

provided that the self-regulatory organization 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, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6)¹¹ thereunder.

The Exchange has requested that the Commission waive the five-day pre-notice requirement and the 30-day operative delay, to permit the Exchange to implement the proposal on September 30, 2002, the date of filing. September 30, 2002 is the first trading day after expiration of the pilot program on Saturday, September 28, 2002. Under Rule 19b-4(f)(6)(iii), a proposed "non-controversial" rule change does not become operative for 30 days after the date of filing, unless the Commission designates a shorter time.

The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because it will allow for the continued operation of the pilot without interruption.¹² According to CBOE, with the continuation of the pilot program, market makers will continue to have greater incentive to compete effectively for orders in the crowd, which benefits investors and promotes the public interest. In addition, CBOE maintains that given the widespread use of the 100 Spoke RAES Wheel in equity options trading stations, requiring the Exchange to discontinue the use of the 100 Spoke RAES Wheel as of September 30, 2002 would cause disruption to those trading stations and thus, be disruptive to investors and the public interest. For these reasons, the Commission designates the proposed rule change to be effective and operative upon filing with the Commission. The Commission also waives the five-business-day pre-filing requirement. At any time within 60 days of the filing of the proposed rule change, the Commission may summarily abrogate such 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.

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, 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 at 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 the File No. SR-CBOE-2002-60 and should be submitted by November 12, 2002.

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. 34-46637; File No. SR-CME-2002-01]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Mercantile Exchange, Inc. Relating to Customer Margin Requirements for Security Futures

October 10, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 27, 2002, Chicago Mercantile Exchange, Inc. ("CME" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CME. On October 7, 2002, the CME submitted

Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The CME proposes to amend its Rules as they pertain to customer performance bonds (or "margins") for Security Futures as detailed below. Below is the text of the proposed rule change. Proposed new language is italicized; deletions are bracketed.

* * * * *

833. Customer Performance Bonds for Security Futures Held in Futures Accounts

Performance bond (or "margin") requirements associated with Security Futures, as defined by Section 1a(31) of the Commodity Exchange Act (CEA), on behalf of Customers, as defined in Rule 930.B.2.b., whether effected on the Exchange or on a Marketplace apart from Exchange but cleared by the Clearing House per Chapter 8B, and held in a futures account (with any exceptions noted in the Rules), shall be determined and administered per the Rules of the Exchange; and, in compliance with CFTC Regulation Sections 41.42 through 41.49; and, SEC Regulation 242.400 through 242.406, including any successor Regulations. If Exchange Rules should be found to be inconsistent with CFTC Regulation Sections 41.42 through 41.49; and, SEC Regulation 242.400 through 242.406, including any successor Regulations, the CFTC and SEC Regulations shall prevail.

930. Performance Bond Requirements: Account Holder Level

930.A. Performance Bond System

The Standard Portfolio Analysis of Risk (SPAN®) Performance Bond System is the performance bond system adopted by the Exchange. SPAN generated performance bond requirements shall constitute Exchange performance bond requirements. All references to performance bond within the rules of the Exchange shall relate to those computed by the SPAN system.

Performance bond systems other than the SPAN system may be used to meet Exchange performance bond

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² For the purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹³ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Phupinder S. Gill, Managing Director and President, Clearing House Division, CME, to Office of Market Supervision, Division of Market Regulation, Commission, dated October 4, 2002 ("Amendment No. 1"). In Amendment No. 1, the Exchange replaced in its entirety the Form 19b-4 filed on September 27, 2002.

requirements if the clearing member can demonstrate that its system will always produce a performance bond requirement equal to or greater than the SPAN performance bond requirements.

930.B. Performance Bond Rates

1. Non-Security Futures

Exchange staff shall determine initial and maintenance performance bond rates used in determining Exchange performance bond requirements. The Board reserves the right to change or modify any performance bond levels determined by Exchange staff.

2. Security Futures

a. *Initial and maintenance performance bond (or "margin") rates used in determining Exchange performance bond requirements applied to Security Futures on behalf of Customers, whether effected on the Exchange or on a Marketplace apart from Exchange but cleared by the Clearing House per Chapter 8B, and held in a futures account, shall be established at levels no lower than those prescribed by CFTC Regulation Section 41.45; and, SEC Regulation 242.403, including any successor Regulations.*

b. *As used in this Rule, the term "Customer" does not include (a) an "exempted person" as defined in CFTC Regulation 41.43(a)(9) and SEC Regulation 242.401(a)(9); or (b) Market Makers as defined below.*

A Person shall be a "Market Maker" for purposes of this Rule, and shall be excluded from the requirements set forth in CFTC Regulations 41.42 through 41.49; and, SEC Regulations 242.400 through 242.406 in accordance with

CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v), with respect to all trading in Security Futures for its own account, if such Person is an Exchange Member that is registered with the Exchange as a "Security Futures Dealer."

