

equity. Further, the Exchange believes that public customers are unable to react as quickly as professional traders to significant news releases made prior to the close of options trading. The Exchange states that a change in the options trading close to 4:02 p.m. would limit the disruptive effect on Exchange products that these significant news announcements can create.

Accordingly, the Commission finds that a closing time of 4:02 p.m. for equity and narrow-based index options is a reasonable means to address the Exchange's desire to balance the need for some extended trading period with the need to prevent negative impact from issuers' major news announcements made while only the options markets remain open.

The Commission also finds that permitting a closing rotation in non-expiring options five minutes after news of such rotation is publicly disseminated is reasonable. The Exchange states that the change from a ten minute notice period to a five minute notice period will conform the Exchange's rule to the rules of the other exchanges, such as the Chicago Board Options Exchange, Inc. ("CBOE").⁸

It is contemplated that the Exchange will implement this rule change on or about June 23, 1997.⁹

The Commission finds good cause for approving Amendment No. 2 to the filing prior to the 30th day after the date of publication of the notice of the filing. Amendment No. 2 serves to conform the Exchange's proposal to other exchanges' rules. Accordingly, the Commission believes there is good cause, consistent with Sections 6(b)(5) and 19(b)(2) of the Act, to approve Amendment No. 2 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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-AMEX-96-45, and should be submitted by June 12, 1997.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 6 of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-Amex-96-45) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Jonathan G. Katz,

Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38543; File No. SR-CBOE-96-71]

Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Relating to the Establishment of a 3:02 p.m. Closing Time for Equity and Narrow-Based Index Options Trading

May 14, 1997.

I. Introduction

On October 25, 1996, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") a proposed rule change pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder.² On February 24, 1997, the Exchange filed an amendment to the rule proposal.³

¹⁰ 15 U.S.C. § 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).

¹ U.S.C. § 78s(b)(1).

² 17 CFR 240.19b-4.

³ Letter from Timothy Thompson, Senior Attorney, CBOE, to Janice Mitnick, Attorney, Division of Market Regulation, Commission, dated February 24, 1997 ("Amendment No. 1"). Amendment No. 1 describes the purpose for the proposed change to the required notice period, from

Notice of the substance of the proposed rule change was provided by issuance of a release⁴ and by publication in the **Federal Register**.⁵ No comments were received. This order approves the proposed rule change, as amended, and solicits comments on Amendment No. 1.

II. Description of the Proposal

The exchange proposes to amend Rule 6.1, Interpretation .01 and Rule 24.6 governing the hours of trading in equity options and narrow-based index options. Currently, the ten minute period for trading equity and narrow-based index options after the close of the underlying stocks allows options traders to respond to late reports of closing prices over the consolidated tape. The proposed rule change will result in the close of trading in equity and narrow-based index options at 3:02 p.m.⁶ instead of the existing close of 3:10 p.m.

The Exchange also proposes to amend its rules to provide for a five minute notice period before a trading rotation may begin after the close of trading. Currently, a ten minute notice must be given under CBOE Rule 6.2, Interpretation .02. The Exchange states that it is now able to send notice to its members of its intent to have a closing rotation almost instantaneously.⁷ The Exchange also proposes to amend its trading rotation rule, Interpretations .01 and .03 and Rule 6.2, to reflect the changes in the closing time from 3:10 p.m. to 3:02 p.m. for equity options and narrow-based index options.

Finally, the Exchange is proposing to amend Interpretation .01 to Rule 6.1 to make it clear that the Board may designate a person or persons to change the hours for the trading of options when unusual conditions exist. This change is consistent with the Exchange's current Rule 24.6.

II. 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, and in particular, Section 6(b)(5).⁸ Section 6(b)(5) requires, among other things, that the rules of an exchange be designed to promote just and equitable principles of trade, perfect

ten minutes to five, prior to the commencement of a trading rotation.

⁴ Securities Exchange Act Release No. 37988 (November 26, 1996).

⁵ 61 FR 64405 (December 4, 1996).

⁶ All time references are in Central Time.

⁷ See Amendment No. 1.

⁸ 15 U.S.C. § 78f(b)(5).

⁸ See SR-CBOE-96-71 (amending CBOE Rule 6.2, Interpretation .02 to permit a five minute notice period for closing rotations).

⁹ Phone conversation between Claire McGrath, Exchange and Janice Mitnick, Commission, on May 14, 1997.

the mechanism of a free and open national market, and in general, to further investor protection and the public interest.

