securities: (i) The Federal Home Loan Mortgage Corporation, (ii) the Federal National Mortgage Association, (iii) the Student Loan Marketing Association, and (iv) the Financing Corporation.

3. Securities issued by, or guaranteed as to principal and interest by, the following Multilateral Development Banks—the obligations of which are backed by the participating countries, including the U.S.—may be pledged when borrowing any securities: (i) The International Bank for Reconstruction and Development, (ii) the Inter-American Development Bank, (iii) the Asian Development Bank, (iv) the African Development Bank, (v) the European Bank for Reconstruction and Development, and (vi) the International Finance Corporation.

4. Mortgage-backed securities meeting the definition of a ''mortgage related security'' set forth in section 3(a)(41) of the Exchange Act may be pledged when borrowing any securities.

5. Negotiable certificates of deposit and bankers acceptances issued by a ''bank'' as that term is defined in section 3(a)(6) of the Exchange Act, and which are payable in the United States and deemed to have a ''ready market'' as that term is defined in 17 CFR 240.15c3–1 (''rule 15c3–1''),[4] may be pledged when borrowing any securities.

6. Foreign sovereign debt securities may be pledged when borrowing any securities, *provided* that, (i) at least one nationally recognized statistical rating organization (''NRSRO'') has rated in one of its two highest rating categories either the issue, the issuer or guarantor, or other outstanding unsecured long-term debt securities issued or guaranteed by the issuer or guarantor; and (ii) if the securities pledged are denominated in a different currency than those borrowed,[5] the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of rule 15c3–3 (100%) by 1% when the collateral is denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen, or by 5% when it is denominated in another currency.

7. Foreign sovereign debt securities that do not meet the NRSRO rating condition set forth in item 6 above may be pledged only when borrowing non-equity securities issued by a person organized or incorporated in the same jurisdiction (including other debt securities issued by the foreign sovereign); *provided* that, if such foreign sovereign debt securities have been assigned a rating lower than the securities borrowed, such foreign sovereign debt securities must be rated in one of the four highest rating categories by at least one NRSRO. If the securities pledged are denominated in a different currency than those borrowed, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of rule 15c3–3 by 1% when the collateral is denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen, or by 5% when it is denominated in another currency.

8. The Euro, British pound, Swiss franc, Canadian dollar or Japanese yen may be pledged when borrowing any securities, *provided* that, when the securities borrowed are denominated in a different currency than that pledged, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of rule 15c3–3 by 1%. Any other foreign currency may be pledged when borrowing any non-equity securities denominated in the same currency.

9. Non-governmental debt securities may be pledged when borrowing any securities, *provided* that, in the relevant cash market they are not traded flat or in default as to principal or interest, and are rated in one of the two highest rating categories by at least one NRSRO. If such securities are not denominated in U.S. dollars or in the currency of the securities being borrowed, the broker-dealer shall provide collateral in an amount that exceeds the minimum collateralization requirement in paragraph (b)(3) of rule 15c3–3 by 1% when the securities pledged are denominated in the Euro, British pound, Swiss franc, Canadian dollar or Japanese yen, or by 5% when they are denominated in any other currency.

The categories of permissible collateral identified above do not include securities that (i) have no principal component, or (ii) accrue interest at the time of the pledge at a stated rate equal to or greater than 100% per annum (expressed as a percentage of the actual principal amount of the security).

Broker-dealers pledging any of the securities set forth above must, in addition to satisfying the notice requirements already contained in paragraph (b)(3) of rule 15c3–3, include in the written agreement with the customer a notice that some of the securities being provided by the borrower as collateral under the agreement may not be guaranteed by the United States.

By the Commission.

