

SECOND FAIR ACT RELEASE 2003—Continued

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National Transportation Safety Board .....	Ms. Barbara Czech, (202) 314-6169, www.nts.gov.
Office of Personnel Management .....	Mr. Alfred Chatterton III, (202) 606-1004, www.opm.gov.
Office of the U.S. Trade Representative .....	Ms. Susan Buck, (202) 395-9412, www.ustr.gov.
Peace Corps .....	Mr. George Schutter, (202) 692-1630, www.peacecorps.gov.
Railroad Retirement Board .....	Mr. Henry Valiulius, (312) 751-4520, www.rrb.gov.
Railroad Retirement Board (Inspector General) .....	Ms. Henrietta Shaw, (312) 751-4345, www.rrb.gov/oig/Rrboig.htm.
Selective Service System .....	Mr. Calvin Montgomery, (703) 605-4038, www.sss.gov.
Small Business Administration .....	Mr. Robert J. Moffitt, (202) 205-6610, www.sba.gov.
Small Business Administration (Inspector General) .....	Ms. Janis Coughlin, (202) 205-7373, www.sba.gov/ig.
U.S. Trade Development Agency .....	Ms. Barbara Bradford, (703) 875-4357, www.tda.gov.

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-49078; File No. SR-CBOE-2003-58]

**Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Its Summary Fine Schedule for Position Limit Violations**

January 14, 2004.

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 December 10, 2003, the Chicago Board 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 CBOE proposes to amend its summary fine schedule for position limit violations. The text of the

proposed rule change is below. Additions are *italicized*; deletions are in brackets.

\* \* \* \* \*

**Chapter XVII—Discipline**

**Rule 17.50 Imposition of Fines for Minor Rule Violations**

(a)–(f) No change.  
(g) The following is a list of the rule violations subject to, and the applicable fines that may be imposed by the Exchange pursuant to, this Rule:

(1) Violation of position limit rules. (Rule 4.11)

(a) For violations occurring in the accounts of non-member customers (*i.e.*, customers that are not Exchange members):

Number of Cumulative Violations In Any Twelve (12) Month Rolling Period*.	Fine Amount (imposed on Exchange member firm).
<i>First Offense</i> [1–6] .....	Letter of Caution[, up to 5% in excess of the applicable limit; above that level, \$1 per contract].
<i>Second Offense</i> [7–12] .....	\$500 [1 per contract over limit].
<i>Third Offense</i> [13+] .....	\$1,000 [5 per contract over limit].
<i>Fourth and Each Subsequent Offense</i> .....	\$2,500.

(b) For violations occurring in all other accounts:

Number of Cumulative Violations In Any Twelve (12) Month Rolling Period*.	Fine Amount.
<i>First Offense</i> [1–3*] .....	Letter of Caution[, up to 5% in excess of the applicable limit; above that level, \$1 per contract].
<i>Second Offense</i> [4–6] .....	\$1,000 [1 per contract over limit].
<i>Third Offense</i> [7–9] .....	\$2,500 [2.50 per contract over limit].
<i>Fourth and Each Subsequent Offense</i> [10+] .....	\$5,000 [5 per contract over limit].

\*A violation [in this category] that consists of (i) a 1 trade date overage, (ii) a consecutive string of trade date overage violations where the position does not change or where a steady reduction in the overage occurs, or (iii) a consecutive string of trade date overage violations resulting from other mitigating circumstances, may be deemed to constitute one offense, provided that the violations are inadvertent. [or a 2 consecutive trade date overage will be counted as a single violation. At staff’s discretion, an informal Staff Interview may be conducted rather than a Letter of Caution issued for the 3rd violation.]

[Fines imposed for violations of Rule 4.11 shall be in the minimum amount of \$100.]

(2)–(10) No change.  
\* \* \* \* \*

*Interpretations and Policies:*

.01 [(a) Violations of the position limit rule that continue over

consecutive business days will be subject to a separate fine, pursuant to subsection (g)(1) of this Rule and except as provided in the footnote to (g)(1)(b) for member accounts, for each day

during which the violation occurs and is continuing.] For purposes of subsection (g)(1)(a), all accounts of non-member broker-dealers will be treated as customer accounts. In calculating fine

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

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

thresholds under subsection (g)(1)(a) for each Exchange member, all violations occurring in any twelve-month *rolling* period in all of that member's non-member customer accounts are to be added together.

