

to CBOE Rule 6.45 provides that the provisions of CBOE Rule 6.45 are subject to CBOE Rule 8.7, Interpretation and Policy .05, and CBOE Rule 8.51, which set forth market maker responsibilities and firm quote requirements.

The Commission further notes that the CBOE has made clear that a DPM that already has been allocated its DPM participation entitlement amount would not receive a share of the declined contracts unless the other market participants do not wish to participate in the declined contracts.¹¹ The Commission believes that this will help assure fair allocation of orders and maintain a competitive environment on the Exchange.

The Commission also finds reasonable CBOE's proposal to apportion equally among any other market participants in the trading crowd who bid at the best price in a reasonably prompt manner subsequent to the time the market was established, any contracts that remain in an order after giving effect to the priority rules described above.

IV. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (SR-CBOE-2002-08) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45936; File No. SR-CBOE-2002-10]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Allocation of Orders for Lead Market-Makers and Supplemental Market-Makers Logged On to the Exchange's Rapid Opening System

May 15, 2002.

I. Introduction

On February 15, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section

19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change relating to the allocation of orders for Lead Market-Makers ("LMMs") and Supplemental Market-Makers ("SMMs") logged on to the Exchange's Rapid Opening System ("ROS"). On March 15, 2002 and March 22, 2002, CBOE submitted Amendment Nos. 1 and 2, respectively, to the proposed rule change. The proposed rule change and Amendment Nos. 1 and 2 were published for comment in the **Federal Register** on April 2, 2002.³ The Commission received no comments on the proposed rule change. This order approves the proposed rule change.

II. Description of Proposal

CBOE is proposing changes to Interpretation and Policies .01 of CBOE Rule 6.2A ("Interpretation .01"), relating to the allocation of orders for LMMs and SMMs logged onto ROS.⁴ The proposed rule change was filed by the CBOE pursuant to subparagraph IV.B.j. of the Commission's Order of September 11, 2000, which requires that respondent options exchanges adopt new, or amend existing, rules to make express any practice or procedure "whereby market makers trading any particular option class determine by agreement * * * the allocation of orders in that option class."⁵

Currently, Interpretation .01 limits the use of ROS to LMMs and SMMs in S&P 100 ("OEX") Options. The proposed rule change would establish that ROS may be used by LMMs and SMMs appointed pursuant to CBOE Rule 8.15 to conduct rotations in any options class. The proposed rule change would also clarify that despite CBOE Rule 6.2A(b), which assigns ROS contracts to trade to participating market-makers, ROS contracts to trade will be assigned only to the LMMs and SMMs logged onto ROS in crowds to which LMMs and SMMs are appointed.

The proposed rule change would also permit the appropriate Floor Procedure Committee to establish a participation right for the LMM who determines the

formula for generating automatically updated market quotations during the trading day and provides the primary quote feed for an option class during the current expiration month. This participation right would apply only to ROS contracts to trade, and would be subject to the following conditions: (1) The LMM would receive this participation right only during the time it is actually providing the primary quote feed for an option class; and (2) the LMM must log onto ROS the minimum number of times established by the appropriate Floor Procedure Committee.

As part of the proposed rule change, the CBOE also submitted the draft text of a Regulatory Circular that would establish a specific entitlement formula for qualifying LMMs, and would be used by the appropriate Floor Procedure Committee to adopt the participation entitlement. The formula provides for participation entitlements that range from 34 percent to 40 percent for the LMM providing the primary quote feed, depending on the total number of appointed LMMs and SMMs in the option, when the number is three or more. If the number is two, each of the two will be assigned an equal portion of ROS contracts, and if there is only one, all ROS contracts to trade will be assigned to the appointed LMM or SMM.⁶

In explaining the purpose of the participation guarantee, the CBOE stated that it has introduced a vendor quote program in OEX to replace the Autoquote system. The vendor system accepts a quote stream from a firm's proprietary quote system and then sends this quote information to the Trading Support System to be disseminated as market quotes. The CBOE believes that the LMM that provides the primary quote feed for an option class during the current expiration cycle provides a valuable service that ensures that the quotes are being updated in timely fashion to reflect the current state of the market.

III. Discussion

After careful consideration, the Commission has determined to approve the proposed rule change.⁷ For the reasons discussed below, the Commission finds that the proposed

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 45640 (March 25, 2002), 67 FR 15644 (April 2, 2002) ("Notice").

⁴ ROS is the Exchange's automated system for opening classes of options at the beginning of the trading day or for re-opening classes of options during the trading day. See CBOE Rule 6.2A.

⁵ See Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000).

⁶ The Exchange has stated that changes to this Regulatory Circular, including changes to a participation entitlement formula, will be submitted to the Commission pursuant to Section 19(b) of the Exchange Act. See Notice.

⁷ In approving this proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹¹ See Notice, *supra* note 3, at n.8.

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).

