

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47332; File No. SR-CBOE-2002-69]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by Chicago Board Options Exchange, Incorporated Relating to Broker-Dealer Orders on RAES

February 10, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 26, 2002, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The Exchange submitted Amendment No. 1 to the proposed rule change on January 21, 2003.<sup>3</sup> 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 amend its rules regarding broker-dealer access to RAES. The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

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

In its filing with the Commission, CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The CBOE has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

##### 1. Purpose

CBOE proposes to amend Interpretation and Policy .01 of CBOE Rule 6.8 to allow the appropriate Floor Procedure Committee to determine, on a class and/or series basis, to prohibit access to RAES for broker-dealer orders after 3 p.m. Currently, the appropriate Floor Procedure Committee may permit broker-dealer orders on RAES during the trading day for options by class and/or series. CBOE proposes to expand access to RAES for broker-dealer orders, but some issues arise from 3 p.m. until the close especially for American style options, which permit early exercise.

Options pricing models used by CBOE members to generate the autoquote on CBOE utilize the price of underlying securities on the appropriate securities exchange.<sup>4</sup> Once the underlying stock stops trading, there is no price feed from the underlying securities to automatically update the options pricing models. Therefore, the hundreds of options series must be updated manually. If broker-dealer orders are permitted on RAES this could potentially increase the number of automatically executed orders significantly, (especially when a news release occurs after the close of the securities exchanges but before the close of CBOE), which if the increase in orders is significantly large, could create even more difficulties in updating the option pricing models in a timely manner.

Due to the increase in potential orders occurring electronically at a greater speed, CBOE would like to permit RAES access in more classes and/or series for broker-dealer orders, but permit the appropriate floor procedure committee to limit the access in classes or series, where appropriate, to the time period when the exchanges for the underlying securities are open for their regular trading session, *i.e.*, until 3 p.m. The proposed rule change would provide a solution that would permit broker-dealers to have access for the vast majority of the trading, while at the same time minimizing stress to the options pricing models when they are manually updated. CBOE believes that this proposed rule change would provide flexibility, while at the same time permitting increased competition for electronic orders.

<sup>4</sup> For purposes of this discussion securities exchanges includes NASDAQ.

##### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Exchange Act<sup>5</sup> in general and furthers the objectives of section 6(b)(5)<sup>6</sup> in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. The proposed rule change would promote competition, remove impediments to and perfect the mechanism to a free and open market by permitting greater competition for electronic order. The proposed rule change would permit broker-dealer orders to have RAES access in more option classes and/or series, and thus promote competition for these orders.

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

This proposed rule change does not 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

No written comments were solicited or received with respect to the proposed rule change.

#### III. Date of Effectiveness of 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 self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

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

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

<sup>3</sup> See letter from Jaime Galvan, Attorney, CBOE, to Jennifer Colihan, Special Counsel, Division of Market Regulation, Commission, dated January 17, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange changed the Statement of the Terms of Substance of the Proposed Rule Change and the Purpose section of the filing to correctly describe the proposal, and made non-substantive, clarifying changes to the rule text.

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 Section. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to SR-CBOE-2002-69 and should be submitted by March 7, 2003.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>7</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47333; File No. SR-CBOE-2002-18]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Relating to its DPM Membership Ownership Requirement

February 10, 2003.

#### I. Introduction

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 19, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") a proposed rule change to amend CBOE Rule 8.85(e). On June 10, 2002, the proposed rule change was published in the **Federal Register**.<sup>3</sup> The Commission received one comment letter.<sup>4</sup> On January 23, 2003, the

Exchange filed Amendment No. 1.<sup>5</sup> The Commission approves the proposed rule change, as amended, and publishes this notice to solicit comments on Amendment No. 1. The Commission also approves Amendment No. 1 on an accelerated basis.

#### II. Description of the Proposed Rule Change

The CBOE proposes to amend Rule 8.85(e) pertaining to the Designated Primary Market-Maker ("DPM") seat ownership requirement. Currently, the DPM seat ownership requirement,<sup>6</sup> contained in CBOE Rule 8.85(e), requires each DPM to own at least one Exchange membership. The rule also provides that this requirement is satisfied if the senior principal of the DPM owned the required membership(s).