Each Market Maker shall (a) be registered as a floor trader or a floor broker with the CFTC under Section 4f(a)(1) of the CEA or as a dealer with the SEC under Section 15(b) of the Exchange Act; (b) maintain records sufficient to prove compliance with the requirements set forth in this Rule and CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v), including without limitation, trading account statements and other financial records sufficient to detail activity and verify conformance with the standards set forth herein; and (c) hold itself out as being willing to buy and sell Security Futures for its own account on a regular or continuous basis.

Market Makers satisfy condition (c) above if (a) at least 75% of their gross revenues, on an annual basis, is derived from business activities or occupations from trading listed financial derivatives, and the instruments underlying those derivatives, including security futures; stock index futures and options; stock and index options; stocks; foreign currency futures and options; foreign currencies; interest rate futures and options; fixed income instruments; and, commodity futures and options; or (b) except for unusual circumstances, at least 50% of their security futures trading activity on the Exchange in any calendar quarter, measured in terms of contract volume, is in security futures

contracts to which the Market Maker is assigned as a Security Futures Dealer by the Exchange.

Any Market Maker that fails to comply with the applicable Rules of the Exchange, CFTC Regulations 41.41 through 41.49 and SEC Regulations 242.400 through 242.406 shall be subject to disciplinary action in accordance with Chapter 4. Appropriate sanctions in the case of any such failure shall include, without limitation, a revocation of such Market Maker's registration as a Security Futures Dealer.

This Rule 930.B.2.b shall apply regardless whether the position(s) in Exchange security futures are held in a futures account, or held in a securities account.

c. *The Exchange shall establish initial and maintenance performance bond requirements applicable to Security Futures and held in a futures account, provided that the performance bond requirement for any long or short position held by a clearing member on behalf of a Customer shall not be less than 20% of the current market value of the relevant Contract; or, such other requirement as may be established by the CFTC and SEC for purposes of CFTC Regulation 41.45(b)(1) and SEC Regulation 242.403(b)(1) except as provided below.*

d. *Initial and maintenance performance bond requirements for offsetting positions involving Security Futures and related positions are provided in the schedule below, for purposes of CFTC Regulation 41.45(b)(2) and SEC Regulation 242.403(b)(2).*

Performance Bond (or "Margin") Requirements for Offsetting Positions

Description of offset	Security underlying the security future	Initial margin requirement	Maintenance margin requirement
1. Long security future (or basket of security futures representing each component of a narrow-based securities index ¹) and long put option ² on the same underlying security (or index).	Individual stock or narrow-based security index.	20% of the current market value of the long security future, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price ³ of the put plus the aggregate put out-of-the-money ⁴ amount, if any; or (2) 20% of the current market value of the long security future.
2. Short security future (or basket of security futures representing each component of a narrow-based securities index) and short put option on the same underlying security (or index).	Individual stock or narrow-based security index.	20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any. Proceeds from the put sale may be applied.	20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any. ⁵
3. Long security future and short position in the same security (or securities basket) underlying the security future.	Individual stock or narrow-based security index.	The initial margin required under Regulation T for the short stock or stocks.	5% of the current market value as defined in Regulation T of the stock or stocks underlying the security future.

