

Room. Copies of such filing will also be available for inspection and copying at the principal office of the CME. All submissions should refer to File No. SR-CME-2003-01 and should be submitted by June 5, 2003.

**IV. Commission Findings and Order Granting Accelerated Approval of a Proposed Rule Change**

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.<sup>7</sup> In particular, the Commission believes that the proposed rule change is consistent with the requirements of section 6(b)(5) of the Act,<sup>8</sup> which requires, among other things, that the rules of the Exchange be designed to promote just and equitable principles of trade and, in general, to protect investors and the public interest.<sup>9</sup> In addition, the Commission believes that the proposed rule change is consistent with section 7(c)(2)(B) of the Act,<sup>10</sup> which provides, among other things, that the margin requirements for security futures must preserve the financial integrity of markets trading security futures, prevent systemic risk, be consistent with the margin requirements for comparable exchange-traded options, and provide that the margin levels for security futures may be no lower than the lowest level of margin, exclusive of premium, required for any comparable exchange-traded option.

The Commission believes that the CME's standards for market makers under Rule 930.B.2.b.(3) are consistent with the Act, and Rule 400(c)(2)(v) thereunder.<sup>11</sup> Specifically, Rule 400(c)(2)(v) provides that the Commissions' joint margin rules do not apply to a member of a national securities exchange that is registered with such exchange as a "Security Futures Dealer" pursuant to exchange rules that must meet several criteria, including a requirement that a Security Futures Dealer be required to "to hold itself out as being willing to buy and sell security futures for its own account on a regular and continuous basis." The Commission believes that the affirmative obligations required by the

CME pursuant to Rule 930.B.2.b.(3) satisfy this requirement.

The CME has requested that the Commission approve the proposed rule change prior to the thirtieth day after publication of notice of the filing in the **Federal Register**. The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. The Commission believes that accelerated approval of the proposed rule change should enable CME members to trade security futures as market makers under the Market Maker Exclusion without undue delay. The Commission notes that it approved the Market Maker Exclusion as a temporary pilot to give members of the public an opportunity to comment on the substance of the Market Maker Exclusion. The Commission received no comments on the Pilot. Accordingly, the Commission finds good cause, consistent with section 19(b)(2) of the Act,<sup>12</sup> to approve the proposed rule change prior to the thirtieth day after publication of the notice of filing.

**V. Conclusion**

It is therefore Ordered, pursuant to section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (File No. SR-CME-2003-01) be approved, on a permanent basis, on an accelerated basis.

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. 34-47817; File No. SR-ISE-2003-10]**

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the International Securities Exchange, Inc. To Amend Its Obvious Error Rule**

May 8, 2003.

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 February 28, 2003, the International Securities

Exchange, Inc. ("ISE" 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 May 1, 2003, the ISE submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> 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 Exchange is proposing to amend ISE Rule 720 (the "Obvious Error Rule"). Proposed new language is *italicized*; proposed deletions are in [brackets].

\* \* \* \* \*

**Rule 720. Obvious Errors**

The Exchange shall either bust a transaction or adjust the execution price of a transaction that results from an Obvious Error as provided in this Rule.

(a) Definition of Obvious Error. For purposes of this Rule only, an Obvious Error will be deemed to have occurred when the *execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least the amount shown below:*

<i>Theoretical price</i>	<i>Minimum amount</i>
<i>Below \$2</i> .....	<i>.25</i>
<i>\$2 to \$5</i> .....	<i>.40</i>
<i>Above \$5 to \$10</i> .....	<i>.50</i>
<i>Above \$10 to \$20</i> .....	<i>.80</i>
<i>Above \$20</i> .....	<i>1.00</i>

[(1) If the Theoretical Price of the option is less than \$3.00:

(i) During regular market conditions (including rotations), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 35 cents or more; or

(ii) During fast market conditions (*i.e.*, the Exchange has declared a fast market status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount of 50 cents or more.

(2) If the Theoretical Price of the option is \$3.00 or higher:

(i) During regular market conditions (including rotations), the execution

<sup>7</sup> 15 U.S.C. 78s(b)(2).

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

<sup>9</sup> In approving the proposed rule, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78g(c)(2)(B).

<sup>11</sup> 17 CFR 240.400(c)(2)(v).

<sup>12</sup> 15 U.S.C. 78s(b)(2).

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

<sup>14</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 letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy Sanow, Assistant Director, Division of Market Regulation, Commission, dated April 30, 2003 ("Amendment No. 1"). In Amendment No. 1, the ISE replaced the proposed rule text in its entirety.

price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least two (2) times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more; or

(ii) During fast market conditions (*i.e.*, the Exchange has declared a fast market status for the option in question), the execution price of a transaction is higher or lower than the Theoretical Price for the series by an amount equal to at least three (3) times the maximum bid/ask spread allowed for the option, so long as such amount is 50 cents or more.]

