

change was published for comment in the **Federal Register** on September 30, 2002.<sup>3</sup> No comments were received on the proposed rule change.

The Commission originally approved the rule governing the Trigger system in 2001.<sup>4</sup> Trigger allows orders resting in the limit order book to be automatically executed, at their limit prices, in the limited situation where the bid or offer for a series of options generated by the Exchange's AutoQuote system (or any Exchange approved proprietary quote generation system used in lieu of the Exchange's AutoQuote system) crosses or locks the Exchange's best bid or offer for that series as established by a booked order. Such orders are executed against market makers participating in the Exchange's Retail Automated Execution System ("RAES").<sup>5</sup>

In general, where Trigger has been activated, when the quote generated by Autoquote either touches or crosses an order in the book, the booked order is automatically executed up to the maximum number of contracts permitted to be entered into RAES. The applicable RAES contract limit is set by the appropriate Floor Procedure Committee ("FPC"), but may not be more than 100 contracts.<sup>6</sup> When the number of contracts in the book is greater than the applicable RAES contract limit, the trading crowd will manually execute the remainder. In the limited circumstance where contracts remain in the book after a Trigger execution and a disseminated quote remains locked or crossed, orders in RAES for options of that series are "kicked-out" of RAES, and immediately and automatically routed to the Public Automated Routing ("PAR") terminal (absent contrary instructions of the firm) for manual execution. Because these orders remain RAES eligible, they will be entitled to receive firm quote treatment when represented in the crowd.<sup>7</sup>

After the Trigger rules were approved, CBOE proposed, and the Commission approved, rule changes to permit the implementation of an options quotation with size system with an automatic decrementation feature ("Dynamic

Quotes with Size").<sup>8</sup> Where this new system has been implemented, it has permitted the Exchange to raise the maximum eligible size for RAES orders from 100 contracts to the size disseminated by the Dynamic Quotes with Size system. The Exchange represents that in some cases, the RAES-eligible order size has been raised up to 250 contracts. The Exchange further asserts that, because the Trigger rules are tied to the RAES eligible order size, the size of booked orders that Trigger removes is now much larger than was contemplated when Trigger was first implemented in 2001.

Therefore, the Exchange proposes to amend the Trigger rule to provide that the Trigger system will automatically remove orders in the Exchange's limit order book up to the "Trigger Volume" amount. This amount could be lower than, but could not exceed, the RAES-eligible size for the particular series of options. The appropriate Floor Procedure Committee ("FPC") would be responsible for setting the Trigger Volume for a particular series of options.

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>9</sup> In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market, and to protect investors and the public interest.

The Commission believes that allowing the Trigger Volume to be set at a size up to, but not more than, the RAES-eligible order size for the particular series of options will not adversely affect the execution price of the booked orders because whether removed by Trigger or executed manually in the trading crowd, these orders may only be executed at their limit prices. The Commission points out that the proposed rule change does not alter CBOE members' duty to comply

with the Commission's rule relating to the firmness of quotations.<sup>11</sup>

Additionally, the Commission approves the amended Trigger rule to provide that the appropriate FPC shall be responsible for setting the Trigger Volume for a particular series of options. Currently, the Trigger rule provides only that the appropriate FPC has the authority to determine those classes of options that are eligible for Trigger. The Commission believes that it is appropriate to set forth in the rule that the appropriate FPC also has the authority to set the maximum number of contracts eligible for Trigger, not to exceed the maximum size of RAES-eligible orders.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (File No. SR-CBOE-2002-46) be, and it hereby is, 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. 34-47068; File No. SR-CHX-2002-37]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Stock Exchange, Incorporated Relating to Execution of Limit Orders Following Primary Market Block-Size Trade-Through

December 20, 2002

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 December 11, 2002, the Chicago Stock Exchange, Incorporated ("CHX" or "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(6)<sup>4</sup> thereunder,

<sup>3</sup> See Securities Exchange Act Release No. 46519 (September 20, 2002), 67 FR 61358 (September 30, 2002).

<sup>4</sup> See Securities Exchange Act Release No. 44462 (June 21, 2001), 66 FR 34495 (June 28, 2001). See also Securities Exchange Act Release No. 45992 (May 29, 2002), 67 FR 38530 (June 4, 2002) (approving SR-CBOE-2002-12).

<sup>5</sup> CBOE Rule 6.8(d).

<sup>6</sup> CBOE Rule 6.8(c)(v).