(b) [A member whose position limit summary fine(s) meets one of the levels below shall have the opportunity to submit one written offer of settlement in accordance with the provisions of Rule 17.8(a)—Submission of Offer, provided, however, that the Interpretations and Policies to Rule 17.8 shall not apply to an offer made hereunder and the member must submit the offer within 30 days of the date of service of the written statement informing the member of the fine(s) imposed. The member may also appear once before the Business Conduct Committee to make an oral statement in support of the offer. A member may make one offer:

(1) when the fine calculated pursuant to subsection (g)(1) of this Rule would be greater than \$2,500 per day and not more than \$5,000 per day; or

(2) when position limit violations continue over 5 or more consecutive trade dates and the fine calculated pursuant to subsection (g)(1) would be greater than \$10,000 in the aggregate and not more than \$5,000 on any day.]

Any member who is issued a summary fine notice for the same conduct covered in sub-paragraph (g)(5) that meets one of the levels below shall have the opportunity to submit one written offer of settlement to the Business Conduct Committee in accordance with the provisions of Rule 17.8(a)—Submission of Offer, provided, however, that the Interpretation and Policies to Rule 17.8 shall not apply to an offer made hereunder and the member must submit the offer within 30 days of the date of service of the written notice informing the member of the fine(s) imposed. The member may also appear once before the Business Conduct Committee to make an oral statement in support of the offer. In considering an offer of settlement, the Business Conduct Committee shall consider the Principal Considerations in Determining Sanctions as set forth in Interpretation and Policy .01 of Rule 17.11. A member may make one offer:

(1) When the summary fine amount would be greater than \$2,500 but not more than \$5,000 for a single offense, regardless of whether the single offense is the result of one violation or multiple violations aggregated together; or

(2) When the total fine for multiple offenses would be greater than \$10,000 in the aggregate and not more than \$5,000 for any single offense, again regardless of whether any single offense

is the result of one violation or multiple violations aggregated together.

A decision of the Business Conduct Committee accepting an offer of settlement hereunder shall be reported on a current basis pursuant to Rule 19d-1 under the Securities Exchange Act of 1934. The member shall report a decision accepting an offer of settlement on the member's broker-dealer and Form U-4 (uniform application for securities industry registration or transfer) forms as a decision in a contested Exchange disciplinary proceeding.

.02-.04 No change.

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## 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 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 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's disciplinary rules authorize the imposition of fines for minor rule violations, which are set forth in CBOE Rule 17.50. With respect to option position limit violations, current CBOE Rule 17.50(g)(1) sets forth a graduated fine schedule that increases the dollar amount of the fine as the number of cumulative violations increase. The dollar amount of the fines range from \$1.00 to \$5.00 per contract for every contract exceeding the applicable position limit. Pursuant to CBOE Rule 17.50(a),<sup>3</sup> a violation where the fine amount exceeds \$5,000 is not a minor rule violation under CBOE Rule 17.50 and is subject to the disciplinary procedures under CBOE Rule 17.2 *et seq.*

Based on its experience with processing position limit violations, the

Exchange has found that most position limit violations are technical in nature. Accordingly, the Exchange believes that they should be processed under a summary fine schedule. For example, the Exchange often encounters situations that involve inadvertent calculation errors or computer systems problems, which result in sizable position limit overages and a consecutive string of single trade date violations. The violations are often sizeable and occur over a string of days because the member is unaware of the problem that caused the violation. In these situations, once the Exchange has identified the overage and notified the member, the member has taken appropriate action to bring the position into compliance and, if the overage was based on a computer systems problem, implemented appropriate procedures to prevent a recurrence.

Notwithstanding the unintentional nature of the violations, the Exchange's current rules provide for the imposition of fines for position limit violations in accordance with the fine schedule set forth in CBOE Rule 17.50(g). For violations occurring in the accounts of non-member customers, CBOE Rule 17.50(g)(1)(a) deems one violation to equal a single date overage. For violations occurring in all other accounts, CBOE Rule 17.50(g)(1)(b) deems one violation to equal either a one trade date overage or a two consecutive trade date overage. Therefore, a single position limit overage that continues over a string of consecutive days will significantly increase the probability that the fine will exceed the \$5,000 threshold set forth in CBOE Rule 17.50(a) as a result of reaching the next level in the graduated fine schedule. In these situations, the Exchange rules require the Exchange to remove the violation from the summary fine process of CBOE Rule 17.50(g) and place it under the disciplinary process set forth in CBOE Rule 17.2 *et seq.*

