

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58778; File No. SR-CBOE-2008-90]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change Related to Trades in Restricted Classes

On August 29, 2008, the Chicago Board Options Exchange, Incorporated ("CBOE" 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 amend CBOE Rules 6.25 and 24.16 (collectively, the "Obvious Error Rules") to permit the nullification of opening transactions that do not satisfy the requirement of CBOE Rule 5.4 (withdrawal of approval of underlying security) and to clarify certain provisions in CBOE Rule 5.4 and the Obvious Error Rules. The proposed rule change was published for comment in the **Federal Register** on September 13, 2008.<sup>3</sup> The Commission received no comment letters on the proposal. This order approves the proposed rule change.

The Exchange proposes to amend the Obvious Error Rules to permit the nullification of opening transactions in "restricted series" that do not satisfy the requirements of CBOE Rule 5.4.<sup>4</sup>

<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. 58460 (September 4, 2008), 73 FR 53060.

<sup>4</sup> In relevant part, CBOE Rule 5.4 provides that, whenever the Exchange determines that an underlying security previously approved for Exchange option transactions does not meet the then current requirements for continuance of such approval or for any other reason should no longer be approved, the Exchange will not open for trading any additional series of options of the class covering that underlying security and therefore two floor officials, in consultation with a designated senior executive officer of the Exchange, may prohibit any opening purchase transactions in series of options of that class previously opened (except that (i) opening transactions by Market-Makers executed to accommodate closing transactions of other market participants and (ii) opening transactions by CBOE member organizations to facilitate the closing transactions of public customers executed as crosses pursuant to and in accordance with paragraph (b) or (d) of CBOE Rule 6.74, *Crossing Orders*, may be permitted), to the extent it deems such action necessary or appropriate (such series are referred to herein and in the proposed new text in CBOE Rules 6.25 and 24.16 as "restricted series"); provided, however, that where exceptional circumstances have caused an underlying security not to comply with the Exchange's current approval maintenance requirements, regarding number of publicly held shares or publicly held principal amount, number of shareholders, trading volume or market price the

Currently, when the Exchange makes a determination that trading in a series is restricted pursuant to CBOE Rule 5.4, the Exchange notifies the membership of that determination through issuance of a regulatory circular. In addition, the Exchange's systems are programmed to automatically restrict the entry of electronic opening transactions. However, opening orders entered in open outcry are not systemically prevented and, in addition, opening market-maker activity is still permitted both electronically and in open outcry. As a result, it is possible that an opening transaction that does not satisfy the requirements of CBOE Rule 5.4 may occur inadvertently. In order to address these scenarios, the Exchange proposes to permit the nullification of opening transactions in CBOE Rule 5.4 restricted series provided notification is received by designated personnel in the Exchange's control room from any member or person associated with a member that believes it participated in such transaction within the timeframes prescribed in CBOE Rules 6.25(b)(1) and 24.16(b)(1). In addition, absent unusual circumstances, designated personnel in the control room (either on their own motion or upon request of a member) would initiate action within sixty (60) minutes of such a transaction. Such actions would be reviewed and determinations rendered by the senior official in the control room. Any determinations rendered by the senior official would be subject to the same review procedures as determinations rendered by Trading Officials.

The Exchange also proposes to permit a member to initiate an Obvious Error Rule action by contacting either a Trading Official or designated personnel in the control room. Under the current rule, a member is only permitted to contact Trading Officials to initiate such action. Once either a Trading Official or a control room designee is contacted, all reviews and determinations will continue to be rendered by Trading Officials except that, as proposed herein, actions to nullify an opening trade in a restricted series will be reviewed and determinations rendered by the senior official in the control room.

Lastly, the Exchange proposes to clarify in the text of CBOE Rule 5.4 that the restrictions on opening transactions contained in the rule, as well as the related exceptions, apply to both opening purchases and opening sales in

restricted series. The Exchange notes that its intention is that the restrictions, and related exceptions, also apply to opening sales; however, the current rule text indicates that the restrictions are applicable only to opening purchase transactions. Proposed changes to the rule text make this clear.

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 and, in particular, the requirements of section 6(b) of the Act<sup>5</sup> and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with section 6(b)(5) of the Act,<sup>6</sup> in that the proposal is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission notes that, in approving proposals relating to adjustment or nullification of trades involving obvious errors, it has stated that the determination of whether an obvious error has occurred and the process for reviewing such a determination should be based on specific and objective criteria and subject to specific and objective procedures.<sup>7</sup> The Commission believes that the CBOE's proposal provides specific and objective criteria for determining when transactions in restricted classes should be nullified. Specifically, under the rule, opening transactions that do not satisfy the requirement of CBOE Rule 5.4 will be nullified. Market participants will be on notice that trading in a series is restricted pursuant to CBOE Rule 5.4 through a regulatory circular. The Commission also believes that other proposed changes to the Obvious Error Rules and Rule 5.4 are specific and objective.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-CBOE-2008-90) is hereby approved.

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

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

<sup>7</sup> See, e.g., Securities Exchange Release Nos. 54228 (July 27, 2006), 71 FR 44066 (August 3, 2006) (SR-CBOE-2006-14) (approving revisions to CBOE's Obvious Error Rule) and 48097 (June 26, 2003), 68 FR 39604 (July 2, 2003) (SR-CBOE-2003-10) (approving revisions to CBOE's Obvious Error Rule).

<sup>8</sup> 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

**Florence E. Harmon,**

*Acting Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-58757A; File No. SR-DTC-2008-12]

### Self-Regulatory Organizations; The Depository Trust Company; Notice of Filing of Proposed Rule Change as Amended To Increase Liquidity Resources

October 14, 2008.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),<sup>1</sup> notice is hereby given that on August 26, 2008, The Depository Trust Company ("DTC") filed with the Securities and Exchange Commission ("Commission") and on September 9, 2008 and on September 30, 2008, amended the proposed rule change as described in Items I, II, and III below, which items have been prepared primarily by DTC. The Commission is publishing this notice to solicit comments on the proposed rule change as amended from interested parties.

