

6(c)(4),⁷ in particular, in that it is designed to increase or to remove any limitation on the number of memberships in the Exchange or the number of members or designated representatives of members permitted to effect transactions on the floor of the Exchange.

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

The Exchange does not believe that the proposed rule change will result in any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange did not solicit or receive written comments on the proposed rule change.

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

Within 35 days of the date of publication of this notice in the **Federal Register** or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) By order approve such proposed rule change, or

(B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 the filing will also be available for inspection and copying in the Commission's Public Reference Room. Copies of the filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to the File No. SR-Amex-00-36 and should be submitted by August 28, 2000.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁸

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43099; File No. SR-CBOE-99-35]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment Nos. 1, 2 and 3 to the Proposed Rule Change by the Chicago Board Options Exchange, Inc., Relating to Facilitation Crosses of Index Options Orders

July 31, 2000.

1. Introduction

On June 29, 1999, the Chicago Board Options Exchange, Inc. ("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")¹ and Rule 19b-4 thereunder,² a proposed rule change to amend the Exchange's rule governing facilitation crosses as it applies to index option orders. Notice of the proposed rule change was published for comment in the **Federal Register** on August 20, 1999.³ The Commission received two comment letters regarding the proposal.⁴ On April 20, June 1, and July 18, 2000, the CBOE filed, respectively, Amendment Nos. 1, 2, and 3 to the proposal.⁵ This order approves the proposed rule change, as amended, and solicits comments from interested persons on Amendment Nos. 1, 2 and 3.

⁸ 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. 41742 (August 13, 1999), 64 FR 45578.

⁴ See Section III below.

⁵ The substantive modifications made by these amendments are incorporated in the description of the proposal in Section II below, and are further discussed in Section IV below.

II. Description of the Proposal

CBOE Rule 6.74(b) sets forth the procedures by which a floor broker representing the order of a member firm's public customer may cross it with a contra side order provided by the firm from its own proprietary account. In these circumstances, the firm is said to be "facilitating" the customer order, and the transaction is called a "facilitation cross."

Under the current version of the rule as applicable to index options,⁶ a floor broker seeking to execute a facilitation cross must first bring the transaction to the trading floor and request a market from the trading crowd. After receiving bids and offers from the crowd, the floor broker must propose a price at which to cross the order that improves upon the price provided by the crowd. However, before the floor broker can execute the cross, the market makers in the crowd are given the opportunity to take all or part of the transaction at the proposed price.

Under the current rule, if the crowd does not want to participate in the trade, the floor broker may proceed with the cross. If the crowd wants to take part of the order, however, the crowd has precedence and the floor broker may cross only that amount remaining after the crowd has taken its portion. If the crowd wants to take the entire order, the floor broker will not be able to cross any part of the order.

The proposed rule change would add new paragraph (e) to Rule 6.74, to apply to facilitation crosses in broad-based index options that are not traded in equity option crowds.⁷ The proposal would entitle the floor broker, under certain conditions, to cross a specified percentage of the customer order on behalf of the member firm before market makers in the crowd could participate in the transaction. The floor broker would be permitted to exercise this right even when he proposes the facilitation cross a price that matches, but does not improve upon, the best bid or offer

⁶ A related rule change recently approved by the Commission separately amended CBOE Rule 6.74 with respect to equity options. See Securities Exchange Act Release No. 42835 (May 26, 2000), 65 FR 35683 (June 5, 2000) (File No. SR-CBOE-99-10).

⁷ See Amendment No. 3, which specifies that the proposed rule change, originally described as applicable to index options, would apply only to broad-based index options not traded in equity option trading crowds. "Broad-based index" is defined in CBOE Rule 24.1(i). The CBOE represents that broad-based index options currently not traded at equity options posts on the Exchange include Standard & Poor's 100 Stock Index options ("OEX"), Standard & Poor's 500 Stock Index options ("SPX"), and options on the Dow Jones Industrial Average ("DJX").

⁷ 15 U.S.C. 78f(c)(4).

provided by the crowd in response to his initial request for a market.⁸

Under the proposal, all public customer orders in the book and those represented in the trading crowd at the time the market was established would first need to be satisfied.⁹ Afterward, the floor broker would be entitled to cross 20% of the remaining contracts with the facilitation order provided by the firm, which priority over members of the crowd.¹⁰

The proposed rule change would pertain only to orders of a certain minimum size determined by the appropriate Floor Procedure Committee of the Exchange on a class by class basis. That size could not be less than 50 contracts.¹¹

As under existing procedures in Rule 6.74(b), the floor broker seeking to execute a facilitation cross under proposed paragraph (e) would be required, when initially asking for a market in the option series, to make all persons in the trading crowd, including the Order Book Official, aware of his request.

