

**Mercury Variable Trust [File No. 811-8163]**

*Summary:* Applicant seeks an order declaring that it has ceased to be an investment company. Shareholders approved the merger of Applicant's fund on November 17, 2003, and Applicant distributed its assets on November 21, 2003. The fund surviving the merger is the Merrill Lynch International Value V.I. Fund, a series of Merrill Lynch Variable Series Fund, Inc. Legal expenses of \$52,138.08 were deducted from Applicant's assets prior to consummation of the merger. Other merger related expenses of approximately \$143,597.51 were paid by the Applicant's investment adviser, Fund Assets Management, L.P.

*Filing Date:* The application was filed on November 30, 2005, as amended.

*Applicant's Address:* 800 Scudders Mill Road, Plainsboro, NJ 08536.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Nancy M. Morris,  
Secretary.

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-53357; File No. SR-BSE-2005-52]

**Self-Regulatory Organizations; Boston Stock Exchange, Inc.; Notice of Filing of Amendments No. 2, 3, and 4 to Proposed Rule Change To Modify the Information Contained in a Directed Order on the Boston Options Exchange**

February 23, 2006.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 25, 2005, the Boston Stock Exchange, Inc. ("BSE" 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 BSE. On December 20, 2005, the BSE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change and Amendment No. 1 were published for

comment in the **Federal Register** on December 29, 2005.<sup>4</sup> The Commission received eight comment letters.<sup>5</sup> In response to the concerns raised in the comment letters and discussions with Commission staff, the BSE filed Amendments No. 2, 3, and 4 on February 7, 2006, February 15, 2006, and February 21, 2006, respectively.<sup>6</sup> The Commission is publishing this notice to solicit comments on Amendments No. 4 to the proposed rule change from interested persons.

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

The BSE proposes to amend its rules governing its Directed Order process and to modify the information contained in a Directed Order on BOX. Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in [brackets].

\* \* \* \* \*

**Rules of the Boston Options Exchange Facility**

\* \* \* \* \*

**Chapter VI Market Makers**

\* \* \* \* \*

**Section 5 Obligations of Market Makers**

(a)-(b) No Change

(c) When acting as agent for a Directed Order, a Market Maker must comply with subparagraphs (i)-(iii) of this Paragraph (c).

i. A Market Maker shall not receive a Directed Order other than through the BOX Trading Host. A Market Maker that receives a Directed Order shall not, under any circumstances, reject the *receipt of the Directed Order from the BOX Trading Host*. A Market Maker who desires to accept Directed Orders must systemically indicate [they are an executing participant] each day [that] *and whenever* the Market Maker

<sup>4</sup> See Securities Exchange Act Release Act No. 53015 (December 22, 2005), 70 FR 77207.

<sup>5</sup> See letters to Nancy Morris, Secretary, Commission, from Adam C. Cooper, Senior Managing Director & General Counsel, Citadel, dated January 11, 2006 and January 12, 2006 ("Citadel Letters"); from Michael Simon, General Counsel, International Securities Exchange ("ISE"), dated January 19, 2006 ("ISE Letter"); from James Gray, Chairman, optionsXpress Holdings, Inc., dated January 19, 2006 ("optionsXpress Letter"); from Thomas Peterffy, Chairman, and David M. Battan, Vice President, Interactive Brokers Group, dated January 24, 2006 ("IB Letter"); from David Chavern, Vice President and Chief of Staff, U.S. Chamber of Commerce, dated January 25, 2006 ("Chamber of Commerce Letter"); and from Neal L. Wolkoff, Chairman & Chief Executive Officer, American Stock Exchange, dated February 3, 2006 and February 7, 2006 ("Amex Letters").

<sup>6</sup> Amendment No. 2 superseded and replaced the original filing and Amendment No. 1. Amendment No. 3 superseded and replaced the original filing and Amendments No. 1 and 2. Amendment No. 4 supersedes and replaces the original filing and all previous amendments.