<sup>7</sup> CBOE Rule 6.8(d)(v); see Securities Exchange Act Release No. 44462 (June 21, 2002), 66 FR 34495 (June 28, 2002) (approving implementation of Trigger system).

<sup>8</sup> See Securities Exchange Act Release No. 45676 (March 29, 2002), 67 FR 16478 (April 5, 2002) (approval); Securities Exchange Act Release No. 45490 (March 1, 2002), 67 FR 10778 (March 8, 2002) (proposal).

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

<sup>10</sup> 15 U.S.C. 78f(b)(5).

<sup>11</sup> 17 CFR 240.11Ac1-1.

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

<sup>13</sup> 17 CFR 200.30-3(a)(12).

<sup>14</sup> 15 U.S.C. 78s(b)(1).

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend certain provisions of CHX Article XX, Rule 37(a)(3), which governs, among other things, execution of limit orders in a CHX specialist's book following a trade-through in the primary market. Specifically, the CHX seeks to add a provision that would permit, but not require, a CHX specialist to enable a functionality that would automatically execute designated limit orders represented in the specialist's quotation, following a "block size"<sup>5</sup> trade-through in the primary market, at the block price instead of the limit price. The text of the proposed rule change is available at the Commission and at the CHX.

### **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 CHX included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received regarding the proposal. The text of these statements may be examined at the places specified in Item IV below. The CHX 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 proposed rule change would permit a CHX specialist to enable a functionality that would automatically execute designated limit orders represented in the specialist's quotation, following a "block size" trade-through in the primary market, at the block price instead of the limit price.

Under existing Exchange rules relating to listed securities, whenever a block trade in the primary market trades through a specialist's quote, the specialist must execute all limit orders in the book (that are priced at the block price or better) at the better block price, rather than at their less-favorable limit

prices.<sup>6</sup> This requirement protects resting customer limit orders against large trade-throughs in the primary market.

At the time a trade-through occurs, however, it is impossible to determine whether it qualifies as a "block trade."<sup>7</sup> For that reason, the Exchange's systems have been designed to automatically execute resting customer limit orders at their limit prices; CHX specialists must later correct those prices to the better block price, if they have determined that a block trade occurred.

This practice of correcting execution prices, even when it results in a better execution for the customer, is a large inconvenience to some key CHX order-sending firms. These electronically sophisticated firms must send out two trade confirmations to each customer—one that is generated as soon as the trade occurs and a second to reflect the corrected execution price.

To accommodate CHX order-sending firms, the proposed rule change would permit, but not require, a CHX specialist to enable a functionality that would automatically execute designated limit orders when a block-size trade-through occurs in the primary market *at the block price*. We anticipate that the use of this functionality will result in a dramatic reduction of price corrections and, thus, will provide better customer service to some of the Exchange's key order-sending firms.

In addition to adding the optional functionality detailed above, the proposed rule change would relocate the existing provision currently located in Article XX, Rule 7.06 to Article XX, Rule 37(a)(3) of the CHX Rules, which governs execution of limit orders in a CHX specialist's book when certain conditions occur in the primary market. It is important to note that the proposed rule change does not seek to modify a CHX specialist's execution obligations whatsoever. Rather, it represents the Exchange's attempt to address the concerns of its order-sending firms by providing CHX specialists with a functionality that they can utilize to

meet their obligations automatically, instead of by means of the manual price correction procedure currently used. Moreover, the proposed functionality would only permit a CHX specialist to designate an order for automatic execution based on objective criteria such as the size of the order. For this reason, as set forth below, the Exchange believes that immediate effectiveness of the rule change is amply warranted.

The Exchange intends to allow its specialists to begin using this new functionality floor-wide on January 2, 2003; a pilot version of the functionality likely will be tested in a limited number of issues beginning the week of December 16, 2002.

##### **2. Statutory Basis**

The CHX believes the proposal is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange, and, in particular, with the requirements of Section 6(b).<sup>8</sup> The CHX believes the proposal is consistent with Section 6(b)(5) of the Act<sup>9</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments, and 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.

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

The Exchange does not believe that the proposed rule change will impose any inappropriate burden on competition.

#### **C. Self-Regulatory Organization's Statement on Comments Regarding the Proposed Rule Change Received From Members, Participants or Others**

Written comments were neither solicited nor received.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>10</sup> and Rule 19b-4(f)(6)<sup>11</sup> thereunder because the proposal: (1) Does not significantly affect the protection of investors or the public interest; (2) does not impose any significant burden on competition; and (3) does not become operative for 30 days from the date of filing, or such shorter time as the Commission may

<sup>5</sup> A "block size trade" means a trade that involves 10,000 or more shares of a Dual Trading System (i.e., listed) issue, or having a market value of \$200,000 or more.