(b) Definition of Theoretical Price. For purposes of this Rule only, the Theoretical Price of an options series is:

(1) If the series is traded on at least one other options exchange, the last bid price with respect to an erroneous sell transaction, [or] and last offer price with respect to an erroneous buy transaction, just prior to the trade, [found on] disseminated by the competing options exchange that has the most liquidity in that option [as provided in Supplementary Material .02 below]; or

(2) If there are no quotes for comparison purposes, as determined by designated personnel in the Exchange's market control center ("Market Control").

[(c) Adjustments. Where the execution price of a transaction executed as the result of an Obvious Error is adjusted, the adjusted price will be:

(1) The Theoretical Price of the option in the case where the erroneous price is displayed in the market and subsequently executed by quotes or orders that did not exist in the System at the time the erroneous price was entered; or

(2) The last bid or offer, just prior to the trade, found on the exchange that has the most liquidity in that option as provided in Supplementary Material .03 below in the case where an erroneous price executes against quotes or orders already existing in the System at the time the erroneous price was entered.

(d) [(c) Obvious Error Procedure. Market Control shall administer the application of this Rule as follows.

(1) *Notification.* If a market maker on the Exchange believes that it participated in a transaction that was the result of an Obvious Error, it must notify Market Control within five (5) minutes of the execution. If an Electronic Access Member believes an order it executed on the Exchange was the result of an Obvious Error, it must notify Market Control within twenty (20) minutes of the execution. Absent unusual circumstances, Market Control will not grant relief under this Rule

unless notification is made within the prescribed time periods.

(2) *Adjust or Bust.* Market Control will determine whether there was an Obvious Error as defined above. If it is determined that an Obvious Error has occurred, Market Control shall take one of the [following] actions *listed below.* [Upon taking final action, Market Control shall promptly notify both parties to the trade.

(i) [w]Where each party to the transaction is a market maker on the Exchange, the execution price of the transaction will be adjusted by Market Control to the prices provided in paragraphs (A) and (B) below unless both parties agree to adjust the transaction to a different price or agree to bust the trade within ten (10) minutes of being notified by Market Control of the Obvious Error. [; or]

(A) *Erroneous buy transactions will be adjusted to their Theoretical Price (1) plus \$.15 if the Theoretical Price is under \$3, and (2) plus \$.30 if the Theoretical Price is at or above \$3.*

(B) *Erroneous sell transactions will be adjusted to their Theoretical Price (1) minus \$.15 if the Theoretical Price is under \$3, and (2) minus \$.30 if the Theoretical Price is at or above \$3.*

(ii) [w]Where at least one party to the Obvious Error is not a market maker on the Exchange, the trade will be busted by Market Control unless both parties agree to [adjust the] an adjustment price [of] for the transaction within thirty (30) minutes of being notified by Market Control of the Obvious Error. [Upon taking final action, Market Control shall promptly notify both parties to the trade.]

(e) Obvious Error Panel.

(1) *Composition.* An Obvious Error Panel will be comprised of representatives from four (4) Members. Two (2) of the representatives must be directly engaged in market making activity and two (2) of the representatives must be employed by an Electronic Access Member.

(2) [Request for] *Scope of Panel's Review.* If a party affected by a determination made under this Rule so requests within the time permitted in (3) below, the Obvious Error Panel will review decisions made by Market Control under this Rule, including whether an Obvious Error occurred, whether the correct Theoretical Price was used, and whether an adjustment was made at the correct price. A party may also request that the Obvious Error Panel provide relief [under] as provided in this Rule in cases where the party failed to provide the notification required in paragraph [(d)](c)(1) and Market Control declined to grant an

extension, but unusual circumstances must merit special consideration.

(3) *Procedure for Requesting Review.* A request for review must be made in writing within thirty (30) minutes after a party receives verbal notification of a final determination by Market Control under this Rule, except that if notification is made after 3:30 p.m. Eastern Time, either party has until 9:30 a.m. Eastern Time the next trading day to request review. The Obvious Error Panel shall review the facts and render a decision on the day of the transaction, or the next trade day in the case where a request is properly made after 3:30 on the day of the transaction or where the request is properly made the next trade day.

[(3)] (4) Panel Decision. The Obvious Error Panel may overturn or modify an action taken by Market Control under this Rule upon agreement by a majority of the Panel representatives. All determinations by the Obvious Error Panel shall constitute final Exchange action on the matter at issue.

Supplementary Material to Rule 720

.[01 For purposes of paragraph (a) of this Rule, the maximum bid/ask spread shall be the maximum bid/ask spread allowed under Rule 803(b), unless a wider spread has been allowed by the Exchange for the option because of unusual market conditions, such as high market volatility.