[wishes to receive Directed Orders] *reconnects after disconnection during the day that it is willing to accept Directed Orders ("Executing Participant" or "EP")*. If a Market Maker does not systemically indicate that [they are] *it is an [e]Executing Participant*, the BOX Trading Host will not forward any Directed Orders to the Market Maker. *In such a case, the BOX Trading Host will send the order directly to the BOX Book. Prior to accepting a Directed Order through the Trading Host, an EP must inform BOX of the OFPs from which it has agreed to accept Directed Orders through the Trading Host ("Listed OFPs" or "LOFPs"). The Trading Host will then only send to the EP Directed Orders from LOFPs. Such orders will be sent to the EP on an anonymous basis.*

ii.-iii. No change.

\* \* \* \* \*

**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 BSE 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 BSE 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

Amendment No. 4 supersedes and replaces the previous amendments and the original filing in its entirety. The original rule filing and Amendment No. 1 proposed to clarify that, when Directed Orders are sent to a Market Maker, they contain an identifier associated with the firm that sent the Directed Order. In response to the original filing, the BSE received comments both in support of and opposing the proposal. The commenters opposing the proposal argue that the lack of anonymity of Directed Orders allows the Market Maker receiving such orders to discriminate among the firms for which it will seek to execute Directed Orders, and suggest that this selection process is discriminatory, may discourage aggressive quoting, and is inconsistent with the Act.<sup>7</sup> The commenter supporting the proposal argues that the lack of anonymity of Directed Orders encourages greater levels of price improvement, allows

<sup>7</sup> See Citadel Letters, ISE Letter, Chamber of Commerce Letter, optionsXpress Letter, and Amex Letters, *supra* note 5.

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

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

<sup>3</sup> In Amendment No. 1, the BSE amended the rule text of Chapter V, Section 14(e) of the Boston Options Exchange ("BOX") Rules to clarify that the identities of Options Participants that send Directed Orders to the Trading Host are not anonymous.

Market Makers to protect themselves from predatory firms that engage in anti-competitive behavior, and is consistent with the Act.<sup>8</sup>

While, as is discussed more fully below, the BSE completely disagrees with the core concern expressed by the commenters opposing the original proposal, the BSE does believe that it is appropriate to amend its proposal to permit EPs to choose the firms from which they will accept Directed Orders while providing complete anonymity for Directed Orders that are passed on to the Executing Participant (“EP”) for possible representation in a PIP auction.<sup>9</sup> The BSE believes that certain commenters have materially mischaracterized the Directed Order process. The BSE assumes this mischaracterization is in the pursuit of enlisting the Commission to support a market model that better suits its firm-centric business approach. In order to more fully address this mischaracterization, the BSE starts by first providing a brief overview of the Directed Order process. Subsequently, the BSE explains why it believes that the identification of the Order Flow Provider (“OFP”) in the Directed Order process is not only appropriate and consistent with applicable legal standards but also would increase investor welfare by expanding, relative to the approach suggested by the commenter, the amount of price improvement provided investors. Finally, the BSE offers an explanation of the amendment to its proposal.

Under the BSE’s Directed Order process, Market Makers on BOX are able to handle orders on an agency basis directed to them by OFPs. An OFP sends a Directed Order to BOX with a designation of the Market Maker to whom the order is to be directed. BOX then routes the Directed Order to the appropriate Market Maker. Under Chapter VI, section 5(c)(ii) of the BOX Rules, a Market Maker only has two choices when he receives a Directed Order: (1) Submit the order to the PIP process; or (2) send the order back to BOX for placement onto the BOX Book.

Under Chapter VI, section 5(c)(i) of the BOX Rules, a Market Maker who desires to accept Directed Orders must

systemically indicate that it is an EP each day the Market Maker wishes to receive Directed Orders from the BOX Trading Host. Further, the BOX system requires a Market Maker to systematically indicate that it is an EP during any day the Market Maker has disconnected from the system and seeks to reconnect.<sup>10</sup> If a Market Maker does not systemically indicate that it is an EP, then the BOX Trading Host will not forward any Directed Orders to that Market Maker. In such a case, the BOX Trading Host will send the order directly to the BOX Book.