<sup>6</sup> See CHX Article XX, Rule 7.06.

<sup>7</sup> A block trade is a trade that involves (a) a trade of "block size" (10,000 shares or more, or with a market value of \$200,000 or more); and (b) either (i) a cross of block size (where a single firm represents all of one side of the transaction and all or a portion of the other side) or (ii) any other transaction where a single firm represents an order of block size on only one side of the transaction, so long as the transaction does not occur at the Exchange's current bid or offer. At the time a transaction occurs on another market, the CHX can determine whether it is a *block size trade*; the CHX does not yet know, however, which firms were on which sides of the transaction and therefore cannot determine whether it meets the other requirements of a *block trade*.

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

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>11</sup> 17 CFR 240.19b-4(f)(6).

designate if consistent with the protection of investors and the public interest; provided that the Exchange has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the filing date of the proposed rule change. At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate, in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

The Exchange has requested that the Commission accelerate the operative date. The Commission believes waiving the 30-day operative delay is consistent with the protection of investors and the public interest.<sup>12</sup> The Commission believes that acceleration of the operative date will allow the Exchange to implement this new automatic functionality floor-wide on January 2, 2002 and to permit a pilot version of the functionality to be tested beginning the week of December 16, 2002. For these reasons, the Commission designates this proposal as both effective and operative upon filing with the Commission.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposal 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 CHX. All submissions should refer to File No. SR-CHX-2002-37 and should be submitted by January 21, 2003.

<sup>12</sup> For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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. 34-47075; File No. SR-ISE-2002-29]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by International Securities Exchange, Inc., Relating to Fee Changes

December 20, 2002.

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 16, 2002, the International Securities Exchange, Inc. ("Exchange" or "ISE") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the self-regulatory organization. On December 20, 2002, the Exchange submitted Amendment No. 1 to the proposal.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange is proposing to establish a \$.10 surcharge for non-Public Customer transactions in options on certain exchange traded funds ("ETFs") based on indexes developed by the Frank Russell Company ("Russell").

<sup>13</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See letter from Michael J. Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission, dated December 20, 2002 ("Amendment No. 1"). In Amendment No. 1, the Exchange amended the schedule of fees to list the specific ETFs based on indexes developed by the Frank Russell Company that ISE either has listed or have been allocated to a Primary Market Maker and will soon be listed for trading. The Exchange also clarified the fee schedule by stating that public customer orders are exempted from the proposed fee. The Commission notes that this is consistent with the manner in which the fee has been imposed with respect to options on the Nasdaq 100 Index Tracking Stock and the Nasdaq Biotechnology Index, and represents only a change in terminology.

#### 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 has entered into a license agreement to use various indexes and trademarks of Russell in connection with the listing and trading of options on certain ETFs based on Russell indexes. The purpose of this proposed rule change is to adopt a fee for trading in five of these options that the ISE either has listed or have been allocated to a Primary Market Maker and will soon be listed for trading.<sup>4</sup> The ISE believes that charging the participants that trade in options on these instruments is the most equitable means of recovering the costs of the license. However, because competitive pressures in the industry have resulted in the waiver of all transaction fees for customer transactions, we do not propose to charge this additional fee with respect to customer transactions. Specifically, Public Customer Orders will be exempted from the proposed surcharge.<sup>5</sup>

This fee would be charged to the executing member of the ISE if the order is for the account of a broker-dealer. For example, if broker A has a Public Customer Order that broker A gives to broker B (an ISE electronic access member) to execute on the ISE, broker B will not be charged the proposed \$.10 fee. On the other hand, if broker A gives broker B (an ISE electronic access

<sup>4</sup> The proposed fee will apply to options on the following ETFs: Russell 2000 iShares, Russell 2000 Value iShares, Russell 2000 Growth iShares, Russell 1000 Growth iShares, and Russell 1000 Value iShares.

<sup>5</sup> Under ISE Rule 100, a Public Customer is a person that is not a broker or dealer in securities, and a Public Customer Order is an order for the account of a Public Customer. Accordingly the execution of orders for the account of a non-broker-dealer will not be subject to the proposed \$.10 fee. All other orders, i.e., orders for the account of a broker-dealer, will be subject to the proposed fee.