

The Exchanges represent that all of the options exchanges continue to work towards implementation of a permanent linkage, which likely will include contracting with a third party to build a linkage infrastructure. According to the Exchanges, because the implementation of a permanent linkage is expected to take a significant amount of time, the options exchanges have proposed implementing an "interim" linkage. An interim linkage would use the existing market infrastructure to route orders between market makers on the participating exchanges in a more efficient manner. The Exchanges propose that the interim linkage would be in effect on a pilot basis until January 31, 2002.<sup>7</sup>

The interim linkage would require the participating exchanges to open their automated customer execution systems, on a limited basis, to market maker orders. Specifically, market makers would be able to designate certain orders as "customer" orders, and thus, would receive automatic execution of those orders on participating exchanges.

The proposals would authorize the CBOE and the ISE to implement bilateral or multilateral interim arrangements with the other options exchanges to provide for equal access between market makers on the respective exchanges. The Exchanges represent that the initial arrangements would allow ISE Primary Market Makers ("PPMs"), CBOE Designated Primary Market Makers ("DPMs"), and their equivalents on the other exchanges,<sup>8</sup> when they are holding customer orders, to send orders reflecting the customer orders to another market for execution when such other market has a better quote. Such orders would be limited in size to the lesser of the size of the two markets' "firm" quotes for customer orders. The Exchanges expect that the interim linkage may expand to include limited access for pure principal orders, for orders of no more than 10 contracts.

Under the Exchanges' proposals, all interim linkage orders must be "immediate or cancel",<sup>9</sup> and a market maker can send a linkage order only when the other (receiving) market is displaying the best national bid or offer and the sending market is displaying an

inferior price. The Exchanges represent that this will allow a market maker to access the better price for its customer. In addition, if the interim linkage includes principal orders, it would allow market makers to attempt to "clear" another market displaying a superior quote. Further, the Exchanges represent that they will implement heightened surveillance procedures to help ensure that their market makers send only properly qualified orders through the interim linkage.

DPM and PMM participation in the interim linkage would be voluntary under the terms of the proposals. Only when a DPM or PMM and its equivalent on another exchange believe that this form of mutual access would be advantageous would the exchanges employ the interim linkage procedures. The Exchanges represent that the interim linkage will benefit investors and will provide useful experience that will help the Exchanges in implementing the permanent linkage.

### III. Discussion

After careful review, the Commission finds that the CBOE and the ISE proposed rule changes are consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>10</sup> and, in particular, the requirements of Section 6 of the Act.<sup>11</sup> Among other provisions, Section 6(b)(5) of the Act requires that the rules of an exchange be designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating securities transactions; 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.

The Commission notes that developing and fully implementing a permanent intermarket linkage may take a significant amount of time. According to the Exchanges, the interim linkage will be introduced on a voluntary basis, to allow participating exchanges to route customer orders to an away market that is displaying the best available price in a multiply-traded options class. The Commission believes that this interim linkage should enable customers to benefit from the Exchanges' immediate ability to use their existing market infrastructure to route their orders between market

makers on the participating exchanges in a more efficient manner.<sup>12</sup>

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule changes (SR-CBOE-00-58 and SR-ISE-00-15) are approved, as amended, on a pilot basis until January 31, 2002.

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. 34-43908; File No. SR-CBOE-00-53]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to Permanent Approval of Live Ammo to RAES

January 30, 2001.

#### I. Introduction

On November 8, 2000, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to 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 to adopt the rule governing the execution of orders on the live ammo screen on a permanent basis. On December 11, 2000, the proposal was published in the **Federal Register**.<sup>3</sup> The Commission did not receive any comments on the proposed rule change. This order approves the proposed rule change.

#### II. Background

The CBOE originally proposed to amend its Rule 7.4, which governs the execution of orders by order book officials ("OBOs") or designated primary market makers' ("DPMs") book staff, to permit the electronic execution of certain orders on the live ammo screen, in June 1998 ("Original Proposal").<sup>4</sup> The Commission approved the Original Proposal on a pilot basis on

2000); 43573 (November 16, 2000), 65 FR 70851 (November 28, 2000); and 43574 (November 16, 2000), 65 FR 70850 (November 28, 2000).