Chapter VI, section 5(c)(i) prohibits a Market Maker from rejecting a Directed Order. The BSE wishes to clarify this to mean that upon systematically indicating its desire to accept Directed Orders, the BOX system prevents a Market Maker that receives a Directed Order from either rejecting the receipt of the Directed Order from the BOX Trading Host or rejecting the Directed Order back to the OFP who sent it.

The BSE notes that in all events, whether a Market Maker elects to accept Directed Orders or chooses systematically not to accept any Directed Orders, its displayed best bid and offer are firm and accessible for automatic executions by all order submitters. In other words, the Directed Order process is a discretionary service that Market Makers may choose to provide or not, above and beyond satisfying their core Market Maker obligations of providing continuous two-sided firm quotations on a non-discriminatory basis. Just as Market Makers may and do choose to provide, or not, other discretionary services, such as payment for order flow, the BSE believes that Market Makers also may identify the firms for which they may choose to provide such discretionary services.<sup>11</sup>

<sup>10</sup> Telephone conversation between Susie Cho, Special Counsel, Jan Woo, Attorney, Division of Market Regulation, Commission, and Alden Adkins, General Counsel, BSE, on February 23, 2006.

<sup>11</sup> See *id.*; see also Securities Exchange Act Release No. 47351 (February 11, 2003), 68 FR 8055 (February 19, 2003) (SR–NASD–2002–60). As stated in the adopting release, the New York Stock Exchange comment letter on the Primex rule proposal argued that “participants may selectively trade against agency orders alone by using a mechanism to screen out professional orders.” The Nasdaq Stock Market responded “that this feature ensures that any price improvement or enhanced liquidity opportunities be reserved for public customers, and not necessarily professional traders who could otherwise take advantage of the System’s benefits and ‘pre-empt’ the ability of a public customer to receive such benefits.” See Securities Exchange Act Release No. 47351 (February 11, 2003), 68 FR 8055, 8058 (February 19, 2003) (SR–NASD–2002–60). See generally Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11,388 (March 2, 2000) (stating that the Primary

The BOX system provides Market Makers with information regarding the identity of the firms from which a Directed Order originates.<sup>12</sup> The BSE believes that this is not inconsistent with the fact that the Directed Order process is a discretionary service and with the statute—which does not prohibit broker-dealers from determining which customer for whom it will provide a discretionary service (again, as used here to mean a service the broker-dealer is not legally required to provide at all)—but also is highly desirable. As is true with respect to any discretionary service, without some control over the OFPs from which Market Makers will accept Directed Orders, Market Makers could be expected to provide less of the service. This is specifically true with respect to the Directed Order process because the customer protections built into the Directed Order process, absent the ability to control the OFPs for which it will provide the service, could and almost certainly would have the unintended consequences of creating an opportunity for Options Participants to engage in abusive practices that jeopardize the ability of all Market Makers to price improve customer orders. Some Options Participants, including Market Makers, could send large numbers of proprietary Directed Orders to competitors using strategies that effectively amount to arbitraging the PIP auction against previous executions obtained on exchanges that do not provide price improvement opportunities. The EP receiving these Directed Orders either will end up providing a competitor’s order price improvement, or yielding priority (if it declines to submit the order to the PIP auction) and yet still guarantee his Firm Quote for three seconds regardless of whether market prices change during that time. The latter outcome is particularly problematic since, at a minimum, the EP is forced to forgo whatever time priority he may have had over his competitors at the top of the BOX book for the option series in the Directed Order. Moreover, the EP is also obligated to freeze his quote for three seconds and trade with any unexecuted Directed Order quantity (but only if no other Market Maker wants to trade with the Directed Order). Essentially this means the EP will trade with the

Market Makers and Competitive Market Makers on the ISE “will have the ability to set parameters regarding their willingness to trade generally with a broker-dealer’s proprietary order.”)

