transaction submitted for matching and clearing, are subject to and will be assessed the appropriate fees in accordance with the Exchange's fee schedule. Depending on the size of the trades involved, the Exchange further states that the cost to the affected parties can be considerable. As such, the Exchange believes that it is appropriate to refund, with limitations, to the affected parties the fees generated by the transactions required to correct this type of error.

To qualify for this rebate, the error in question must be of a narrow scope. Specifically, the trade must be directly related to the entering of pertinent trade information for clearing purposes. For instance, the Exchange states that the typical situation would involve a member's clerk, or other similar personnel, inputting the wrong clearing firm code into the appropriate form or program. As a result, the trade is cleared through the wrong clearing firm and, in order to correct the situation, corrective transactions are entered to reverse the error trades and then new trades are submitted to reflect the original intentions of the parties. Because the fee assessment process is automated, transaction fees are unavoidably incurred through the subsequent execution of the corrective transactions. As a matter of economy, the Exchange has established a *de minimis* standard for qualifying members for a rebate. Only those transactions that require a minimum of 500 contracts to correct the error, or errors, would be eligible for

³ See "Chicago Board Options Exchange, Inc. Fee Schedule" as amended from time to time.

¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.