<sup>7</sup> See *supra* note 3.

<sup>8</sup> Specialists on other exchanges would be permitted to use the interim linkage after filing appropriate rules with the Commission and executing agreements with the participating exchanges.

<sup>9</sup> Thus, interim linkage orders could not be placed on an exchange's limit order book.

<sup>10</sup> The Commission has considered the proposed rules' 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> *Id.*

<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> Securities Exchange Act Release No. 43646 (November 30, 2000), 65 FR 77403.

<sup>4</sup> Securities Exchange Act Release No. 40283 (July 30, 1998), 63 FR 42085 (August 6, 1998).

February 2, 2000,<sup>5</sup> which was scheduled to expire on October 30, 2000. On October 26, 2000, the CBOE submitted a proposed rule change, pursuant to Section 19(b)(3)(A) of the Act,<sup>6</sup> to extend the pilot until December 15, 2000.<sup>7</sup> On December 7, 2000, the CBOE submitted a proposed rule change, pursuant to Section 19(b)(3)(A) of the Act,<sup>8</sup> to extend the pilot until January 31, 2001.<sup>9</sup>

In addition, on July 14, 2000, the CBOE submitted a related proposed rule change, pursuant to Section 19(b)(3)(A) of the Act,<sup>10</sup> to implement a systems change to its Order Routing System ("ORS") to provide for the automatic rerouting of cancel replace orders.<sup>11</sup>

### III. Description of the Proposal

The live ammo screen, which is an undisplayed portion of the CBOE's electronic customer limit order book, known as the Electronic Book or EBook, receives for further processing orders that are market orders or limit orders that improve the market. An order may be routed to the live ammo screen under a number of circumstances. First, market orders that are received through the Exchange's order shoe<sup>12</sup> that are manually booked are automatically routed to the live ammo screen. Second, limit orders that better the quote that are received through the order shoe and that are manually booked are automatically routed to the live ammo screen. Third, limit orders that better the quote and that are routed directly to the EBook when the routing parameters have been

set at "0" are automatically sent to the live ammo screen.<sup>13</sup> Finally, marketable limit orders that are electronically booked from a floor broker's PAR workstation are automatically routed to the live ammo screen.<sup>14</sup>

The Original Proposal, which CBOE proposes to implement on a permanent basis, permits OBOs or DPMs, as the case may be, to designate certain orders on the live ammo screen to be electronically executed against market makers standing in the crowd, *i.e.*, the live ammo to RAES feature of the live ammo screen.<sup>15</sup> The live ammo to RAES feature of the live ammo screen permits an OBO (or DPM) to send RAES-eligible orders on the live ammo screen to RAES for automatic execution.<sup>16</sup> The OBO (or DPM) may select all or any portion of the orders displayed on the live ammo page to be routed to RAES.<sup>17</sup> Selected RAES-eligible orders are routed based on time priority, pursuant to CBOE Rule 6.45. Orders that are not RAES-eligible must be manually represented in the crowd by the OBO (or DPM) or sent to the EBook, if book eligible.<sup>18</sup>

### IV. Discussion

After careful review, 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>19</sup> In particular, the Commission finds that the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act,<sup>20</sup> which provides, among other things, that the rules of an exchange be designed to promote just and equitable principals of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, and

processing information with respect to, and facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market, and in general to protect investors and the public interest.

The Commission continues to believe that the live ammo to RAES feature should help in providing timely executions of orders on the live ammo screens of the CBOE's EBook. In absence of this feature, an OBO (or DPM) will be again required to manually represent each order on the live ammo screen in the crowd. As discussed in the Original Order, during periods of high volume or volatility, the OBO (or DPM) may be unable to manually represent these live ammo orders in a timely fashion, which could result in investors' orders receiving inferior executions.<sup>21</sup> The live ammo to RAES feature enables an OBO (or DPM) to address live ammo orders and provide for their execution faster than would occur if each order had to be individually represented in the crowd by the OBO (or DPM). Thus, the Commission believes that it is in the public interest for the live ammo to RAES feature to be implemented on a permanent basis.