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) of the Act.⁸

In the Commission's view, it is reasonable to expand the use of ROS to all options classes in which LMMs and SMMs conduct rotations. The Commission also believes that it is reasonable to assign ROS contracts to trade only to the LMMs and SMMs logged onto ROS in crowds in which LMMs and SMMs are appointed. The Commission notes that when Interpretation .01 was first adopted to permit the use of ROS under the LMM system (at the time, for OEX options), the CBOE stated that ROS was not meant to supplant the LMM system, which the Exchange believed had added accountability to openings, but to be used as a tool by the LMM to facilitate openings.⁹

The Commission further believes that it is reasonable to grant a participation entitlement to the LMMs who provide the primary quote feed for an option class during an option cycle is reasonable, in view of the service such LMMs provide. The Commission notes that the proposed entitlement would never be greater than 40 percent. The Commission has found with respect to participation guarantees in other contexts that 40 percent is not inconsistent with statutory standards of competition and free and open markets.¹⁰

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-CBOE-2002-10) be, and hereby is, approved.

⁸ 15 U.S.C. 78f(b)(5). Section 6(b)(5) requires that the rules of an exchange, among other things, 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 a national market system, and, in general, to protect investors and the public interest; and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

⁹ See Securities Exchange Act Release No. 4366 (December 4, 2000), 65 FR 77943 (December 13, 2000). The CBOE also stated at the time that "to the extent that market-makers want to participate in the opening of a series in which they do not hold LMM or SMM appointments, they will continue to be able to transmit written non-cancelable proprietary and market-makers orders to the LMM in the appropriate zone ten minutes prior to the opening of trading, pursuant to the terms of Interpretation .02 to CBOE Rule 24.13." *Id.*

¹⁰ See, e.g., Securities Exchange Act Release Nos. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) at 11398; and 43100 (July 31, 2000), 65 FR 48778 (August 9, 2000) at notes 96-99 and accompanying text.

¹¹ 15 U.S.C. 78s(b)(2).

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45933; File No. SR-NASD-2002-27]

Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Granting Approval to a Proposed Rule Change and Amendment No. 1 Thereto Amending NASD Rule 3070 Concerning the Reporting of Criminal Offenses by Members and Persons Associated With a Member to the NASD

May 15, 2002.

On February 21, 2002, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly owned subsidiary NASD Regulation, Inc. ("NASD Regulation"), filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to amend NASD Conduct Rule 3070 to limit reporting under this category to any felony, certain types of misdemeanors, and substantially equivalent activity in a domestic, foreign or military court. According to NASD Regulation, this proposed rule change would conform NASD Rule 3070(a)(5) to a proposed rule change by the New York Stock Exchange, Inc. ("NYSE") to amend NYSE Rule 351(a)(5).³ The proposed rule change was published for comment in the **Federal Register** on March 8, 2002.⁴ The Commission received one comment letter on the proposal,⁵ which supports the proposed rule change. On May 14, 2002, NASD Regulation filed Amendment No. 1 to the proposed rule change with the Commission.⁶ This

¹² 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 45869 (May 3, 2002), 67 FR 31398 (May 9, 2002) (approving SR-NYSE-2002-06).

⁴ See Securities Exchange Act Release No. 45493 (March 1, 2002), 67 FR 10783.

⁵ See letter to Jill M. Peterson, Assistant Secretary, Commission, from Selwyn J. Notelovitz, Senior Vice President, Global Compliance, Charles Schwab & Co., Inc., dated March 21, 2002 ("Schwab Letter").

⁶ See letter to Katherine England, Assistant Director, Division of Market Regulation, Commission, from Shirley Weiss, Associate General

order approves the proposed rule change, as amended.

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange⁷ and, in particular, the requirements of Section 15A of the Act⁸ and the rules and regulations thereunder. The Commission finds specifically that the proposed rule change is consistent with Section 15A(b)(6) of the Act⁹ because narrowing the scope of reportable criminal offenses that members and member organizations would be required to report to the NASD is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling and facilitating transactions in securities. In particular, by continuing to require that every felony be reported, but only the proposed misdemeanors, would in effect, minimize the number of immaterial filings and maximize the effective use of resources committed to fulfilling self-regulatory responsibilities at the Association. Moreover, the proposed rule change would continue to capture the reporting of arrests for which any subsequent conviction would subject the individual to a statutory disqualification under Section 3(a)(39) of the Act.¹⁰

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change and Amendment No. 1 thereto (File No. SR-NASD-2002-27) are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland,

Deputy Secretary.

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Counsel, NASD Regulation, dated May 14, 2002 ("Amendment No. 1"). In Amendment No. 1, NASD Regulation amended the proposed rule change to require that an arrest, arraignment, or conviction before a *military* court of any of the enumerated crimes be reported to the NASD. In addition, NASD Regulation added the conspiracy to commit any one of the enumerated misdemeanors under NASD Conduct Rule 3070(a)(5) to the list of crimes that must be reported to the NASD. This is a technical amendment and is not subject to notice and comment.

⁷ In approving this proposed rule change, the Commission notes that it has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78o-3.

⁹ 15 U.S.C. 78o-3(b)(6).

¹⁰ 15 U.S.C. 78c(a)(39).

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).