.02 The Theoretical Price will be determined under paragraph (b)(1) above as follows: (i) The bid price from the exchange providing the most volume will be used with respect to an erroneous bid price entered on the Exchange, and (ii) the offer price from the exchange providing the most volume will be used with respect to an erroneous offer price entered on the Exchange.

.03 The price to which a transaction is adjusted under paragraph (c)(2) above will be as follows: (i) The bid price from the exchange providing the most volume for the option will be used with respect to an erroneous offer price entered on the Exchange, and (ii) the offer price from the exchange providing the most volume for the option will be used with respect to an erroneous bid price entered on the Exchange. If there are no quotes for comparison purposes, the adjustment price will be determined by Market Control.]

.[04].01 When Market Control determines that an Obvious Error has occurred and action is warranted under paragraph [(d)](c)(2) above, the identity of the parties to the trade will be disclosed to each other in order to encourage conflict resolution.

[.05] .02 To qualify as a representative of an Electronic Access Member on an Obvious Error Panel, a person must (i) be employed by a Member whose revenues from options market making activity do not exceed ten percent (10%) of its total revenues; or (ii) have as his or her primary responsibility the handling of Public Customer orders or supervisory responsibility over persons with such responsibility, and not have any responsibilities with respect to market making activities.

[.06] .03 The Exchange shall designate at least ten (10) market maker representatives and at least ten (10) Electronic Access representatives to be called upon to serve on Obvious Error Panels as needed. In no case shall an Obvious Error Panel include a person related to a party to the trade in question. To the extent reasonably possible, the Exchange shall call upon the designated representatives to participate on an Obvious Error Panel on an equally frequent basis.

[.07] .04 All determinations made by the Exchange, Market Control or an Obvious Error Panel under this Rule shall be rendered without prejudice as to the rights of the parties to the transaction to submit a dispute to arbitration.

.05 *Buyers of options with a zero bid and \$.05 offer (i.e., a Theoretical Price of \$.05) may request that their execution be busted if at least the three strikes below (for calls) or above (for puts) in the same options class were quoted with a zero bid and \$.05 offer at the time of the execution. Such buyers must follow the procedures of paragraph (c)(1) above.*

.06 *For purposes of paragraph (b)(1) of Rule 720, the competing options exchange with the most liquidity will be the options exchange that had the highest total contract volume in the options class for the previous two months (e.g., if an obvious error occurs on March 9, the total contract volume from January 8 to March 8 will be used).*

.07 *For purposes of Rule 720, an "erroneous sell transaction" is one in which the price received by the person selling the option is erroneously low, and an "erroneous buy transaction" is one in which the price received by the person purchasing the option is erroneously high.*

\* \* \* \* \*

## 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 proposes to amend ISE Rule 720 to simplify its application. When the Exchange first adopted the Obvious Error Rule,<sup>4</sup> it was the first such rule of its kind on any options exchange. During the nearly two-year period since the Rule was approved by the Commission, the Exchange made minor adjustments to the Rule to address specific issues that arose.<sup>5</sup>

The current proposed rule change represents the result of a comprehensive analysis of the effectiveness of the Rule in addressing obvious error situations. After consultation with Members, the Exchange believes that the structure and standards of the Rule have worked very well. However, the Rule itself is unnecessarily complex, which can create confusion and uncertainty regarding when trades qualify as obvious errors and the prices to which qualifying trades may be adjusted. Accordingly, the Exchange proposes the changes described herein.

#### Determining Whether or Not an Obvious Error Has Occurred

Currently, under paragraph (b) of the Rule and Supplementary Material .02, the Theoretical Price for an option is determined by the bid price on the options exchange other than ISE that has the most volume in the option for erroneous buy orders or bid quotes. Similarly, the Theoretical Price for an option is determined by the offer price on the other options exchange for erroneous sell orders or offer quotes. Determining the Theoretical Price in this manner is counter-intuitive to market participants, which generally look to the offer as the price at which one can buy and the bid as the price at which one can sell. Moreover, under paragraph (a) of the Rule, the required deviation from the Theoretical Price necessary to qualify the trade as an

obvious error is a multiple of the option's maximum allowable bid/ask spread, with a greater multiple applied in fast market conditions.

The Exchange proposes to amend the Rule to provide that the Theoretical Price for trades caused by erroneous buy orders or bid quotes will be determined by the offer from the other options exchange, and that the Theoretical Price of trades caused by erroneous sell orders or offer quotes will be determined by the bid from the other options exchange. Because the side to which the Rule will look to determine the Theoretical Price is switched, the Exchange proposes to reduce the required deviation necessary for a trade to qualify as an obvious error to the amount equivalent to the maximum bid/ask spread for the series, rather than a multiple of the allowable spread. The result of these two changes taken together is not material for options priced \$3 and higher, as the price at which a trade must occur to qualify as an obvious error does not change.<sup>6</sup> For options priced under \$3, the proposed rule change will increase the deviation required for a trade to qualify as an obvious error.