<sup>12</sup> Telephone conversation between Susie Cho, Special Counsel, Jan Woo, Attorney, Division of Market Regulation, Commission, and Alden Adkins, General Counsel, BSE, on February 23, 2006.

<sup>8</sup> See IB Letter, *supra* note 5.

<sup>9</sup> See Securities Exchange Act Release No. 52827 (November 23, 2005), 70 FR 72139 (December 1, 2005) (SR–PCX–2005–56) (generally approving proposal by the Pacific Exchange to “add a provision that requires Users to be given permission by DMMs in order to send a Directed Order to that DMM.”); see also Rule 229A(b)(1) of the Philadelphia Stock Exchange (generally providing for directed orders which are defined as orders that a member organization directs to a particular specialist pursuant to an agreement).

declined Directed Order only when no one else wishes to interact with the order.

The BSE's original proposal addressed this unfair competitive situation by enabling EPs to limit Directed Orders from hostile competitors and to provide price improvement to the customers for whom the Directed Order process was intended. Without this protection, the BSE believes that EPs will have to modify their risk assessment and therefore give less price improvement to everyone—or perhaps stop giving price improvement at all. This would significantly harm the retail investors who have benefited from the BOX price improvement system since its inception.<sup>13</sup>

The BSE's amended proposal seeks to maintain these very significant investor benefits of the original proposal by allowing EPs to provide the Exchange a list of firms to which the EP will provide Directed Order services. At the same time the BSE also believes that it is appropriate to modify the original proposal to prohibit Directed Orders delivered to EPs from identifying the firm from which the order comes. This would protect the anonymity of individual orders of Options Participants and their Directed Orders entered into the Trading Host. An EP has no need to know the identity of the Options Participant sending a Directed Order on an order-by-order basis once the threat from competitors has been mitigated. The BSE believes that the decision to price improve, or not, an anonymous Directed Order would be based only on objective factors.

## 2. Statutory Basis

The Exchange believes that the proposal, as amended, is consistent with the requirements of section 6(b) of the Act,<sup>14</sup> in general, and section 6(b)(5) of the Act,<sup>15</sup> in particular, in that it is designed to promote just and equitable principles of trade, 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.

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

The Exchange does not believe that the proposed rule change 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 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, 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 Amendment No. 4 is consistent with the Act. Comments may be submitted by any of the following methods:

#### *Electronic Comments*

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-BSE-2005-52 on the subject line.

#### *Paper Comments*

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, Station Place, 100 F Street, NE., Washington, DC 20549-1090.

All submissions should refer to File Number SR-BSE-2005-52. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). 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 also will be available for inspection and copying at the principal office of the BSE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-BSE-2005-52 and should be submitted on or before March 23, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Nancy M. Morris,**  
Secretary.

[FR Doc. E6-2929 Filed 3-1-06; 8:45 am]

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-53355; File No. SR-CBOE-2005-105]

### **Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change Relating to the Membership Rules for Foreign Member Organizations**

February 23, 2006.

#### **I. Introduction**

On December 7, 2005, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), 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> a proposed rule change to amend CBOE Rule 3.4, "Qualifications of Foreign Member Organizations," to provide that a member organization that is not organized under the laws of one of the states of the United States (a "foreign member organization"), and that is approved by the Exchange to act solely as a lessor, need not register as a broker or dealer pursuant to section 15 of the Act.<sup>3</sup> The proposed rule change was published for comment in the

<sup>13</sup> Over half of marketable public customer orders sent to BOX in 2005 received price improvement—slightly under 3,000 public customer orders each day, with an average price improvement per contract of over \$2.50. Price improvement particularly benefited small customer orders, as over 85% of all price improvement was for orders of 20 contracts or fewer.

<sup>14</sup> 15 U.S.C. 78f(b).

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

<sup>16</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> 15 U.S.C. 78o.