

limit order book. Implementation of the ABP system should provide for more efficient execution of both RAES and booked orders. The proposed rule change, which would result in RAES orders being routed to the trading crowd when the Exchange's Autoquote system locks or crosses CBOE's best bid or offer as established by the book, limits market-maker risk where CBOE is unable to remove a quote based on a customer limit order that has already been executed. The Exchange has represented that this exception should occur very infrequently.

In light of the likely benefits to customer limit orders expected to be gained by implementation of the ABP system, particularly in those classes, discussed above, where CBOE currently permits RAES orders to trade through orders on the limit order book, the Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission hereby requests that CBOE provide monthly reports to the Commission regarding the number of times the exception that is the subject of this pilot is used to allow the Commission to determine whether to approve the proposal permanently.<sup>12</sup>

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-CBOE-99-61) is hereby approved through February 21, 2000.

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. 34-42167; File No. SR-CBOE-99-57]

### Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 by the Chicago Board Options Exchange, Inc. Governing the Operation of Its Retail Automatic Execution System

November 22, 1999.

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 October 14, 1999, 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 CBOE. Additionally, on November 15, 1999, the Exchange filed with the Commission Amendment No. 1 to the proposal.<sup>3</sup> 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 amend its rules governing the operation of its Retail Automatic Execution System ("RAES"). 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.

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

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Letter from Timothy Thompson, Director of Regulatory Affairs, CBOE, to Gordon Fuller, Special Counsel, Division of Market Regulation, SEC, dated November 15, 1999. The Amendment clarifies the wording of the proposed rule change. Because of the substantive nature of the amendment, the Commission deems the filing date of the proposed rule change to be November 15, 1999.

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

##### 1. Purpose

The purpose of the proposed rule change is to permit the appropriate Floor Procedure Committee ("FPC") to designate that RAES orders for a particular option series will default for manual representation in the trading crowd in situations where the National Best Bid or Offer ("NBBO") for that particular series of that class is crossed (e.g., 6 1/8 bid, 6 asked) or locked (e.g., 6 bid, 6 asked). The proposed rule will provide market-makers participating on RAES protection from having to fill orders at crossed or locked prices since the NBBO can become crossed or locked as a result of one market disseminating inaccurate or delayed quotes.

Currently, under CBOE Rule 6.8(a)(ii), when RAES receives an order, the system automatically will attach to the order its execution price, determined by the prevailing market quote at the time of the order's entry into the system, except as otherwise provided in Interpretation .02 of CBOE Rule 6.8 in respect of multiply-traded options. A buy order will pay the offer; a sell order will sell at the bid.

Pursuant to Interpretation .02, when RAES receives an order for a multiply-traded option at a time when a better bid or offer for that option is displayed on another exchange, the order will either be rejected for manual handling (so that the order is not automatically executed at an inferior price to the NBBO) or the order will be executed at the NBBO, if the NBBO is better than the CBOE bid or offer by no more than the designated number of minimum trading variations ("ticks"). The appropriate FPC determines which option classes will be entitled to be executed automatically at the better bid or offer and also determines the number of ticks better than the CBOE bid or offer that the NBBO may be and at which the order still will be executed automatically on RAES.<sup>4</sup> In situations where the NBBO for a particular series is more than the designated number of ticks better than the CBOE bid or offer, the order for that multiply-traded class will be rerouted for manual handling.<sup>5</sup>

<sup>4</sup> See Securities Exchange Act Release No. 41821 (September 1, 1999), 64 FR 50313 (September 16, 1999), approving SR-CBOE-99-17. SR-CBOE-99-17 amends Interpretation .02 to authorize the appropriate FPC to establish a step-up amount greater than the one-tick increment established under CBOE Rule 6.42.

<sup>5</sup> Any orders prevented from being automatically executed by operation of this policy will be

<sup>12</sup> The approval of the pilot should not be interpreted as suggesting that the Commission is predisposed to approving the proposal permanently.

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

In addition, pursuant to the Exchange's firm quote rule, CBOE Rule 8.51, any order that is rerouted will be entitled to be executed at the Exchange's displayed bid or offer when that order is represented in the trading crowd. Depending on the circumstances, that order may be filled at a price better than the CBOE's displayed bid or offer.

