

governors and senior floor officials determine to approve orders as large as seventy-five contracts as eligible for AUTO-EX, those officials or any other Amex officials or Amex committee should disengage AUTO-EX more frequently by, for example, declaring a "fast" market. Disengaging AUTO-EX can negatively affect investors by making it slower and less efficient to execute their option orders. It is the Commission's view that the Exchange, when increasing the maximum size orders that can be sent through AUTO-EX, should not disadvantage all customers—the vast majority of which enter orders for less than seventy-five contracts—by making the AUTO-EX system less reliable.

Finally, the Commission finds good cause for approving Amendment Nos. 1 and 2 prior to the 30th day after notice of the Amendment is published in the **Federal Register** pursuant to section 19(b)(2) of the Act.<sup>12</sup> Amendment No. 1 codifies the proposed increase in the AUTO-EX parameters from fifty contracts to seventy-five option contracts. Amendment No. 2 corrects the rule language in Amex Rule 933, Commentary .02. The Commission finds that accelerated approval of Amendment Nos. 1 and 2 is appropriate in order to allow the Amex to increase its AUTO-EX eligibility limits so that it may better compete with the other option exchanges.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1 and 2, including whether they are 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 Amex. All submissions should refer to File No. SR-Amex-99-45 and should be submitted by December 6, 2000.

#### Conclusion

For the foregoing reasons, the Commission finds that the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, with section 6(b)(5).<sup>13</sup>

*It is Therefore Ordered*, pursuant to section 19(b)(2) of the Act,<sup>14</sup> that the proposed rule change (SR-Amex-99-45) is approved, and Amendment Nos. 1 and 2 are approved on an accelerated basis.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>15</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43525 File No. SR-BSE-98-11]

#### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to an Amendment to the Proposed Rule Change by the Boston Stock Exchange, Inc. Relating to Its Competing Specialist Initiative

November 7, 2000.

#### I. Introduction

On November 23, 1998, the Boston Stock Exchange, Inc. ("BSE" 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 modify the procedures by which a regular specialist may object to competition in a stock.

The proposed rule change was published for comment in the **Federal Register** on January 12, 1999.<sup>3</sup> The Commission received no comments on the proposal. The Exchange filed amendments on March 26, 1999<sup>4</sup> and

April 13, 2000.<sup>5</sup> The Exchange filed a third amendment to the proposed rule change on August 25, 2000, which superseded the earlier amendments.<sup>6</sup> This order approves the proposed rule change, and grants accelerated approval to the third amendment to the proposed rule change.

#### II. Description

The Exchange's Competing Specialist Initiative permits multiple specialists to make a market in individual securities traded on the BSE. The Exchange has proposed a rule change to modify the process that governs objections to competition in a security.

The Procedures for Competing Specialists, which are set forth in chapter XV, section 18 of the Exchange's Rules, currently provide that a regular specialist in a security may object to any application by another specialist to act as a competing specialist in that security. The Exchange's Market Performance Committee will consider the regular specialist's objections as one factor in reviewing applications to act as a competing specialist in a security. The Market Performance Committee may not deny applications based solely on such an objection, but only in circumstances wherein the stock at issue requires special treatment such that an entering competitor could jeopardize the fair and orderly market maintained by the regular specialist.<sup>7</sup>

No. 1 proposed to eliminate the right to appeal rulings by the Market Performance Committee regarding applications to serve as a competing specialist.

<sup>5</sup> See Letter from William Cummings, Manager of Legal and Regulatory Affairs, BSE, to Nancy Sanow, Senior Special Counsel, Division, Commission, dated April 12, 2000, with attachments ("Amendment No. 2"). Amendment No. 2 superseded Amendment No. 1. Amendment No. 2 generally sought to revert the proposed rule change back to a form that was similar to the version that the BSE originally proposed, but which differed from the BSE's original proposal in a few ways: by clarifying that an applicant competing specialist could appear before the Market Performance Committee to respond to issues raised by the regular specialist regarding competition, by omitting language which provided that competition could begin during an appeal of a Market Performance Committee ruling in favor of competition, and by making other changes regarding the appeal process.