Performance Bond (or "Margin") Requirements for Offsetting Positions—Continued

Description of offset	Security underlying the security future	Initial margin requirement	Maintenance margin requirement
4. Long security future (or basket of security futures representing each component of a narrow-based securities index) and short call option on the same underlying security (or index).	Individual stock or narrow-based security index.	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any.
5. Long a basket of narrow-based security futures that together tracks a broad-based index and short a broad-based security index call option contract on the same index.	Narrow-based security index	20% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any. Proceeds from the call sale may be applied.	20% of the current market value of the long basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any.
6. Short a basket of narrow-based security futures that together tracks a broad-based security index and short a broad-based security index put option contract on the same index.	Narrow-based security index	20% of the current market value of the short basket of narrow-based security futures, plus the aggregate call in-the-money amount, if any. Proceeds from the put sale may be applied.	20% of the current market value of the short basket of narrow-based security futures, plus the aggregate put in-the-money amount, if any.
7. Long a basket of narrow-based security futures that together tracks a broad-based security index and long a broad-based security index put option contract on the same index.	Narrow-based security index	20% of the current market value of the long basket of narrow-based security futures, plus pay for the long put in full.	The lower of: (1) 10% of the aggregate exercise price of the put, plus the aggregate put out-of-the-money amount, if any; or (2) 20% of the current market value of the long basket of security futures.
8. Short a basket of narrow-based security futures that together tracks a broad-based security index and long a broad-based security index call option contract on the same index.	Narrow-based security index	20% of the current market value of the short basket of narrow-based security futures, plus pay for the long call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the short basket of security futures.
9. Long security future and short security future on the same underlying security (or index).	Individual stock or narrow-based security index.	The greater of: 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.	The greater of: 5% of the current market value of the long security future; or (2) 5% of the current market value of the short security future.
10. Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put and call must have the same exercise price. (Conversion).	Individual stock or narrow-based security index.	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from the call sale may be applied.	10% of the aggregate exercise price, plus the aggregate call in-the-money amount, if any.
11. Long security future, long put option and short call option. The long security future, long put and short call must be on the same underlying security and the put exercise price must be below the call exercise price (Collar).	Individual stock or narrow-based security index.	20% of the current market value of the long security future, plus the aggregate call in-the-money amount, if any, plus pay for the put in full. Proceeds from call sale may be applied.	The lower of: (1) 10% of the aggregate exercise price of the put plus the aggregate put out-of-the-money amount, if any; or (2) 20% of the aggregate exercise price of the call, plus the aggregate call in-the-money amount, if any.
12. Short security future and long position in the same security (or securities basket) underlying the security future.	Individual stock or narrow-based security index.	The initial margin required under Regulation T for the long stock or stocks.	5% of the current market value, as defined in Regulation T, of the long stock or stocks.
13. Short security future and long position in a security immediately convertible into the same security underlying the security future, without restriction, including the payment of money.	Individual stock or narrow-based security index.	The initial margin required under Regulation T for the long security.	10% of the current market value, as defined in Regulation T, of the long security.
14. Short security future (or basket of security futures representing each component of a narrow-based securities index) and long call option or warrant on the same underlying security (or index).	Individual stock or narrow-based security.	20% of the current market value of the short security future, plus pay for the call in full.	The lower of: (1) 10% of the aggregate exercise price of the call, plus the aggregate call out-of-the-money amount, if any; or (2) 20% of the current market value of the short security future.

Performance Bond (or "Margin") Requirements for Offsetting Positions—Continued

Description of offset	Security underlying the security future	Initial margin requirement	Maintenance margin requirement
15. Short security future, Short put option and long call option. The short security future, short put and long call must be on the same underlying security and the put and call must have the same exercise price. (Reverse Conversion).	Individual stock or narrow-based security index.	20% of the current market value of the short security future, plus the aggregate put in-the-money amount, if any, plus pay for the call in full. Proceeds from put sale may be applied.	10% of the aggregate exercise price, plus the aggregate put in-the-money amount, if any.
16. Long (short) a basket of security futures, each based on a narrow-based security index that together tracks the broad-based index and short (long) a broad-based index future.	Narrow-based security index	5% of the current market value for the long (short) basket of security futures.	5% of the current market value of the long (short) basket of security futures.
17. Long (short) a basket of security futures that together tracks a narrow-based index and short (long) a narrow-based index future.	Individual stock or narrow-based security index.	The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).	The greater of: (1) 5% of the current market value of the long security future(s); or (2) 5% of the current market value of the short security future(s).
18. Long (short) a security future and short (long) an identical security future traded on a different market. ⁶	Individual stock or narrow-based security index.	The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).	The greater of: (1) 3% of the current market value of the long security future(s); or (2) 3% of the current market value of the short security future(s).

¹ Baskets of securities or security futures contracts must replicate the securities that comprise the index, and in the same proportion.

² Generally, for the purposes of these rules, unless otherwise specified, stock index warrants shall be treated as if they were index options.

³ "Aggregate exercise price," with respect to an option or warrant based on an underlying security, means the exercise price of an option or warrant contract multiplied by the numbers of units of the underlying security covered by the option contract or warrant. "Aggregate exercise price" with respect to an index option, means the exercise price multiplied by the index multiplier.

