

since the delay is due to CBOE and the interim linkage currently operating provides CBOE with much the same protection as CBOE's proposal.

#### B. CBOE's Response

On February 28, 2002, CBOE submitted a letter responding to ISE's comment letter.<sup>9</sup> In its letter, CBOE disagreed with ISE's assertions that CBOE's proposal was motivated by CBOE's inability to "clear" superior quotations on other exchanges. CBOE explained that its proposal was designed to eliminate unreliable quotes that result in an inaccurate NBBO because an unreliable NBBO distorts marketplace pricing and can lead to missed executions. CBOE noted that it has refined its systems and no longer removes all ISE quotations for an occurrence of non-firm quotes occurring in just one options class.

With respect to ISE's argument that CBOE's proposal conflicts with the Linkage Plan, CBOE noted that the Linkage Plan is not operational yet and will not be in place until next year. Until the permanent linkage is implemented, CBOE believes it would be unreasonable to apply strictly the provisions of the Linkage Plan to the operation of the options market because without the permanent linkage, it is very difficult for a market maker to test the reliability of a quote in an away market in a quick and efficient manner. Once the permanent linkage is operational, CBOE agrees that the fourth group of exclusions in its proposal need not be broader than the allowable trade-through circumstance in the Linkage Plan. CBOE also stated that the interim linkage is insufficient to address unreliable quotes because such arrangements do not allow DPMs to submit proprietary orders to the auto-execution systems of the linked exchange and thus, do not enable DPMs to efficiently probe the reliability of the quote in the away market. In addition, the interim linkage only covers a small minority of options.

With respect to ISE's objections to the portion of CBOE's proposal relating to firm quote circumstances, CBOE argues that the proposal is designed to prevent a customer from receiving an inferior execution because the alleged "superior" quote is not obtainable. With respect to ISE's objection to the part of CBOE's proposal relating to the redisplay of a quote within 30 seconds, CBOE believes ISE wants to be held to

a different standard from the other options exchanges merely because it is electronic. CBOE notes that although ISE market makers each enter their own quotes, the ISE publishes a collective quote. CBOE states that ISE's collective quote should be held accountable for adherence to trade or fade because individual market makers on ISE do not have to interact with a DPM order. CBOE believes that if the entire DPM order were exposed to all market makers on ISE it might receive a complete fill, thus obviating the need to fade a quote, or not, in which case the quote should be faded.

#### III. Discussion

The Commission finds that the Confirmed Unreliable and Related Procedures Portion of the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>10</sup> and, in particular, the requirements of section 6 of the Act<sup>11</sup> and the rules and regulations thereunder. The Commission finds that the proposed rule change is consistent with section 6(b)(5) of the Act<sup>12</sup> because it provides objective criteria and well-defined procedures for excluding an unreliable quote from CBOE's determination of the NBBO, which should increase the likelihood that only unreliable quotes will be excluded from the CBOE's determination of the NBBO. Specifically, the Commission notes that the floor officials' determination to exclude unreliable quotes contained in the Confirmed Unreliable Quote and Related Procedures Portion of the proposal is limited to circumstances in which the away market has either directly communicated or confirmed that its quotes are unreliable. In this way, the discretion afforded to CBOE floor officials to determine that another market's options quotes are unreliable is appropriately limited. Moreover, the recordkeeping requirements and other procedures proposed in the Confirmed Unreliable Quote and Related Procedures Portion of the proposal are not unreasonable.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>13</sup> that the portion of the amended proposed rule change set forth above as the Confirmed Unreliable Quote and Related Procedures Portion of the proposal (SR-

CBOE-99-45) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority,<sup>14</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45755; File No. SR-CHX-2002-10]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Stock Exchange, Incorporated to Extend a Pilot Rule Interpretation Relating to Trading of Nasdaq/NM Securities in Subpenny Increments

April 15, 2002.