<sup>6</sup> See Letter from John Boese, Assistant Vice President, BSE, to Nancy Sanow, Assistant Director, Division, Commission dated August 24, 2000, with attachments ("Amendment No. 3"). Amendment No. 3, which superseded Amendment No. 2, clarified that competition could begin pending the outcome of an appeal of a pro-competition ruling by the Market Performance Committee, which is consistent with the rule change as it was originally proposed by the BSE.

<sup>7</sup> See Securities Exchange Act Release No. 37045 (March 29, 1996), 61 FR 15318 (April 5, 1996) (order permanently approving Competing Specialist Initiative).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> 15 U.S.C. 78s(b)(2).

<sup>15</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. 40883 (January 5, 1999), 64 FR 1839 (January 12, 1999).

<sup>4</sup> See Letter from Karen Aluise, Vice President, BSE, to Richard Strasser, Assistant Director, Division of Market Regulation ("Division"), Commission, dated March 25, 1999, with attachments ("Amendment No. 1"). Amendment

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

As presently written, section 18(2) requires the regular specialist to object in writing within 48 hours of notice of another specialist's application to compete in a stock. This section also states that the Market Performance Committee's decision may be appealed to the Executive Committee of the Exchange. Moreover, decisions of the Executive Committee may be appealed to the Board of Governors of the Exchange.<sup>8</sup> Competition may not begin during the appeal process.<sup>9</sup>

The Exchange is proposing to amend its existing rules that govern a regular specialist's ability to object to another specialist's application to serve as a competing specialist in a security. As amended, the proposal would divide section 18(2) into four parts (a to d). Proposed section 18(2)(a) would continue to require that a regular specialist file its objection within 48 hours after receiving notice of the request to compete, and would now require that the specialist submit the objection on a form designated by the Exchange.

Proposed section 18(2)(b) would require that when a specialist objects to competition, the specialist set forth the reasons in writing and deliver them to the Exchange within 24 hours of the filing of the objection.

Proposed section 18(2)(c) would provide that a Market Performance Committee meeting will be scheduled to review the reasons for objection and to determine whether competition could jeopardize the regular specialist's ability to maintain a fair and orderly market in the issue. That section adds that the regular specialist would be permitted to appear before that committee to discuss the reasons for objection, and that the applicant competing specialist would also be permitted to appear before that committee to respond to any issues raised. That section further states that after the committee renders its decision, either party may appeal the decision to the Exchange's Executive Committee, and, if necessary, to the Exchange's Board of Governors. A footnote to proposed section 18(2)(c) further would provide that the appeal must be submitted to the Exchange within 10 days notice of the Market Performance Committee's or the Executive Committee's final decision.

<sup>8</sup> See BSE Constitution, Art. II, Section 6, which provides that certain persons affected by a decision of a committee acting under powers delegated by the Board of Governors may require that the Board review the decision.

<sup>9</sup> The Exchange's existing procedures for handling objections to competition were clarified during a conversation between Karen Aluise, Vice President, BSE, and Joshua Kans, Attorney, Division, Commission, December 2, 1998.

Proposed section 18(2)(d) would provide that if the Market Performance Committee rules in favor of competition, competition will commence pending the outcome of any appeal process.

### III. Discussion

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>10</sup> Specifically, the Commission believes that the proposal is consistent with the section 6(b)(5)<sup>11</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, 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.

The Commission believes that the proposed rule change is appropriate because it permits the Exchange to evaluate applications to serve as a competing specialist in a security more efficiently. In particular, the Commission believes that proposed chapter XV, sections 18(2)(a), (b) and (c)—which would require the regular specialist to submit objections using an Exchange-designated form and set forth the reasons for objection in writing within 24 hours of the objection, and which would permit the regular specialist and applicant competing specialist to discuss those reasons at a Market Performance Committee meeting scheduled to review the reasons for the objection—would streamline the process for evaluating a regular specialist's objections while paying due regard to the interests of the regular specialist and applicant competing specialist. The Commission also believes that proposed Section 18(2)(d), which would provide that competition will commence during the appeal process, provides a reasonable means of reconciling the interests of the Exchange, the regular specialist, and the applicant competing specialist.