In the Original Order, the Commission expressed concern that the use of the live ammo screen may disadvantage customer orders. Specifically, the Commission stated that it expected the Exchange to make systems enhancements to ensure that a maximum number of customer orders in the CBOE system are matched against each other. The Commission continues to encourage the CBOE to develop systems enhancements to ensure that a maximum number of customer orders in the CBOE system are matched against one another. However, the Commission believes that, in the meantime, the live ammo to RAES feature should provide investors with enhanced executions and should be implemented on a permanent basis.

In addition, the Commission directed the Exchange to develop systems enhancements to ensure that when there are no opportunities for the matching of customer orders in the CBOE-system, RAES-eligible orders will be routed directly to RAES without the interim step of appearing first on the live ammo screen. In response to this directive, the Exchange proposed the ORS Modification, which will permit cancel

<sup>5</sup> Securities Exchange Act Release No. 42379, 65 FR 6665 (February 10, 2000) ("Original Order").

<sup>6</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>7</sup> Securities Exchange Act Release No. 43499 (October 31, 2000), 65 FR 67023 (November 8, 2000).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> Securities Exchange Act Release No. 43727 (December 14, 2000), 65 FR 80968 (December 22, 2000).

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

<sup>11</sup> Securities Exchange Act Release No. 43185 (August 21, 2000), 65 FR 51884 (August 25, 2000) ("ORES Modification"). The ORES Modification will permit the processing of a cancel replace order for an order residing on the EBook by routing the replace order through the ORS as a new order, after the cancel portion has been completed. The replace order, as with any new incoming order, may be eligible for execution in the Retail Automatic Execution system ("RAES"), crossing with other EBook orders through the Automated Book Priority system, routing directly to the EBook (automatically updating the quote if it improves the market), or routing to the Public Automated Routing ("PAR") terminal or Booth Automated Routing terminal for price improvement. According to the Exchange, the ORES Modification was implemented on January 24, 2001. Telephone call between Jamie Galvin, CBOE and Kelly Riley, Division of Market Regulation, SEC, on January 30, 2001.

<sup>12</sup> The order shoe is where orders are manually held, *i.e.* where paper order tickets are actually placed at the trading post.

<sup>13</sup> The "0" parameter is an order routing parameter that may be implemented under high volume situations to route all limit orders to the EBook.

<sup>14</sup> At the time of the Original Proposal, approximately 90 percent of orders routed to the live ammo screen were cancel replace orders. According to the CBOE, the ORS Modification should significantly reduce the amount of orders routed to the live ammo screen. See note 11, *supra*.

<sup>15</sup> Prior to the Original Proposal, an OBO or DPM, acting in his or her capacity as an OBO, represented in the trading crowd each order that resided on the live ammo screen.

<sup>16</sup> Orders selected for automatic execution must satisfy RAES requirements. Currently, RAES accepts market and marketable limit orders that meet the applicable size requirements.

<sup>17</sup> A live ammo screen page may contain up to sixteen orders.

<sup>18</sup> A "book all" button permits the OBO (or DPM) to send all book eligible orders on the live ammo screen to the EBook.

<sup>19</sup> In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>20</sup> 15 U.S.C. 78f(b)(5).

<sup>21</sup> See note 5, *supra*. In the Original Order, the Commission also noted that delayed execution of customer orders may implicate a broker-dealer's best execution responsibilities. See letter from Arthur Levitt, Chairman, SEC, to Michael Kelly, President, First Options of Chicago, Inc., dated April 13, 1999.

replace orders to be rerouted through the ORS without having to be sent to the live ammo screen. The Commission notes that, according to the Exchange, the majority of orders that were sent to the live ammo screen were cancel replace orders. Therefore, the Commission is encouraged by the new ORS Modification and its impact on the ability of customer orders to be routed directly through the ORS without having the interim step of first going to the live ammo screen. That having been said, however, the Commission urges the Exchange to continue to consider other systems modifications to address those orders that continue to be routed to the live ammo screen.