The Commission believes that it is reasonable for the Exchange to amend its rules to close trading in equity and narrow-based index options at 3:02 p.m., versus the existing 3:10 p.m. close. Changing the closing time for these options to 3:02 p.m. preserves the Exchange's stated need to continue trading options for some period of time after the close of trading in the underlying securities. The Exchange has stated that this two minute extension from the close of the stock markets will allow options traders to respond to late reports of closing prices over the consolidated tape, thereby bringing options quotes into line with the closing price of the underlying security. Due to improvements in the processing and reporting of transactions, the Exchange believes that two minutes of options trading after the underlying equities close is sufficient to bring options quotes into line with the closing prices of the underlying securities.

In determining an appropriate closing time, the Exchange has also considered problems that might result when the Exchange remains open after the close of the primary exchange for the underlying stocks. The Exchange states that a number of issuers have adopted the practice of disseminating important corporate news after the close of trading on the primary equity exchange in order to minimize the short-term disruptive effect of the news on the market price of the stock by allowing investors the opportunity to digest the significance of the news after the markets have closed. These announcements, if made while options markets are still trading, impact narrow-based index options, as well as equity options, because a significant news announcement on one component of a narrow-based index may have substantial impact on that index. Despite the fact that most Exchange products trade until 3:10 p.m., important corporate news is often disseminated between 3:00 and 3:10 p.m. Consequently, the Exchange states that it is often deluged with option orders as a result of a significant news announcement after 3:00 p.m., most often made between 3:02 p.m. and 3:10 p.m. The Exchange has found that these orders have a disruptive effect on the options market at a time when the Exchange is attempting to close in a fair and orderly fashion.⁹ The Exchange also

states that as a result of these news announcements, orders are regularly routed through the Exchange's Retail Automatic Execution System ("RAES") and executed in rapid succession on markets that have not had a chance to be updated to reflect the significant news.¹⁰ The Exchange states that a change in the options trading close to 3:02 p.m. would limit the disruptive effect on Exchange products that these significant news announcements can create.

Accordingly, the Commission finds that a closing time of 3:02 p.m. for equity and narrow-based index options is a reasonable means to address the Exchange's desire to balance the need for some extended trading period with the need to prevent negative impact from issuers' major news announcements made while only the options markets remain open.

The Commission also believes that it is reasonable for the Exchange to amend its rules to provide for a five minute notice period before a trading rotation may begin after the close of trading. The Exchange states that it is now able to send notice to its members of its intent to have a closing rotation almost instantaneously. The Commission concurs with the Exchange that it is appropriate to reduce the notice period, permitting the Exchange to allow the establishment of closing prices in as timely a manner as possible. The Commission also finds that the change from a ten minute notice to a five minute notice is reasonable in light of the Exchange's goal of appropriately disseminating information of a trading rotation while establishing closing prices in a timely manner.

Finally, the Commission finds that it is reasonable for the Exchange to amend Rule 6, Interpretations and Policies .01 to conform to Rule 24.6 clarifying that

problems caused by news announcements after 3:00 p.m., this procedure requires the assessment of the situation by two Floor Officials. As a result, the Exchange believes that the Rule 6.6 procedure does not permit the Exchange to act quickly enough to prevent the possible deleterious effects of an unexpected news announcement.

¹⁰ Orders routed through the RAES system are assigned execution prices instantaneously as determined by the prevailing market quotes that exist at the time of the order's entry into the system. As a result, these orders might be assigned a price before the market-makers will have had the chance to update the quotes based upon the unexpected news announcement. To respond to the problem presented when issuers make significant news announcements during the ten minutes period after the close of trading in stocks, the Exchange filed a rule with the Commission which permits the Exchange to employ a system to suspend the operation of the RAES system in the event of news announcements near the close of trading. Securities Exchange Act Release No. 37885 (October 29, 1996), 61 FR 56724 (approving CBOE-96-55).

either the Board or its designee may change the hours of the trading of options when unusual conditions occur. The rule change will provide the Exchange with the necessary flexibility in order to respond to unusual market conditions.

It is contemplated that the Exchange will implement this rule change on or about June 23, 1997.¹¹

The Commission finds good cause for approving Amendment No. 1 to the filing prior to the 30th day after the date of publication of the notice of the filing. Amendment No. 1 merely serves to effect a clarification to the Exchange's proposal and does not materially affect the substance of the proposal.¹² Accordingly, the Commission believes there is good cause, consistent with Sections 6(b)(5) and 19(b)(2) of the Act, to approve Amendment No. 1 to the proposal on an accelerated basis.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. 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 CBOE. All submissions should refer to File No. SR-CBOE-96-71, and should be submitted by June 12, 1997.

V. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act, and, in particular, Section 6 of the Act.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹³ that the proposed rule change (SR-CBOE-96-71) is approved.

¹¹ Phone conversation between Timothy Thompson, Exchange and Janice Mitnick, Commission, May 14, 1997.

¹² See n.3, *supra*.

¹³ 15 U.S.C. § 78s(b)(2).