The Commission finds good cause for approving Amendment No. 3 prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. Amendment No. 3, which supplanted two earlier proposed amendments, most significantly modified the Exchange's original language by clarifying that an applicant competing specialist has the right to appear before the Market Performance

Committee to respond to issues raised by the regular specialist. The Commission finds that clarifying this right will better enable the committee to make fully informed decisions and will promote the adequate representation of applicant competing specialists. Amendment No. 3 also modified the rule change as it was originally proposed by specifying that appeals of decisions by the Market Performance Committee would go first to the Executive Committee and then, if necessary, to the Board of Governors (in contrast to the original version of the proposed rule change, which would have provided that appeals go directly to the Board of Governors), and by making technical changes to the structure and language of the proposed rule change. The Commission finds that modifying the appeal process is consistent with the Exchange's right to set forth rules governing its own administration, and that the technical changes to the rule language do not change the substance of the proposed rule change. Based on the above, the Commission believes that good cause exists, consistent with sections 6(b)(5) and 19(b)(2)<sup>12</sup> of the Act, to accelerate approval of Amendment No. 3.

### IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 3, including whether it 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 Exchange. All submissions should refer to File No. SR-BSE-98-11 and should be submitted by December 6, 2000.

### V. Conclusion

*It Is Therefore Ordered*, pursuant to section 19(b)(2) of the Act, that the proposed rule change SR-BSE-98-11,

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

<sup>11</sup> 15 U.S.C. 78f(b)(5).

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

including Amendment No. 3, in approved.

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. 34-43517; File No. SR-CBOE-99-51]

### Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 by the Chicago Board Options Exchange, Inc. Relating to the Maximum Size of Option Orders Eligible for Automatic Execution

November 3, 2000.

#### I. Introduction

On September 1, 1999, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "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 amending its rules regarding the automatic execution of options orders to increase the maximum number of contracts eligible to be executed on the Exchange's Retail Automatic Execution System ("RAES") from fifty contracts to seventy-five contracts. Notice of the proposal was published in the **Federal Register** on June 21, 2000.<sup>3</sup> The Commission received no comments on the proposal. On October 3, 2000, the Exchange submitted Amendment No. 1 to the proposal.<sup>4</sup> This order approves the proposal and grants accelerated approval of Amendment No. 1.

#### II. Description of the Proposal

RAES automatically executes public customer market and marketable limit orders that fall within designated order size parameters. Generally, the maximum size of public customer market and marketable limit orders

eligible for automatic execution through the RAES is fifty contracts.<sup>5</sup> The Exchange proposes to increase from fifty contracts to seventy-five contracts the maximum size of orders for equity options and certain classes of index options that are eligible to be executed through RAES.<sup>6</sup> In addition, the Exchange seeks to make certain complementary changes to the Exchange's firm quote rule and Interpretation .03 thereunder.<sup>7</sup>

The Exchange notes that increasing the maximum size of orders eligible for execution through RAES to seventy-five contracts will not permit orders up to this size to be entered into RAES unless, for a particular options class, the appropriate Floor Procedure Committee ("FPC") of the Exchange has determined, in its discretion, not to restrict the size of eligible orders in that options class.<sup>8</sup> In addition, the Exchange represents that increasing automatic execution levels should provide the benefits of automatic execution to a larger number of customer orders. Further, the Exchange represents that RAES affords prompt and efficient executions at the CBOE displayed price or, in most cases, at the National Best Bid or Offer ("NBBO") if the NBBO is better than the CBOE's displayed bid or offer.<sup>9</sup>

The Exchange notes that its rules contain several safeguards to ensure the proper handling of RAES orders, even as the maximum order size is increased. First, the Commission has approved the implementation of variable RAES on the CBOE.<sup>10</sup> Variable RAES allows market makers to specify the maximum size of orders that they are willing to trade at any one time on RAES; however, this determination is subject to a minimum size that may be established by the appropriate FPC. Variable RAES was proposed to ensure that market makers are willing to continue participating on RAES even as the maximum contract

size is increased. The Exchange represents that the appropriate FPC will likely implement Variable RAES in any options class that has a contract limit of seventy-five contracts to ensure that there is adequate market-maker participation in that class.