Proposed paragraph (e)(i) provides, in addition, that once the trading crowd has provided a market, it would remain in effect until (a) a reasonable amount of time has passed; (b) a significant change has occurred in the price of the underlying security of the option; or (c) the market is improved. In case of dispute, "significant change" would be determined on a case-by-case basis by two Floor Officials, based upon the extent of recent trading in the option and the underlying security and any other relevant factor.¹²

In the case of a multi-part or spread order, one leg alone of the order would need to meet the eligible size requirement to qualify for the provisions of the proposed rule change. In addition, the facilitating firm would be required to disclose on the order ticket for the public customer order all terms of the order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The floor broker would be required to disclose all

securities that are components of the public customer order before requesting bids and offers for the execution of all components of the order.¹³

If the same member firm of the Exchange is both the firm from which the customer order originated and the Designated Primary Market Maker ("DPM") for the class of options in which the transaction takes place, and the floor broker acting on behalf of the member firm takes advantage of the crossing right provided by the proposed rule change, the firm would not be entitled to any participation in the trade based on the guaranteed percentage ordinarily granted to DPMs.¹⁴

If the DPM in the options class is not the same member organization as the facilitating firm, and the trade takes place at the DPM's principal bid or offer, the DPM will be entitled to participate in a percentage of the contracts remaining after relevant public customer orders have been filled and the originating firm's crossing rights have been exercised. The percentage that the DPM will receive is determined by reference to the established DPM participation rate—subject to limitation. If the floor broker crosses the full 20% of the facilitating firm's entitlement, the number of contracts guaranteed to the DPM may not exceed 25% of the remainder of the order after the facilitating firm has taken its share.¹⁵ If the floor broker does not cross 20%, the DPM may be entitled to more, but in no case will the DPM be guaranteed a percentage that, when combined with the percentage crossed by the floor broker, exceeds 40% of the original order (after relevant public customer orders have been satisfied).¹⁶

The proposed rule change makes clear, however, that it is not intended to prohibit either a floor broker or DPM from trading more than their percentage entitlements if the other members of the

trading crowd do not choose to trade with the remainder of the order.¹⁷

The proposed rule change also provides that the members of the crowd who establish the market in response to the floor broker's initial request would have priority over all other orders that were not represented in the crowd at the time the market was established, except for orders that improve upon those quotes. Further, a floor broker who holds a customer order and a facilitation order and who makes a request for a market would be deemed to be representing both the customer order and the facilitation order, so that the customer order and the facilitation order would also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.¹⁸

III. Summary of Comments

The Commission received two comment letters regarding the proposed rule change, both from the Amex Options Markets Makers Association ("OMMA").¹⁹ The OMMA states that the proposed rule change would harm investors because the allocation of a fixed percentage of trades to member firms seeking to cross orders would reward the firms for trading at an unfair price. The association also argues that the proposal would create a disincentive for price improvement.

IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the provisions of the Act applicable to a national securities exchange, particularly Sections 6(b)(5)²⁰ and 6(b)(8)²¹ of the Act, and the rules and regulations thereunder.²² The Commission believes that the proposal will enable the CBOE to better compete with other options exchanges in attracting the order flow or broker-

¹⁷ See Amendment Nos. 1 and 3.

¹⁸ See Amendment Nos. 1 and 2.

¹⁹ Letters from Daniel Mintz, Chairman, Amex Option Market Makers Association, to the Securities and Exchange Commission, dated August 31, 1999, and September 15, 1999.

²⁰ 15 U.S.C. 78f(b)(5). Section 6(b)(5) requires that the rules of a national securities exchange be designated to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. It also requires that those rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

²¹ 15 U.S.C. 78f(b)(8). Section 6(b)(8) requires that the rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

²² 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).

⁸ See Amendment No. 1, which extends the proposed guaranteed participation to the situation where the facilitation cross is proposed *at* the best bid or offer provided by the crowd.

⁹ See Amendment No. 2.

¹⁰ The same 20% participation would be guaranteed to the member firm whether the transaction takes place *at* or *between* the best bid or offer provided by the trading crowd in response to the floor broker's request for a market. See Amendment No. 1.

¹¹ See Amendment No. 1. The original proposal would have restricted the eligible order size to 500 contracts or more.

¹² See Amendment No. 1.

¹³ *Id.*

¹⁴ *Id.* The CBOE represents that none of the options classes covered by the proposed rule change currently is traded in a DPM trading crowd. However, the Exchange is including provisions in the proposed rule change concerning DPM participation guarantees because at some time in the future these options classes may be traded in DPM crowds. See Amendment No. 3.

¹⁵ See Amendment No. 3. Thus, if the original order was for 1,000 contracts, and the facilitating firm, crossing at the best bid or offer price given by the crowd, took its full share of 200 contracts (20%)—assuming no public customer order were represented in the book or in the crowd—the DPM would be entitled to 200 contracts (25% of the remaining 800) and the total combined participation guarantees of the facilitating firm and the DPM would be limited to 400 contracts, or 40% of the original order.