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

DTC is seeking to increase its liquidity resources to ensure that it has sufficient liquidity to cover the failure of a family of financially affiliated DTC participants.

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

In its filing with the Commission, DTC 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. DTC has prepared summaries, set forth in sections (A), (B), and (C) below, of the most significant aspects of these statements.<sup>2</sup>

#### (A) Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The proposed rule change seeks to increase the liquidity resources of DTC to ensure it has sufficient liquidity to cover the failure of a financial family of affiliated DTC Participants ("Affiliated Family").<sup>3</sup> An Affiliated Family means a Participant that controls another Participant or other Participants and each Participant that is under the control of the controlling Participant. For purposes of this definition, "control" means the direct or indirect ownership of more than 50% of the voting securities or other voting interests of any entity.<sup>4</sup>

To ensure that DTC is able to complete its settlement obligations each day in the event of a Participant's inability to settle with DTC, DTC currently maintains liquidity resources of \$2.5 billion composed of a \$600 million all-cash Participants Fund and a committed line of credit in the amount of \$1.9 billion with a consortium of banks. DTC's committed line of credit was recently increased from \$1.4 billion. Given that financial firms have become increasingly interdependent, DTC recognizes that there is a possibility of "contagion" among several related Participants. Financial problems at one Participant may impact the stability of another related Participant, potentially causing both to fail simultaneously. Because of concerns about this potential, DTC and its regulators have agreed that DTC should increase its available liquidity resources so that DTC would be able to withstand the failure of a financial family of affiliated DTC Participants.<sup>5</sup> In order to address these concerns, DTC is proposing to (i) increase by \$700 million the total cash deposits to DTC's all-cash Participants Fund, so that the aggregate amount of the required cash deposits to DTC's Participant Fund and the required preferred stock investments of Participants would be increased to \$1.3 billion from \$600 million and (ii) limit

<sup>3</sup> DTC currently has 332 Participants, most of which are broker-dealers or banks with one Participant account. Large integrated organizations, however, typically have several "legal entities" that each are DTC Participants (e.g., a bank custodian entity and a separate securities firm entity).

<sup>4</sup> Under this definition, DTC currently has 47 Affiliated Families.

<sup>5</sup> The Commission is the primary federal regulator of DTC as a clearing agency. DTC is also a limited purpose trust company established under New York Banking Law and a state member bank of the Federal Reserve System. As such, the The Federal Reserve Bank of New York (FRBNY) and the New York State Department of Banking have regulatory authority over DTC.

the aggregate maximum net debit cap<sup>6</sup> for any Affiliated Family to \$3 billion.

The following variables are currently used in the determination of each Participant's required Fund deposit:

(1) The six largest intra-day net debit peaks for a Participant over a rolling 60-business day period.

(2) Minimum Fund Deposit: \$10,000.

(3) Fund Size: \$600 Million.

DTC will continue to employ these variables to calculate the first \$600 million of the required \$1.3 billion Fund. The remaining \$700 million will be allocated proportionately among the Affiliated Families whose aggregate net debit caps per family exceed \$2.3 billion.<sup>7</sup> An Affiliated Family whose net debit cap exceeds \$2.3 billion would be required to contribute a portion of the remaining \$700 million calculated by dividing the amount by which the Affiliated Family's net debit cap exceeds \$2.3 billion by the sum of the amount by which each Affiliated Family's net debit cap exceeds \$2.3 billion.<sup>8</sup> Once an Affiliated Family's additional Participant's Fund requirement has been established, DTC will allocate this sum among the Participants comprising the Affiliated Family in proportion to each Participant's adjusted net debit cap.<sup>9</sup> This algorithm will be systematically used to calculate the allocations for the Participants of Affiliated Families, unless each of the Participants that comprise an Affiliated Family provides DTC with written instructions to allocate the aggregate net debit cap differently. While the Participants of an

<sup>6</sup> DTC ensures that timely settlement can be completed in the event of an inability to settle by a Participant with the largest settlement obligation, by setting limits (called net debit caps) for each Participant. A Participant's net debit is limited throughout the processing day to a net debit cap that is the lesser of four amounts: (1) An amount based on the average of the three largest net debits that the Participant incurred over a rolling 70 business day period, (2) an amount, if any, determined by the Participant's settling bank, (3) an amount, if any, determined by DTC, or (4) \$1.8 billion.

<sup>7</sup> In accordance with its current practice, DTC would continue to maintain a liquidity cushion of \$200 million between its largest net debit cap and its liquidity resources (i.e., DTC's current liquidity of \$2.5 billion minus the \$200 liquidity cushion it maintains).

<sup>8</sup> DTC will adjust the net debit caps of the Participants that comprise the Affiliated Families so that the aggregate affiliated net debit cap does not exceed \$3 billion. Currently 18 Affiliate Families consisting of 57 DTC Participants would be subject to these Affiliated Family provisions. Thirteen Affiliated Families would be required to reduce their overall Net debit cap.

<sup>9</sup> The proposed DTC Affiliated Family Algorithm can be viewed on the Commission's Web site at <http://www.sec.gov/rules/sro/dtc/2008/34-58757.pdf> and at DTC's Web site at [http://www.dtcc.com/downloads/legal/rule\\_filings/2008/dtc/2008-12.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2008/dtc/2008-12.pdf).

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

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

<sup>2</sup> The Commission has modified the text of the summaries prepared by DTC.