⁴ "Out-of-the-money" amounts shall be determined as follows:

(1) for stock call options and warrants, any excess of the aggregate exercise price of the option or warrant over its current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System);

(2) for stock put options or warrants, any excess of the current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System) of the option or warrant over its aggregate exercise price;

(3) for stock index call options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier; and

(4) for stock index put options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant. See, e.g., NYSE Rule 431 (Exchange Act Release No. 42011 (October 14, 1999), 64 FR 57172 (October 22, 1999) (order approving SR-NYSE-99-03)); Amex Rule 462 (Exchange Act Release No. 43582 (November 17, 2000), 65 FR 71151 (November 29, 2000) (order approving SR-Amex-99-27)); CBOE Rule 12.3 (Exchange Act Release No. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (order approving SR-CBOE-97-67)); or NASD Rule 2520 (Exchange Act Release No. 43581 (November 17, 2000), 65 FR 70854 (November 28, 2000) (order approving SR-NASD-00-15)).

⁵ "In-the-money" amounts must be determined as follows:

(1) for stock call options and warrants, any excess of the current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System) of the option or warrant over its aggregate exercise price;

(2) for stock put options or warrants, any excess of the aggregate exercise price of the option or warrant over its current market value (as determined in accordance with Regulation T of the Board of Governors of the Federal Reserve System);

(3) for stock index call options and warrants, any excess of the product of the current index value and the applicable index multiplier over the aggregate exercise price of the option or warrant; and

(4) for stock index put options and warrants, any excess of the aggregate exercise price of the option or warrant over the product of the current index value and the applicable index multiplier.

⁶ Two security futures will be considered "identical" for this purpose if they are issued by the same clearing agency or cleared and guaranteed by the same derivatives clearing organization, have identical contract specifications, and would offset each other at the clearing level.

930.C. Acceptable Performance Bond Deposits

1. Non-Security Futures

Clearing members may accept from their account holders as performance bond cash currencies of any denomination, readily marketable securities (as defined by SEC Rule 15c3-1(c)(11) and applicable SEC interpretations), money market mutual funds allowable under CFTC Regulation 1.25, and bank-issued letters of credit.

Clearing members shall not accept as performance bond from an account holder securities that have been issued

by the account holder or an affiliate of the account holder unless the clearing member files a petition with and receives permission from Exchange staff.

Bank-issued letters of credit must be in a form acceptable to the Exchange. Such letters of credit must be drawable in the United States. Clearing members shall not accept as performance bond from an account holder letters of credit issued by the account holder, an affiliate of the account holder, the clearing member, or an affiliate of the clearing member.

All assets deposited by account holders to meet performance bond requirements must be and remain unencumbered by third party claims against the depositing account holder.

Except to the extent that Exchange staff shall prescribe otherwise, cash currency performance bond deposits shall be valued at market value. All other performance bond deposits other than letters of credit shall be valued at an amount not to exceed market value less applicable haircuts as set forth in SEC Rule 240.15c3-1.

2. Security Futures

a. Clearing Members may accept from their Customers as performance bond (or "margin") for Security Futures held in a futures account, deposits of cash, margin securities (subject to the limitations set forth in the following sentence), exempted securities, any other assets permitted under Regulation T of the Board of Governors of the Federal Reserve System (as in effect from time to time) to satisfy a performance bond deficiency in a securities margin account, and any combination of the foregoing, each as valued in accordance with CFTC Regulations 41.46(c) and 41.46(e); and, SEC Regulations 242.404(c) and 242.404(e). Shares of a money market mutual fund that meet the requirements of CFTC Regulation 1.25 may be accepted as a performance bond deposit from a Customer for purposes of this Rule.

b. A Clearing Member shall not accept as performance bond from any Customer securities that have been issued by such Customer or an Affiliate of such Customer unless such Clearing Member files a petition with and receives permission from the Exchange for such purpose.

c. All assets deposited by a Customer to meet performance bond requirements must be and remain unencumbered by third party claims against the depositing Customer.

930.D. Acceptance of Orders

Clearing members may accept orders for an account provided sufficient performance bond is on deposit in the account or is forthcoming within a reasonable time. For an account which has been subject to calls for performance bond for an unreasonable time, clearing members may only accept orders that reduce the performance bond requirements of existing positions in the account. Clearing members may not accept orders for an account that has been in debit an unreasonable time.

930.E. Calls for Performance Bond

1. Clearing members must issue calls for performance bond that would bring an account up to the initial performance bond requirement: a. when performance bond equity in an account initially falls below the maintenance performance bond requirement; and b. subsequently, when performance bond equity plus existing performance bond calls in an account is less than the maintenance performance bond requirement.

Such calls must be made within one business day after the occurrence of the event giving rise to the call. Clearing

members may call for additional performance bond at their discretion. Notwithstanding the foregoing, a clearing member is not required to call for or collect performance bond for day trades.