The proposal adds another situation in which an order for a multiply-traded class may be rerouted for manual handling. The authority for determining when these orders will be rejected for manual handling will be set forth in Interpretation .06 to CBOE Rule 6.8. The Exchange is proposing to allow the appropriate FPC to designate option classes that will be rerouted for manual handling in situations in which the NBBO for a particular series of that class is crossed or locked. Depending on the circumstances, the appropriate FPC may determine to have such orders rerouted only when the NBBO is crossed but not locked.<sup>6</sup> The appropriate FPC may also determine to have orders be rejected only when the CBOE's market becomes crossed or locked as a result of the step-up amount having been applied to a particular options series. Also, the FPC may determine to allow for automatic executions of the orders notwithstanding that the NBBO is crossed or locked (assuming no other reason for the order to be rerouted exists) if the circumstances warrant such action to maintain a fair and orderly market.

The proposed rule would allow for the rerouting of RAES orders of a particular class notwithstanding that the orders of that particular class may not have been designated to automatically step up to the NBBO and notwithstanding that the NBBO may be more ticks away from the CBOE market than the designated step-up amount. Nonetheless, the CBOE believes that

rerouted to the Public Automated Routing ("PAR") machine of the Designated Primary Market-Maker ("DPM") for manual handling. Upon receipt of that order, in accordance with CBOE Rule 6.73, the floor broker or DPM will be obligated to use due diligence in the handling of the order to execute the order at the best price or prices available to him.

<sup>6</sup> The Commission recently published an order declaring immediately effective CBOE's proposal to adopt new Interpretation .08 to Rule 6.8. New Interpretation .08 requires a RAES order to be rerouted for representation in the trading crowd when the CBOE market becomes crossed as a result of quotes "stepping-up" to match the NBBO. See Securities Exchange Act Release No. 42012 (October 15, 1999), 64 FR 57502 (October 25, 1999). The current filing will supersede that filing because it will provide the appropriate FPC with the discretion to have orders rejected from RAES when the CBOE market is not only crossed as a result of quotes "stepping-up" to match the NBBO, but also when it becomes locked as a result of application of the "step-up" Interpretation.

market makers are at risk for filling orders automatically in situations in which the NBBO is crossed or locked even if they are not stepping up to the NBBO on RAES because the fact that the NBBO is crossed or locked may be an indication that the prices are inaccurate. The NBBO may become crossed or locked because of communications or systems problems, or due to keystroke errors, or quotation dissemination delays. The proposal will allow the floor broker or DPM to determine if the locked or crossed market is actually a true market.

## 2. Statutory Basis

The CBOE believes that this proposal will enhance its ability to provide instantaneous, automatic execution of public customers' orders at the best available prices. This furthers the objectives of Section 6(b) of the Act<sup>7</sup> in general and furthers the objectives of Section 6(b)(5)<sup>8</sup> in particular by promoting just and equitable principles of trade, removing impediments to and perfecting the mechanism of a free and open market and national market system, and protecting investors and the public interest.

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

The CBOE does not believe that the proposed rule change will impose any burden on competition.

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

No written comments were solicited or received with respect to the proposed rule change.

## III. Date of Effectiveness of the Proposed Rule Change and Amendment No. 1 and Timing for Commission Action

The proposed rule filing has been filed by the Exchange pursuant to Section 19(b)(3)(A) of the Act<sup>9</sup> and subparagraph (f)(6) of Rule 19b-4 thereunder.<sup>10</sup> The proposed rule change: (i) Does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative until thirty days after the date of filing, or such shorter time as the Commission may designate if consistent with the protection of investors and the public

interest, provided that the Exchange has given the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

The Exchange has requested that the Commission accelerate the operative date of the proposal. In addition, the Exchange provided the Commission with written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, more than five business days prior to the date of the filing the proposed rule change.

The Commission finds that it is appropriate to designate the proposal to become operative today because such designation is consistent with the protection of investors and the public interest. Specifically, the Commission finds that it is appropriate to accelerate the operative date of the proposed rule change because it will limit market-maker risk in situations where the NBBO becomes locked or crossed, by removing the requirement that market-makers execute transactions at prices that may not accurately reflect true market prices at the time the trade is initiated. For these reasons, the Commission finds that designation of the proposal to become operative today is consistent with the protection of investors and the public interest.

The Commission requests, however, that the CBOE provide it with information regarding the occasions in which the Interpretation is applied and the promptness of the manual execution of orders that are prevented from automatic execution by operation of the Interpretation. This data should cover, at a minimum, the period commencing as of the proposed Interpretation's operative date and concluding six months thereafter.

At any time within 60 days of the filing of this rule change, the Commission may summarily abrogate the rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.<sup>11</sup>

## IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing,

<sup>11</sup> In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>10</sup> 17 CFR 240.19b-4(f)(6).

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, NW., Washington, DC 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 CBOE. All submissions should refer to File Number SR-CBOE-99-57 and should be submitted by December 21, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>12</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-42163; File No. SR-NYSE-98-33]

### Self-Regulatory Organizations; Order Approving Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 to the Proposed Rule Change to Amend NYSE Rule 64

November 19, 1999.