⁹ The Exchange notes that although it has the ability to call a "fast" market under current Exchange Rule 6.6 in an effort to deal with the

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁴

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-38637; File No. SR-CBOE-97-16]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to the Trading of Index FLEX Options

May 14, 1997.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"), 15 U.S.C. § 78s(b)(1), notice is hereby given that on March 13, 1997, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") 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 the self-regulatory organization. On May 14, 1997, CBOE submitted Amendment No. 1 ("Amendment No. 1") to the filing to clarify issues related to priority procedures applicable to FLEX options.¹ 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 CBOE proposes to make certain changes to its rules governing the trading of Index FLEX options. Specifically, those changes involve a reduction in the percentage of a trade to which a Submitting Member indicating an intent to cross is entitled and the establishment of bid-offer spreads for certain Index FLEX trades.

The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.

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 CBOE 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 CBOE 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

The purpose of the proposed rule change is to make certain changes to the Exchange's rules governing the trading of Index FLEX options. Specifically, those changes involve a reduction in the percentage of a trade to which a Submitting Member indicating an intent to cross is entitled and the establishment of bid-offer spreads for certain Index FLEX trades. Since their inception,² Index FLEX options have relied on Appointed Market-Makers ("AMMs") supplemented by Qualified Market-Makers ("QMMs) to provide liquidity for FLEX requests for quotes ("RFQs). AMMs are required, pursuant to Rule 24A.9(b), to enter a FLEX Quote in response to any RFQ on any FLEX Option of the class to which the AMM is appointed. A QMM may, but is not required to, enter a FLEX Quote in response to an RFQ.

As an inducement to attract volume that would otherwise be transacted in the over-the-counter market, the Exchange established percentage entitlements for the Exchange member that initiates FLEX bidding and offering by submitting an RFQ ("Submitting Member") where the Submitting Member has indicated an intention to cross or act as principal on the trade and has matched or improved the best bid or offer ("BBO"). Generally, with some qualifications, the Submitting Member is entitled to 50% (1/2) of the trade in the case where the Submitting Member matches the BBO and 66.67% (2/3) of the trade where the Submitting Member improves the BBO.

To the extent Submitting Members accept their entire entitlement on a trade, half of the trade or less would remain for the other market-makers to share. Through experience the Exchange has learned these entitlements have discouraged participation by market-makers in the Index FLEX product. The Exchange has, therefore, decided in order to encourage more active

participation by Exchange market-makers and to provide as liquid a market as possible for Index FLEX options, that the entitlement for Submitting Members should be reduced to the greater of 25% or a proportional share of the trade.³ This means, for example, that if there are four market-makers participating on the trade in addition to the Submitting member then the Submitting member would be entitled to 25% of the trade even though this is greater than a proportional share (1/5) of the trade. However, if there were two market-makers participating on a trade along with a Submitting Member, the Submitting Member would be entitled to a proportional share of the trade, or 1/3 of the trade. This is different from the current entitlement for Submitting Members in Equity FLEX Options who are entitled only to 25% of the trade regardless of the number of participants to the trade. Consequently, the rule will be revised to separate the treatment of Index FLEX and Equity FLEX into different paragraphs.

The proposed rule change also amends the language of subparagraphs (e)(iii) (A) and (B) of Rule 24A.5 to state that a submitting member "will have priority to execute" the specified share of a trade that is the subject of a RFQ, instead of the term "be permitted to execute." The Exchange initially adopted this rule language in Securities Exchange Act Release No. 37337 in order to clarify that a member may cross more than the designated share as to which he has priority if no one else is willing to trade at the same or a better price.⁴ The current filing, however, inadvertently utilized the old rule language. Amendment No. 1 to the filing clarifies that the rule language will remain unchanged.

The Exchange is also proposing to make a second change to its rules governing Index FLEX Options. This change would impose maximum bid-offer spreads on certain Index FLEX Options. Currently, under Rule 24A.9(d), market-makers are not required to quote a minimum bid-offer spread in FLEX Options because of the unique nature of the product in which new series are established periodically by the submission of an RFQ. Through experience with the trading of the

³ The rule currently provides that the Submitting Member is entitled to the largest of the percentage of the trade (1/2 or 2/3), \$1 million Underlying Equivalent Value, or the remaining Underlying Equivalent Value on a closing transaction valued at less than \$1 million. These qualifications of \$1 million Underlying Equivalent Value or the remaining Underlying Equivalent Value remain in the proposed rule.

⁴ See Securities Exchange Act Release No. 37337 (June 19, 1996), 61 FR 33561 (June 27, 1996).

¹⁴ 17 CFR 200.30-3(a)(12).

¹ See Letter from Timothy H. Thompson, Senior Attorney, CBOE, to Steve Youhn, SEC, dated May 13, 1997.

² The Exchange was approved for trading FLEX options on February 24, 1993. See Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993).