2. Clearing members shall only reduce a call for performance bond through the receipt of performance bond deposits permitted under subsection C. of this rule. Clearing members may delete a call for performance bond through: a. the receipt of performance bond deposits permitted under subsection C. of this rule only if such deposits equal or exceed the amount of the total performance bond call; or b. inter-day favorable market movements and/or the liquidation of positions only if performance bond equity in the account is equal to or greater than the initial performance bond requirement. Clearing members shall reduce an account holder's oldest outstanding performance bond call first.

3. Clearing members must maintain written records of all performance bond calls issued, reduced, and deleted.

930.F. Disbursements of Excess Performance Bond

Clearing members may only release performance bond deposits from an account if such deposits are in excess of initial performance bond requirements.

930.G. Loans to Account Holders

Clearing members may not extend loans to account holders for performance bond purposes unless such loans are secured as defined in CFTC Regulation 1.17(c)(3). The proceeds of such loans must be treated in accordance with CFTC Regulation 1.30.

930.H. Aggregation of Accounts and Positions

Clearing members may aggregate accounts under identical ownership within the same classifications of customer segregated, customer secured, special reserve account for the exclusive benefit of customers, and nonsegregated for performance bond purposes. Clearing members may compute performance bond requirements on identically owned concurrent long and short positions on a net basis.

930.I. Hedge Positions

Clearing members shall have reasonable support for bona-fide hedge and risk management positions, as defined by Rule 543, that are afforded hedge performance bond rates.

930.J. Omnibus Accounts

1. Clearing members shall collect performance bond on a gross basis for

positions held in domestic and foreign omnibus accounts.

2. For omnibus accounts, initial performance bond requirements shall equal maintenance performance bond requirements.

3. Clearing members shall obtain and maintain written instructions from domestic and foreign omnibus accounts for positions which are entitled to spread or hedge performance bond rates.

930.K. Liquidation of Accounts

1. Non-Security Futures

If an account holder fails to comply with a performance bond call within a reasonable time (the clearing member may deem one hour to be a reasonable time), the clearing member may close out the account holder's trades or sufficient contracts thereof to restore the account holder's account to required performance bond status. Clearing members shall maintain full discretion to determine when and under what circumstances positions in any account shall be liquidated.

2. Security Futures

If a Customer fails to comply with a performance bond (or "margin") call within a reasonable period of time (the clearing member may deem one hour to be a reasonable period of time), the relevant clearing member shall take the deduction required with respect to an undermargined account in computing its net capital under applicable CFTC Regulations and SEC Regulations.

If at any time there is a liquidating deficit in an account in which security futures are held, the clearing member shall take steps to liquidate positions in the account promptly and in an orderly manner.

930.L. Failure To Maintain Performance Bond Requirements

If a clearing member fails to maintain performance bond requirements for an account in accordance with this rule, the Exchange may direct such clearing member to immediately liquidate all or part of the account's positions to eliminate the deficiency.

930.M. Violation

Violation of this rule may constitute a major offense.

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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 Exchange 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 Exchange 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

1. Purpose

The proposed rule amendments are intended to establish procedures relating to the determination and administration of customer performance bonds (or "margins"). Further, these amendments define the applicability of these requirements, specifically excluding qualifying security futures dealers from customer security futures performance bond requirements and related regulatory requirements. Proposed Rule 833 generally establishes that the determination and administration of customer performance bonds shall be consistent with prevailing practices on the Exchange, except to the extent that Exchange practices may be inconsistent with Commodity Futures Trading Commission ("CFTC") Regulations 41.42 through 41.49 and SEC Regulations 242.400 through 242.406.

General Applicability—Proposed Rule 833 delineates the scope of application of the proposed rule amendments in two important respects: (1) It provides that the proposed rule amendments apply only with respect to security futures transactions executed on CME; or, to those executed on a marketplace apart from CME but cleared through CME facilities. To the extent that security futures intermediaries engage in security futures transactions on or through other exchanges as well, they will need to comply with the respective performance bond requirements established by such other venues; (2) proposed Rule 833 establishes that the proposed rule amendments apply only to customers as defined in proposed Rule 930.B.2.b.; and (3) the proposed rule amendments are applicable only to security futures held in futures accounts. While security futures may be held in a securities account as well, the administration of securities accounts shall be governed, in addition to all applicable Regulations, by Rules adopted by other relevant self-regulatory organizations.

Proposed Rule 930.B.2.b. identifies "exempted persons" and "market

makers" as non-customers for purposes of the proposed rule amendments and, therefore, exempt from the application of such provisions. Exempted persons are specifically identified by reference to applicable CFTC and SEC Regulations.