#### I. Introduction

On October 16, 1998, the New York Stock Exchange, Inc. ("NYSE" 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 NYSE Rule 64. The proposed rule change was published for comment in the **Federal Register** on November 12, 1998.<sup>3</sup> On November 1, 1999, the

Exchange filed Amendment No. 1.<sup>4</sup> The Commission received no comments on the proposal. This notice and order approves the proposed rule change, as amended, and solicits comments from interested persons on Amendment No. 1.

#### II. Description of Proposal

Currently, NYSE Rule 64 requires Floor Official approval for all "non-regular way"<sup>5</sup> trades during all but the final calendar week of the year. During the last calendar week of the year such approval is required only for sales more than  $\frac{1}{16}$  point away from the regular way bid or offer. The Exchange proposes to amend the rule to eliminate the requirement of Floor Official approval for certain non-regular way trades that do not occur during the final calendar week of the year. Under the proposed rule change, Floor Official approval would be required only for those non-regular way trades that are more than  $\frac{1}{16}$  point away from the regular way bid or offer throughout the year, but not during the final calendar week of the year.<sup>6</sup> The proposal does not change the existing requirement for Floor Official approval for non-regular way trades that are more than  $\frac{1}{16}$  point away from the regular way bid or offer during the last calendar week of the year.<sup>7</sup> Under the proposed rule change, Floor Officials will still be required to "take into consideration whether the price of the transaction is reasonable in relation to the 'regular way' market" when deciding whether to grant approval for a non-regular way trade.

Exchange staff analyzed price changes from the current bid or offer for non-regular way trades during June 1998.<sup>8</sup> The Exchange's analysis showed that approximately 80% of non-regular way trades occurred at  $\frac{1}{16}$  point or less

away from the regular way bid or offer. The Exchange believes that the proposed rule change would relieve members of the burden of obtaining Floor Official approval for routine non-regular way trades at small price variations, while preserving Floor Official supervision for those instances where it is most needed.

#### III. 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, with the requirements of Section 6(b)(5) of the Act.<sup>9</sup> Section 6(b)(5)<sup>10</sup> requires, among other things, that an exchange have rules which are designed to promote just and equitable principles of trade, to facilitate transactions in securities, 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 believes that the proposed rule change should help to alleviate the administrative burden for Floor Officials and members with regard to non-regular way trades, which should in turn permit the reallocation of valuable resources, and thereby increase operational efficiency for Floor Officials and members. As mentioned above, the Exchange's analysis of non-regular way trades indicates that this proposal should substantially reduce the number of Floor Official approvals required for such trades.<sup>11</sup> The Commission believes that by requiring Floor Official approval for non-regular way trades that are more than  $\frac{1}{16}$  point away from the regular way bid or offer throughout the year, but not during the final calendar week of the year, the proposal should facilitate transactions in securities and help to remove impediments to and perfect the mechanism of a free and open market. The Commission notes, however, that the approval of the elimination of the requirement for Floor Official approval for non-regular way trades with a  $\frac{1}{16}$  point, or less, deviation from the regular way bid or offer does not relieve brokers of their best execution duty. The Commission further notes that Floor Officials, as per NYSE guidelines, will still be required to consider whether the price of the transaction is reasonable in relation to the regular way market when deciding whether to grant approval for

<sup>4</sup> See Letter from James E. Buck, Senior Vice President and Secretary, NYSE, to Richard Strasser, Assistant Director, Division of Market Regulation, Commission, dated October 29, 1999 ("Amendment No. 1"). Amendment No. 1 changes the proposal to require Floor Official approval for non-regular way trades throughout the year, but not during the last calendar week of the year, to  $\frac{1}{16}$  point away from the regular way bid or offer from  $\frac{1}{16}$  point away. Initially, the proposed rule change would have extended the existing requirement of NYSE Rule 64 for Floor Official approval for end-of-the-year non-regular way trades to the entire year. In other words, Floor Official approval would have been required for non-regular way trades that were more than  $\frac{1}{16}$  point away from the regular way bid or offer throughout the year.

<sup>5</sup> A "non-regular way" trade is a trade that is settled in a different time frame from "regular-way" trades, which settle on the third business day following the transaction. See NYSE Rule 64(a)(3).

<sup>6</sup> See note 4, above.

<sup>7</sup> *Id.*

<sup>8</sup> See NYSE Analysis of Non-Regular Way Trades for June 1998.

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> *Id.*

<sup>11</sup> See note 8, above.

<sup>12</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. 40631 (November 3, 1998), 63 FR 63347 (November 12, 1998).