As described below, the Exchange is also proposing a manner in which to address obvious errors in the purchase of certain very low-priced options. Finally, the Exchange proposes to eliminate entirely the current rule's distinction between regular market condition and fast market condition, as the higher standard for fast market conditions is unnecessary in the Exchange's electronic environment.

#### Adjusting Prices

Paragraph (c) in Supplementary Material .03 of the current Rule governs the price to which a trade is adjusted when there is an obvious error. Currently, the price used is dependent on whether the erroneous price existed in the market first, or whether the erroneous price executed against an existing order or quote in the book. The Exchange proposes to apply a single adjustment standard to all executions that qualify as an obvious error: erroneous buy executions will be adjusted to the Theoretical Price (the offer) plus \$.15 for options under \$3, and plus \$.30 for options as or above \$3.

<sup>6</sup> For example, assume the quote on the options exchange other than ISE for an option is \$6 to \$6.50. Under the current Rule, the execution price of a buy order must be \$7 higher, i.e., the Theoretical Price (the bid from the other options exchange) plus an amount equal to twice the allowable spread (\$.50). Under the amended Rule, the execution price of the buy order must still be \$7 or higher, i.e., the Theoretical Price (the offer from the other options exchanges) plus an amount equal to the allowable spread (\$.50).

<sup>4</sup> See Securities Exchange Act Release No. 44376 (June 1, 2001), 66 FR 30772 (June 7, 2001).

<sup>5</sup> See Securities Exchange Act Release No. 46110 (June 25, 2002), 67 FR 44487 (July 2, 2002).

Erroneous sell executions will be adjusted to the Theoretical Price (the bid) minus \$.15 for options under \$3, and minus \$.30 for options at or above \$3. This change addresses two issues under the current Rule. First, it simplifies the determination of the appropriate adjustment price and creates certainty for Members who generally do not know which price was first in the market at the time a trade occurs. Second, it protects against abuse of the Rule, as the adjustment price is not as favorable as what the party making the error would have received had it not made an error.

#### *The "Nickel Rule"*

The current obvious error Rule does not contain any special criteria for executions in options with a quote of \$0 to \$.05 (no bid, offered at a nickel). The Exchange proposes to create a special standard for no-bid buyers, as a purchase of these options is extremely rare and most often the result of an error. Under proposed Supplementary Material .05, buyers of options priced at no bid, offered at a nickel, may request that their execution be busted if at least the three strike prices below (for calls) or above (for puts) in the same class were quoted no bid, offered at a nickel at the time of the erroneous execution. The buyer must notify market control as otherwise required under the Rule.

#### 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with section 6(b) of the Act<sup>7</sup> in general, and furthers the objectives of section 6(b)(5)<sup>8</sup> in particular, in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism for 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 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 did not solicit or receive written comments on the proposed rule change.

#### **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 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 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 at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the Exchange. All submissions should refer to File No. SR-ISE-2003-10 and should be submitted by June 5, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010-01-P**

#### **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-47810; File No. SR-OC-2003-05]

#### **Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of a Proposed Rule Change and Amendment No. 1 Thereto by OneChicago, LLC To Adopt, on a Permanent Basis, the Standards Under Which a Market Maker Can Qualify for Exclusion From OneChicago's Margin Rules**

May 7, 2003.

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 May 5, 2003, OneChicago, LLC ("OneChicago" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I and II below, which Items have been prepared by OneChicago. On May 6, 2003, OneChicago submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to grant accelerated approval of the proposed rule change.

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

OneChicago proposes to adopt, on a permanent basis, Rule 515(n)(ii)(C) ("Exclusion for Market Makers") (herein referred to as "Margin Rule"). On November 7, 2002, the Commission approved the Margin Rule on a pilot basis, ending May 7, 2003 ("the Pilot").<sup>4</sup> OneChicago believes that permanent approval of the Margin Rule is consistent with the jointly adopted margin rules of the Commission and the Commodity Futures Trading Commission ("CFTC") (collectively, "Commissions").

Below is the text of the proposed rule change that OneChicago proposes to adopt on a permanent basis.

\* \* \* \* \*

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

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

<sup>3</sup> See letter from Madge M. Hamilton, Deputy General Counsel, OneChicago, to Theodore Lazo, Senior Special Counsel, Division of Market Regulation, Commission, dated May 5, 2003.

<sup>4</sup> See Securities Exchange Act Release No. 46787 (November 7, 2002), 67 FR 69059 (November 14, 2002).

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

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

<sup>9</sup> 17 CFR 200.30-3(a)(12).