Market Maker Exclusion—CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v) permit exchanges to adopt rules containing specified requirements for security futures dealers, on the basis of which the financial relations between security futures intermediaries, on the one hand, and qualifying security futures dealers, are excluded from the customer performance bond requirements for security futures. Any rules so adopted by an exchange must meet the criteria set forth in Section 7(c)(2)(B) of the Act.⁴

CME proposes a market maker exclusion in its proposed Rule 930.B.2.b. that relies on CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v). In particular, Exchange members who meet certain qualifications will be permitted to register with the Exchange as security futures dealers. As such, their accounts would not be subject to customer security futures performance bond (or "margin") requirements.

These members will be floor traders or floor brokers registered with the CFTC under Section 4f(a)(1) of the Commodity Exchange Act, as amended, or dealers registered with the SEC under Section 15(b) of the Act.⁵ As such, they may not qualify as exempted persons within the meaning of Regulation 242.401(a)(9) under the Act. Absent the provisions of proposed Rule 930.B.2.b., they arguably would have to be treated as customers for purposes of determining performance bond requirements, even with respect to their proprietary market making activities. This would be different from the treatment of security futures dealers on securities exchanges under Section 7(c)(3) of the Act,⁶ and therefore would be contrary to the statutory objectives reflected in Section 7(c)(2)(B) of the Act.⁷

The market maker exclusion as proposed contains all of the criteria and limitations set forth in CFTC Regulation 41.42(c)(2)(v) and SEC Regulation 242.400(c)(2)(v). In particular, the Exchange intends to test a security futures dealer's willingness to hold itself out to buy and sell on a regular or

continuous basis by application of a revenue test. Note that the Commissions' release regarding security futures customer margins identified three alternate means by which to demonstrate such willingness:

1. An exchange may require members to effect a certain percentage of its security futures trades with persons other than those registered as market makers;

2. Exchange members could be subject to rules that impose an affirmative obligation to quote on a regular or continuous basis;

3. An exchange may require that a "large majority" of an exchange member's revenue is derived from trading listed financial based derivatives including futures and options on stocks, stock indexes, foreign currencies, interest rate instruments.

CME proposes the application of the 3rd standard listed above. Specifically, CME proposes that market makers must derive at least 75% of their gross revenues, on an annual basis, from business activities or occupations from trading listed financial-based derivatives or the instruments underlying those derivatives, including security futures; stock index futures; stock and index options; stocks; foreign currency futures and options; foreign currencies; interest rate futures and options; fixed income instruments; and, commodity futures and options. We believe that it is appropriate to extend the enumeration of derivatives to include the underlying instruments as closely related to the business activities or occupations specifically referenced in the Commissions' release.

Alternatively, a market maker may satisfy this standard if, except for unusual circumstances, at least 50% of its security futures trading activity in any calendar quarter is in security futures to which it is assigned by the Exchange to act as a "Security Futures Dealer."

Market makers are required to maintain books and records including trading statements and other financial records that would evidence compliance with these standards. This recordkeeping requirement includes, without limitation, such trading statements and other financial records as may be necessary specifically to verify compliance. Failure on the part of a market maker to comply with these standards may result in revocation of security futures dealer status or other sanctions provided under CME Rules.

The parameters of this market maker exclusion shall apply to position(s) in Exchange security futures contracts regardless of whether such position(s)

⁴ 15 U.S.C. 78g(c)(2)(B).

⁵ 15 U.S.C. 78o(b).

⁶ 15 U.S.C. 78g(c)(3).

⁷ 15 U.S.C. 78g(c)(2)(B).

are held in a futures account, or held in a securities account.

CME believes proposed Rule 930.B.2.b. to be consistent with the requirements of the Act and with the explanations accompanying the publication of those requirements.

Performance Bond Rates—Proposed Rule 930.B.2.a. addresses the issue of customer performance bond rates by requiring that such rates shall be established at levels no lower than those prescribed by CFTC Regulation 41.45 and SEC Regulation 242.403. Proposed Rule 930.B.2.c. elaborates by establishing the requisite performance bond level for each long or short position in a security future at 20% of the current market value of such security future, as required by SEC Regulation 242.403(b) and CFTC Regulation 41.45(b).