## V. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>22</sup> that the proposed rule change (SR-CBOE-00-53) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>23</sup>

**Margaret H. McFarland,**  
Deputy Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43906; File No. SR-NASD-01-10]

### Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Implementation of Decimal Pricing in the Nasdaq Market

January 30, 2001.

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 January 29, 2001, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary, the Nasdaq Stock Market, Inc. ("Nasdaq"), 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 Nasdaq. 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

Nasdaq proposes to adopt a mandatory conversion rule for the open fractional orders of Nasdaq securities commencing quotation and trading in decimals pursuant to the Decimals Implementation Plan For the Equities and Options Markets ("Implementation Plan" or "Plan"), which was submitted on July 24, 2000, to the Commission. Under the proposal, Nasdaq would mandate that all open orders priced in fractions in NASD member firms' systems on the evening before that security is to commence quoting in decimals be converted to appropriately rounded decimal values of no more than two places beyond the decimal point (to the penny). An NASD member firm would be free to accept, and retain in its internal systems, decimal based orders in those securities of any number of values beyond the decimal point that the firm chooses.<sup>3</sup> Nasdaq proposes to implement the conversion rule change commencing March 12, 2001, and thereafter, on each Nasdaq security as it converts from fractional to decimal pricing pursuant to the Plan. The text of the proposed rule change is below. Proposed new language is in italics.

\* \* \* \* \*

#### 3220. Adjustment of Open Orders

- (a) No Change.
- (1)-(3) No Change.
- (b) No Change.
- (c) No Change.
- (d) No Change.
- (e) No Change.
- (1)-(6) No Change.

*(f) Mandatory Open Order Conversion for Securities Commencing Decimal Pricing All open orders in Nasdaq securities priced in fractions remaining in a firm's internal system on the evening prior to, or received thereafter and prior to, the security's commencing decimal pricing pursuant to the Decimals Implementation Plan for the Equities and Options Markets shall be converted, no later than midnight on that evening prior to their first day of decimal pricing, as follows:*

*(1) Prior to the conversion, member firms should notify their customers and*

<sup>3</sup> Nasdaq notes that its systems will only accept and display quotations to two places beyond the decimal point (to the penny). Quotations submitted to Nasdaq that are not rounded to the penny will be rejected by Nasdaq systems. Similarly, Nasdaq's Automated Confirmation Transaction Service ("ACT") will accept prices in trade reports only to six places beyond the decimal point and Nasdaq's Trade Dissemination Service ("NTDS") will disseminate transaction information only to four places beyond the decimal point.

*inform them of the change to their open fractional order(s) as a result of the conversion to decimal pricing. Customers should be afforded the opportunity to take action if they do not wish to participate in the conversion. Customers not wishing to participate in the mandatory conversion should be allowed the opportunity to cancel their open order(s) prior to the evening of the conversion.*

*(2) No later than midnight on the evening prior to a security's first day of decimal pricing, all open orders priced in fractions that have not been canceled, including those with price qualifiers such as DNR and DNI, shall be converted as follows:*

- *The fractional price of all open Buy Orders (GTC, GTX, Buy Stop and Buy Stop Limits) will be converted to their decimal equivalent and then "rounded down" to the nearest \$0.01.*
- *The fractional price of all open Sell Orders (GTC, GTX, Sell Stop and Sell Stop Limits) will be converted to their decimal equivalent and then "rounded up" to the nearest \$0.01.*

*Example:*

*Buy 1000 MSFT 88<sup>1</sup>/<sub>16</sub> would convert to B 1000 MSFT 88.06 (<sup>1</sup>/<sub>16</sub> = 0.0625)*

*Sell 1000 MSFT 88<sup>1</sup>/<sub>16</sub> would convert to S 1000 MSFT 88.07*

*This rule is to be in effect only in preparation for the first day of decimal trading of the newly-converted security. After conversion, firms may accept orders of any number of spaces beyond the decimal point in the newly-converted security and submit them, after appropriate rounding (See NASD Rule 4613(a)(1)(D)), to Nasdaq for display.*

\* \* \* \* \*

### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, Nasdaq 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. Nasdaq has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

<sup>22</sup> 15 U.S.C. 78s(b)(2).

<sup>23</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.