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 10, 2002, the Chicago Stock Exchange, Incorporated ("CHX" 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 Exchange filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6)<sup>4</sup> thereunder, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to extend through September 30, 2002, the pilot rule interpretation relating to the trading of Nasdaq/NM securities in subpenny increments. The pilot is due to expire on April 15, 2002. The CHX does not propose to make any substantive or typographical changes to the pilot; the only change is an extension of the pilot's expiration date through September 30, 2002. The text of the proposal is available at the Commission and at the CHX.

<sup>14</sup> 17 CFR 200.30-2(a)(12).

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6). The Commission waived the 5-day pre-filing notice requirement.

<sup>10</sup> In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f.

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> See letter from Joanne Moffic-Silver, General Counsel and Corporate Secretary, Legal Department, CBOE, to Jonathan G. Katz, Secretary, Commission, dated February 25, 2002.

## 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 CHX included statements concerning the purpose of and basis for its proposal and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX has prepared summaries, set forth in Sections A, B and C below, of the most significant aspects of such statements.

### A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

#### 1. Purpose

On April 6, 2001, the Commission approved, on a pilot basis through July 9, 2001, a pilot rule interpretation (CHX Article XXX, Rule 2, Interpretation and Policy .06 "Trading in Nasdaq/NM Securities in Subpenny Increments")<sup>5</sup> that requires a CHX specialist (including a market maker who holds customer limit orders) to better the price of a customer limit order in his book which is priced at the national best bid or offer ("NBBO") by at least one penny if the specialist determines to trade with an incoming market or marketable limit order. The pilot was extended on three occasions and is now due to expire on April 15, 2002.<sup>6</sup> The CHX now proposes to extend the pilot through September 30, 2002. The CHX proposes no other changes to the pilot, other than extending it through September 30, 2002.

#### 2. Statutory Basis

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b).<sup>7</sup> In particular, the CHX believes the proposal is consistent with Section 6(b)(5) of the Act<sup>8</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments to, and to perfect the

mechanism of, a free and open market and a national market system, and, in general, to protect investors and the public interest.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

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

No written comments were either solicited or received.

## III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Because the foregoing proposed rule change does not:

- (i) Significantly affect the protection of investors or the public interest;
- (ii) impose any significant burden on competition; and
- (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>9</sup> and Rule 19b-4(f)(6) thereunder.<sup>10</sup> At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Exchange has requested that the Commission waive both the 5-day notice and 30-day pre-operative requirements contained in Rule 19b-4(f)(6).<sup>11</sup> The Commission finds good cause to designate the proposal both effective and operative upon filing with the Commission because such designation is consistent with the protection of investors and the public interest. Acceleration of the operative date will allow the pilot to continue uninterrupted through September 30, 2002, and allow the Commission to further study the trading of Nasdaq/NM securities in subpenny increments. For these reasons, the Commission finds good cause to designate that the proposal is both effective and operative upon filing with the Commission.<sup>12</sup>

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

<sup>11</sup> *Id.*

<sup>12</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposal 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 that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CHX. All submissions should refer to file number SR-CHX-2002-10 and should be submitted by May 13, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

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

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45763; File No. SR-NASD-2002-08]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the National Association of Securities Dealers, Inc. Relating to the Permanent Establishment of a Minimum Quotation Increment for Nasdaq Securities Quoting in Decimals

April 16, 2002.

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 January 15, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its subsidiary The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("SEC" or

efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>13</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.

<sup>5</sup> See Securities Exchange Act Release No. 44164 (April 6, 2001), 66 FR 19263 (April 13, 2001) (SR-CHX-2001-07).

<sup>6</sup> See Securities Exchange Act Release No. 44535 (July 10, 2001), 66 FR 37251 (July 17, 2001) (SR-CHX-2001-15); Securities Exchange Act Release No. 45062 (November 15, 2001), 66 FR 58768 (November 23, 2001) (SR-CHX-2001-21); Securities Exchange Act Release No. 45386 (February 1, 2002), 67 FR 6062 (February 8, 2002) (SR-CHX-2002-02).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).