Exceptions to that 20% requirement are established per proposed Rule 930.B.2.d. These exceptions rely upon SEC Regulation 242.403(b)(2) and CFTC Regulation 41.45(b)(2), which establish that a self-regulatory authority may set the required initial or maintenance performance bond level for offsetting positions involving security futures and related positions at a level lower than the level that would apply if performance bond requirements for such positions were calculated separately based on the aforementioned 20% requirement, provided the rules establishing such lower performance bond levels meet the criteria set forth in Section 7(c)(2)(B) of the Act.⁸ That Section requires that:

(I) The margin requirements for a security futures product be consistent with the margin requirements for comparable option contracts traded on any exchange registered pursuant to Section 6(a) of [the Act];⁹ and

(II) Initial and maintenance margin levels for a security futures product not be lower than the lowest level of margin, exclusive of premium, required for any comparable option contract traded on any exchange registered pursuant to Section 6(a) of [the Act],¹⁰ other than an option on a security future.

Absent the performance bond relief afforded by the proposed Rule 930.B.2.d., security futures intermediaries would be required to collect performance bond from their customers equal to 20% of the current market value of the security futures held on behalf of such customers, irrespective of whether such security futures positions are hedged or unhedged. With respect to option

contracts traded on securities exchanges, the Commission has recognized that it is “appropriate for the SROs to recognize the hedged nature of certain combined options strategies and prescribe margin requirements that better reflect the risk of those strategies.”¹¹

CME believes that the same considerations apply in connection with the determination of performance bond levels for offsetting positions involving security futures and related positions. If performance bond offsets were not available with respect to security futures, the customer performance bond requirements applicable to such instruments would effectively be inconsistent with, and more onerous than, the performance bond requirements for comparable option contracts traded on securities exchanges. This would be contrary to the statutory objectives reflected in Section 7(c)(2)(B) of the Act.¹²

Proposed Rule 930.B.2.d. is accompanied by a schedule which describes in detail the performance bond offsets available with respect to particular combinations of security futures and related positions. Such schedule is substantively identical to the table of offsets included in the Commission’s release on Customer Margin Rules Relating to Security Futures (the “Customer Margin Release”).¹³ While the table differs in certain respects from similar tables in effect for exchange-traded options, the Commission acknowledged in its Customer Margin Release that these limited differences are warranted by different characteristics of the instruments to which they relate. Accordingly, CME believes that the Proposed Margin Offset Rule is consistent with the requirements of the Act and the rules and regulations thereunder.

Performance Bond Administration—Proposed Rule 930.C.2.a identifies the types of performance bonds that a security futures intermediary may accept from a Customer. Consistent with SEC Regulation 242.404(b) and CFTC Regulation 41.46(b), acceptable types of

performance bond are limited to: deposits of cash, margin securities (subject to specified restrictions), exempted securities, any other assets permitted under Regulation T of the Board of Governors of the Federal Reserve System to satisfy a performance bond deficiency in a securities margin account, and any combination of the foregoing. Proposed Rule 930.C.2.b. further provides that the different types of eligible performance bond are to be valued in accordance with the applicable principles set forth in SEC Regulations 242.404(c) and 242.404(e) and CFTC Regulations 41.46(c) and 41.46(e).

Proposed Rule 930.K.2 requires a security futures intermediary to take the deduction required with respect to an underfunded account in computing its net capital under applicable CFTC and SEC Regulations if the customer has failed to comply with a required performance bond call within a reasonable period of time. This requirement is consistent with SEC Regulation 242.406(a) and CFTC Regulation 41.48(a). Further, Proposed Rule 930.K.2 requires the liquidation of an account where there is a liquidating deficit, in accordance with SEC Regulation 242.406(b) and CFTC Regulation 41.48(a).

2. Statutory Basis

The Act Regulations and related provisions of the Act are premised on each self-regulatory organization adopting performance bond requirements that are functionally equivalent to the proposed amendments to CME Rule 930. Accordingly, CME Rule 930, as amended per this proposal, represents a corollary of, and is designed to give effect to, the Act Regulations and related provisions of the Act.

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

CME does not believe that the proposed rule amendments will have an impact on competition because, as described above, (1) the Exchange’s general approach to the question of customer performance bonds for security futures is based on its long standing practices, consistent with standards adopted by the U.S. futures exchanges’ Joint Audit Committee and similar rules in effect for other contract markets, (2) customer performance bond for security futures will be consistent with rules in effect for options traded on exchanges registered pursuant to Section 6(a) of the Act;¹⁴ and (3) CME’s

⁸ 15 U.S.C. 78g(c)(2)(B).

⁹ 15 U.S.C. 78f(a).