Second, the Exchange requires Designated Primary Market-Makers ("DPMs") to participate in any automated execution system which may be open in appointed option classes.<sup>11</sup> Further, Interpretation .07 to CBOE Rule 8.7 states that market makers are expected to participate in and support Exchange-sponsored automated programs, including but not limited to, RAES. The Exchange is in the process of assigning a large percentage of its option classes that were formerly traded in market-maker crowds to DPMs.<sup>12</sup>

Third, the Exchange's rules allow for RAES to be suspended when a fast market has been declared in order to maintain a fair and orderly market.<sup>13</sup> CBOE Rule 6.6(b)(vi) provides the Exchange with the flexibility to intervene if it determines that there is inadequate market maker participation or capital requirements. In addition, CBOE Rule 8.16(b) requires a market maker who has logged onto RAES at any time during an expiration month to log onto RAES in that option class whenever he is present in the trading crowd until the next expiration. Further, CBOE Rule 8.16(c) provides that Floor Officials of the appropriate Market Performance Committee may require market makers who are members of the trading crowd to log on to RAES absent reasonable justification or excuse for nonparticipation if there is inadequate participation on RAES. Alternatively, the Floor Officials may allow market makers in other classes of options to log on to RAES in such classes.

Finally, the Exchange notes that its rules provide a minimum net capital requirement regarding DPMs, which is currently set forth in CBOE Rule 8.86. Further, the clearing firms for market makers and DPMs perform risk management functions to ensure that the market makers have sufficient financial resources to cover their positions throughout the day.

In addition to increasing the maximum size for RAES-eligible orders in certain classes of options, the Exchange proposes to amend its firm quote rule, CBOE Rule 8.51. Currently,

<sup>11</sup> See CBOE Rule 8.85(a)(9).

<sup>12</sup> All equity options have now been assigned to DPMs. Telephone conversation between Timothy Thompson, Director-Regulatory Affairs, CBOE, and Gordon Fuller, Special Counsel, Commission, on March 9, 2000.

<sup>13</sup> See CBOE Rule 6.6(b)(vi).

<sup>5</sup> Options subject to the fifty contract maximum include all classes of equity options, all classes of sector index options and all other classes of index options, except options on the S&P 500 Index, options on the Nasdaq 100 Index, options on the Dow Jones Industrial Average ("DJIA"), options on the High Yield Select Ten, and interest rate options. The RAES eligibility maximum is currently 100 contracts for options on the S&P 500 Index, the Nasdaq 100 Index, the DJIA, the High Yield Select Ten, and interest rate options. See Securities Exchange Act Release No. 41821 (September 1, 1999), 64 FR 50313 (September 16, 1999).

<sup>6</sup> The proposed increase to seventy-five contracts will not apply to those classes of index options cited in footnote 5 above.

<sup>7</sup> See CBOE Rule 8.51.

<sup>8</sup> See CBOE Rule 6.8(e).

<sup>9</sup> See CBOE Rule 6.8, Interpretation .02.

<sup>10</sup> See *supra* note 5 (citing to the order implementing Variable RAES on the CBOE).

<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>3</sup> See Securities Exchange Act Release No. 42930 (June 13, 2000), 65 FR 38618 (June 21, 2000).

<sup>4</sup> See letter from Timothy Thompson, Assistant General Counsel, Legal Department, CBOE, to Gordon Fuller, Special Counsel, Division of Market Regulation, Commission, dated September 29, 2000. ("Amendment No. 1").