¹⁶ See Amendment No. 3.

dealer firms seeking to facilitate customer orders, without adversely impacting the prices those orders receive.

The Commission finds that the CBOE's proposal to grant a 20% participation right, under certain conditions, to member firms seeking to execute facilitation crosses on the Exchange is reasonable. Currently, CBOE market makers have priority rights for the full size of a customer order over the firm that brings a crossing transaction to the CBOE floor.

The Commission does not find persuasive the OMMA's argument that the proposal would allow member firms to trade at an unfair price. A member firm could never execute a facilitation cross, under the proposal, at an inferior price. It would be required at least to match the best bid or offer provided by the crowd in response to the floor broker's request for a market in order to participate in the transaction at all.

While the proposal entitles the member firm to 20% of a facilitation transaction, it leaves 80% of the order to the trading crowd. The Commission believes that because 80% of an order would remain available to the market maker or market makers quoting the best price, the proposal raises no serious concern that price competition will be eroded on the Exchange.²³

The Commission finds good cause for approving Amendment Nos. 1, 2, and 3 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register** pursuant to Section 19(b)(2) of the Act.²⁴ Amendment No. 1 adds the provision, described above, that would provide a participation guarantee to a member firm seeking to facilitate a customer order even when it only matches, but does not improve upon, the prices given by the crowd in response to the floor broker's initial request for a market. Amendment No. 1 also reduces the minimum size of orders to which the proposed rule change would be applicable, from 500 to 50 contracts.

The Commission has already approved rules of several options

exchanges that establish participation guarantees of 20% or more for firms seeking to facilitate orders at the best prices offered by other market participants.²⁵ Similarly, the Commission has already approved rules of several options exchanges that provide such guarantees for order sizes with a minimum of 50 contracts.²⁶ Thus, these aspects of Amendment No. 1 raise no new regulatory issues.

Amendment No. 1, as supplemented and revised by Amendment No. 2, also include further clarifications of procedures and priority rights under the proposed rule change consistent with CBOE's facilitation cross rule for equity options. These provisions strengthen the proposed rule change and raise no new regulatory issues.

Amendment No. 3 specifies that the proposed rule change would apply only to broad-based index options that are not traded in equity trading crowds, clarifying the proposal's applicability and raising no new issues. Amendment No. 3 also includes the provision described above concerning DPM participation, which limits the total percentage of an order that may be guaranteed, to the originating firm and the DPM combined, to no more than 40%. This limitation accords with rules that the Commission has previously found consistent with the Act.²⁷

Accordingly, the Commission finds good cause, consistent with Sections 6(b)(5)²⁸ and 19(b)(2)²⁹ of the Act to accelerate approval of Amendments Nos. 1, 2, and 3 to the proposed rule change.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1, 2, and 3, including whether Amendment Nos. 1, 2, and 3 are consistent with the Act. Persons making written submissions should file six

copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549-0609. 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 CBOE. All submissions should refer to File No. SR-CBOE-99-35 and should be submitted by August 28, 2000.

VI. Conclusion

For the reasons discussed above, the Commission finds that the proposal is consistent with the Act and the rules and regulations thereunder.

It is therefore ordered, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-CBOE-99-35), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.³⁰

Margaret H. McFarland,
Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-43102; File No. SR-NASD-99-76]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the National Association of Securities Dealers, Inc. Relating to Amendments to the Code of Procedure and Other Provisions

August 1, 2000.

On December 28, 1999, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its wholly-owned subsidiary, NASD Regulations, Inc. ("NASD Regulation"), 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

²³ As the Commission recently stated, it is difficult to assess the precise level at which guarantees may begin to erode competitive market maker participation and potential price competition within a given market. However, for the immediate term, the Commission has approved participation guarantees of up to 40% of an order as not clearly inconsistent with the statutory standards of competition and free and open markets. See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000). The proposed rule change, which would allocate only 20% of an order to the member firm, falls well within these parameters.

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ See Securities Exchange Act Release Nos. 42894 (June 2, 2000) (concerning File No. SR-Amex-99-36); 42835 (May 26, 2000), 65 FR 35683 (June 5, 2000) (concerning File No. SR-CBOE-99-10, for equity options); 42848 (May 26, 2000) (concerning File No. SR-PCX-99-18); and 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (concerning registration of the International Securities Exchange ("ISE") as a national securities exchange, and, among other features of the exchange, the ISE's facilitation provisions).

²⁶ See Securities Exchange Act Release Nos. 42894 (June 2, 2000) (concerning File No. SR-Amex-99-36); 42835 (May 26, 2000) (concerning File No. SR-CBOE-99-10, for equity options); and 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000) (concerning ISE's facilitation provisions, among other features).

²⁷ See *supra*, note 23.

²⁸ 15 U.S.C. 78f(b)(5).

²⁹ 15 U.S.C. 78s(b)(2).

³⁰ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).