The Exchange believes that removal of these types of violations from the summary fine process is incongruous with what it believes is the unintentional nature of the majority of the position limit violations that the Exchange comes across. To realign CBOE Rule 17.50(g) with the current landscape, the Exchange proposes to establish a fixed dollar fine amount per each offense, with the maximum fine amount equaling \$2,500 for violations occurring in the accounts of non-member customers and \$5,000 for violations occurring in all other accounts. The cap on the fine amount would permit the Exchange to process

<sup>3</sup> CBOE Rule 17.50(a) provides in relevant part: "In lieu of commencing a disciplinary proceeding pursuant to Exchange Rule 17.2 *et seq.*, the Exchange may, subject to the requirements set forth herein, impose a fine, not to exceed \$5,000, on any member or person associated with or employed by a member with respect to any rule violation listed in section (g) of this Rule. \* \* \*"

the majority of position limit violations under the summary fine process without having to subject the violation to the disciplinary procedures as provided in CBOE Rule 17.2 *et seq.* In addition to restructuring the fine amounts, the proposed rule change provides in the footnote to CBOE Rules 17.50(g)(1)(a) and (b) that (i) a one-trade date overage, (ii) a consecutive string of trade date overage violations where the position does not change or where a steady reduction in the overage occurs,<sup>4</sup> or (iii) a consecutive string of trade violations resulting from other mitigating circumstances, may be deemed to constitute one offense, provided that the violations are inadvertent. Proposed subsection (ii) addresses the majority of violations that the Exchange comes across and proposed subsection (iii) addresses the infrequent, inadvertent violations that may not fall within proposed subsections (i) and (ii). Contemporaneous with the imposition of the fine, the Exchange's regulatory staff will work with the subject member to correct the problem that caused the position limit violation. The Exchange notes that American Stock Exchange LLC Rule 590(g) imposes a similar fine schedule for a violation of its position limit rule.

CBOE Rule 17.50(f) retains the Exchange's authority to remove the position limit overage violation from the summary fine process of CBOE Rule 17.50(g). Under CBOE Rule 17.50(f), the Exchange "may, whenever it determines that any violation is intentional, egregious, or otherwise not minor in nature, proceed under the Exchange's formal disciplinary rules as set forth in Exchange Rule 17.2 *et seq.*, rather than under Exchange Rule 17.50." Therefore, the Exchange may remove the violation from the summary fine process whenever it determines that the violation is intentional, egregious or otherwise not minor in nature.

<sup>4</sup> The Exchange notes that proposed subsection (ii) of the footnote to Rules 17.50(g)(1)(a) and (b) is designed to replace the first sentence of Interpretation .01 to Rule 17.50, which is being deleted in the proposed rule change. The first sentence of Interpretation .01 to Rule 17.50 currently serves to mitigate the substantial fines that would result from sizeable overages and/or consecutive day overages. As provided in the proposed footnote to Rules 17.50(g)(1)(a) and (b), the Exchange will now deem such inadvertent consecutive day overages and/or sizeable overages as one offense, with a corresponding set fine. To the extent a position limit overage is not covered in proposed subsections (i) and (ii) of the footnote to Rules 17.50(g)(1)(a) and (b), such as if the position limit overage increases over a period of consecutive days, the Exchange would apply proposed subsection (iii) of the footnote to Rules 17.50(g)(1)(a) and (b) to the extent the increased position is inadvertent.

The Exchange also proposes to delete the first paragraph of subsection (b) of Interpretation .01 to CBOE Rule 17.50 because the Exchange believes that offers of settlement are inappropriate under the proposed fine schedule. Subsection (b) currently serves to mitigate hefty fines caused by unintentional overages such as those that occur in the examples provided above. Since the proposed rule change replaces the graduated fine schedule with the set fine schedule, each offense is capped at a dollar amount and does not need to be mitigated by an offer of settlement.

## 2. Statutory Basis

The Exchange believes the proposed rule change will enable the Exchange to deal more efficiently with the majority of position limit violations and to provide the Exchange with a more equitable method of dealing with inadvertent position limit overages, which is consistent with section 6(b) of the Act<sup>5</sup> in general and furthers the objectives of section 6(b)(5) of the Act<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.

### 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

No written comments were solicited or received with respect to 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 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. Comments may also be submitted electronically at the following e-mail address: [rule-comments@sec.gov](mailto:rule-comments@sec.gov). All comment letters should refer to File No. SR-CBOE-2003-58. 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, comments should be sent in hardcopy or by e-mail but not by both methods. 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 CBOE. All submissions should refer to file number SR-CBOE-2003-58 and should be submitted by February 13, 2004.

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

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

<sup>7</sup> 17 CFR 200.30-3(a)(12).