The Exchange now proposes to amend CBOE Rule 8.85(e) to make DPM seat ownership requirements applicable to each trading location (as opposed to each DPM organization). Thus, under the rule a DPM organization will be required to own a seat for each trading location in which a DPM organization serves as a DPM, as determined by the Exchange's Modified Trading System Appointments Committee ("MTS Committee").<sup>7</sup> Under the proposal the term "trading location," is defined as "any separate, identifiable unit of a DPM organization that applies for and is allocated options classes by the appropriate Allocations Committee."<sup>8</sup> The proposed rule change also stipulates that each DPM organization will have ninety-days from the date of Commission approval to satisfy the new ownership requirements.

CBOE also proposes to eliminate the provision allowing a senior principal of a DPM to own a membership instead of the DPM organization for the purpose of satisfying a DPM's seat ownership requirements. Thus, each DPM organization would be required to directly own seats to fulfill the

requirements pursuant to CBOE Rule 8.85(e).

#### III. Summary of Comments

The Commission received one comment letter from TD Options, LLC ("TD Options").<sup>9</sup> TD Options expressed concern that the proposal: (1) Did not sufficiently explain its claim that the amendment to the DPM seat ownership rule would promote a long-term commitment to the Exchange, (2) did not provide sufficient rationale to explain why the DPM seat ownership requirement would no longer be satisfied by a principal's seat ownership under the proposal, and (3) lacked clarity with regard to the definition of "trading location."

In CBOE's response to the comments from TD Options,<sup>10</sup> the Exchange indicated that the proposal would ensure that DPMs have a long-term commitment to the Exchange because DPMs are allocated valuable securities by the CBOE, derive considerable benefits from those allocations, but currently do not have to pay for such allocations. Thus, the CBOE suggested that by amending its Rule 8.85(e) to align the DPM seat ownership requirements with the allocation of option classes, the DPM commitment to Exchange would be enhanced, and the likelihood of seat lease-related problems that could compromise a DPM's ability to open trading in its allocated option classes would be reduced. The Exchange also indicated that eliminating a DPM's ability to fulfill its seat ownership requirement through a principal ownership should enable CBOE to better monitor compliance with the rule, particularly in the present environment where individuals join and leave DPM organizations with increased frequency due to industry consolidation. In the CBOE Response Letter, the Exchange also explained that it was seeking to clarify what may be considered a trading location in instances where what physically appears to be two trading stations is actually one trading station, or conversely, where what physically appears to be one trading station is actually two trading stations. In Amendment No. 1, CBOE further clarified that the term "trading location," as used in this proposed rule change would refer to any separate, identifiable unit of a DPM organization that applies for and is allocated options

Regulation ("Division"), Commission, dated July 16, 2002 ("TD Options Comment Letter").

<sup>5</sup> See Letter from Angelou Evangelou, Senior Attorney, Legal Division, CBOE to Deborah Flynn, Assistant Director, Division, Commission, dated January 23, 2003 ("Amendment No. 1"). In Amendment No. 1, CBOE clarifies that the term "trading location," as used in Rule 8.85(e), is defined "as any separate, identifiable unit of a DPM organization that applies for and is allocated options classes by the appropriate Allocation Committee."

<sup>6</sup> See Securities Exchange Act Release No. 43186 (August 21, 2000), 65 FR 51880 (August 25, 2000) (Order approving File No. SR-CBOE-99-37).

<sup>7</sup> The MTS Committee is the Committee responsible for reviewing and ensuring compliance with CBOE Rule 8.85.

<sup>8</sup> See Amendment No. 1, *supra* note 5.

<sup>9</sup> See TD Options Comment Letter, *supra* note 4.

<sup>10</sup> See Letter from Angelou Evangelou, Senior Attorney, Legal Division, CBOE to Marc McKayle, Special Counsel, Division, Commission, dated October 10, 2002 ("CBOE Response Letter").

<sup>7</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>3</sup> See Securities Exchange Act Release No. 46020 (June 3, 2002), 67 FR 39758 (June 10, 2002).

<sup>4</sup> See Letter from Margaret Wiermanski, Chief Compliance Officer, TD Options, LLC, to Kelly Riley, Senior Special Counsel, Division of Market