¹⁰ *Id.*

¹¹ See Securities Exchange Act Release Nos. 41658 (July 27, 1999), 64 FR 42736 (August 5, 1999) (order approving SR-CBOE-97-67 amending CBOE Rule 12.3); 42011 (October 14, 1999), 64 FR 57172 (October 22, 1999) (order approving SR-NYSE-99-03 amending NYSE Rule 431); 43582 (November 17, 2000), 65 FR 71151 (November 29, 2000) (order approving SR-Amex-99-27 amending Amex Rule 462); and 43581 (November 17, 2000), 65 FR 70854 (November 28, 2000) (order approving SR-NASD-00-15 amending NASD Rule 2520).

¹² 15 U.S.C. 78g(c)(2)(B).

¹³ See Securities Exchange Act Release No. 46292 (August 1, 2002), 67 FR 53146 (August 14, 2002).

¹⁴ 15 U.S.C. 78f(a).

proposed Market Maker Exception ensures that qualifying security futures dealers on CME are subject to performance bond requirements that are comparable to those traditionally applicable to security futures dealers on securities exchanges. In addition, it is expected that other self-regulatory organizations listing Security Futures will adopt rules that are substantially similar to the proposed rule amendments.

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

Comments on the proposed rule amendments have not been solicited by the Exchange nor have any such comments been received to date.

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, as amended; 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, as amended, 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, as amended, 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 at the principal offices of the Exchange. All submissions should refer to File No.

SR-CME-2002-01 and should be submitted by November 12, 2002.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁵

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 02-26721 Filed 10-18-02; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-46657; File No. SR-CHX-2002-18]

Self-Regulatory Organizations; The Chicago Stock Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change Relating to Execution Price for Odd-Lot Orders Executed on the Chicago Stock Exchange

October 11, 2002.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on June 20, 2002, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the CHX.³ CHX filed Amendment No. 1 to the proposed rule change on September 23, 2002.⁴ The Commission is publishing this notice, as amended, to solicit comments on the proposed rule change from interested persons, and order accelerated approval of the proposed rule change.

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

The Exchange proposes to amend Article XXXI, Rule 9 of the CHX Rules, which governs, among other things, execution prices for odd-lot orders. The text of the proposed rule follows:

Additions are *italicized*; deletions are [bracketed].

¹⁵ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ This submission is virtually identical to SR-CHX-2001-29, which was filed with the Commission on November 23, 2001, but was erroneously given a pre-existing file number by the CHX.

⁴ See letter from Kathleen M. Boege, Associate General Counsel, CHX, to Nancy J. Sanow, Assistant Director, Division of Market Regulation, Commission (September 20, 2002) ("Amendment No. 1"). In Amendment No. 1, CHX made clarifying and technical changes to the rule text of the proposed rule change.

Chicago Stock Exchange Rules

Article XXXI

Odd-Lots and Odd-Lot Dealers, Dual System

* * * * *

Execution of Odd-Lot Orders During the Primary Trading Session

Rule 9.

* * * * *

(b) Nasdaq/NM Securities and Dually Traded Issues. As to Nasdaq/NM Securities [and to certain stocks dually traded on this Exchange and on another national securities exchange and which stocks have been designated as being in the dual trading system], market orders will be accepted for execution as an odd-lot based on the best bid disseminated pursuant to SEC Rule 11 Ac1-1 on a sell order or the best offer disseminated pursuant to SEC Rule 11 Ac 1-1 on a buy order in effect at the time the order is presented at the specialist post, provided the order is for a number of shares less than the full lot in said stock. *Any market order to purchase or sell a Dual Trading System issue in an odd-lot amount, which is transmitted for execution to an odd-lot dealer or its agent shall be executed, unless otherwise provided herein, at the price of the adjusted ITS bid (in the case of an order to sell) or adjusted ITS offer (in the case of an order to purchase) in the security at the time the order is received by the Exchange system designated to process odd-lot orders (the "odd-lot system").*

* * * * *

(b) General. [An odd-lot market order shall be executed at the proper full lot bid or ask price.]

* * * * *

(vi) *In instances in which quotation information is not available, e.g., the quotation collection or dissemination facilities are inoperable, or the primary market in the security has been determined to be in non-firm mode (as referenced in Interpretation and Policy .01), standard, regular way odd-lot market orders shall be executed based on the next primary market round lot sale or shall be executed by the member organization designated by the Exchange as the odd-lot dealer for the issue, at a price deemed appropriate under prevailing market conditions.*

* * * * *

Interpretations and Policies:

.01 *Adjusted Best Bid or Offer. For purposes of paragraph (b) of this Rule, the terms "adjusted ITS best bid" and "adjusted ITS best offer" for a security shall mean the highest bid and lowest*