Margaret H. McFarland,
Deputy Secretary.
[FR Doc. 03–9845 Filed 4–21–03; 8:45 am]
BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47676; File No. SR–CBOE–2002–05]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment Nos. 1, 2, 3, and 4 Thereto by the Chicago Board Options Exchange, Incorporated Relating to the Introduction of the CBOE Hybrid System

April 14, 2003

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the ''Act''),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on January 18, 2002, April 2, 2002, May 17, 2002, January 16, 2003, and April 7, 2003, respectively, the Chicago Board Options Exchange, Incorporated (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission'') the proposed rule change, and Amendments No. 1, 2, 3, and 4 to the proposed rule change,[3] as described in Items I, II, and III below, which Items have been prepared by the CBOE. 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 CBOE proposes to implement the CBOE Hybrid System, a revolutionary options trading platform that combines the best features of both open outcry and electronic trading systems. When operational, the CBOE Hybrid System will offer automatic executions of eligible electronic orders and still provide an open-outcry trading

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[4] Certificates of deposit and bankers acceptances are deemed to have a ''ready market'' under rule 15c3–1 if, among other things, they are issued by a bank as defined in section 3(a)(6) of the Exchange Act that is (i) subject to supervision by a federal banking authority, and (ii) rated investment grade by at least two nationally recognized statistical rating organizations or, if not so rated, has shareholders' equity of at least $400 million.

[5] For the purposes of this Order, equity securities will be deemed to be denominated in the currency of the jurisdiction in which the issuer of such securities has its principal place of business.

[1] 15 U.S.C. 78(b)(1).
[2] 17 CFR 240.19b–4.
[3] Amendment No. 4 supersedes the original filing and Amendments No. 1, 2, 3 in their entirety.

environment for trades to occur on the floor of the Exchange. 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 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 parts of such statements.

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

1. Purpose

The Exchange hereby proposes the introduction of the CBOE Hybrid System ("Hybrid" or "Hybrid System"), a revolutionary trading platform that will alter the fundamental way in which the Exchange conducts business. When operational, Hybrid will combine the features of electronic trading with the benefits of open outcry, auction market principles to form the most dynamic trading platform in the options industry.

Hybrid merges the electronic and open outcry trading models while at the same time it offers market participants the ability to stream electronically their own quotes. Today, CBOE's disseminated quote represents, for the most part, the DPM's autoquote price and market makers are able to affect changes to that quote in open outcry (or by putting up manual quotes). Hybrid will offer market participants (which are defined as in-crowd market makers, in-crowd DPMs, and in-crowd floor brokers) the opportunity to submit their own firm disseminated market quotes that represent their own trading interest.[4] Whereas there currently is only one autoquote price comprising the CBOE disseminated quote, Hybrid will allow for the introduction of multiple

quotes in the quoting equation. Market makers will have the ability to stream quotes that reflect their individualized trading interest.

Incoming electronic orders from public customers and certain types of broker-dealers that execute against market participants' quotes will be allocated to the best quoters pursuant to a novel and unique trading algorithm. This "Ultimate Matching Algorithm" ("UMA" or the "Algorithm") retains public customer priority and rewards those market participants pursuant to a formula that balances the concepts of quoting at the best price with providing liquidity at the best price. The result will be substantially enhanced incentives for market participants to quote competitively and substantially reduced disincentives to quote competitively.[5] Indeed, the ability to stream electronic quotes combined with the ability to receive electronic and instantaneous allocations of incoming orders will reward market participants that quote at the best price. The Exchange believes that Hybrid, with its ability to allow multiple quotes and instantaneous allocations, may have the attendant benefit of tightening the Exchange's best disseminated quote. Whereas the Exchange's current disseminated quote, which is comprised of only one electronic input, may be replaced by a disseminated quote that reflects multiple inputs, the Exchange expects that spread widths may decline and liquidity may increase.

Hybrid also retains the benefits inherent in a floor-based, open outcry exchange. Order entry firms will continue to have the ability to have their floor brokers walk into a trading crowd and request markets on behalf of their customers. Trading crowds, as is the case today, may continue to offer price improvement to orders of size, complex orders, and other orders that are exposed to the open outcry, auction market environment. The opportunity for market participants to offer price improvement is a concept that exists only in extremely limited instances on all-electronic exchanges. The CBOE Hybrid System will enhance the ability of order entry firms to satisfy their due

diligence and best-execution obligations by providing them with a trading platform that provides efficient and instantaneous electronic executions when CBOE is the NBBO, along with the opportunity for price improvement.

Hybrid will also offer improved access to the broker-dealer community. In this respect, non-market maker broker-dealers will have the same access to the electronic execution feature of Hybrid that public customers will enjoy in designated classes. This will allow eligible broker-dealers to receive more automatic executions of the orders they route to CBOE. Additionally, the Hybrid rules for the first time allow for the "opening of the book" to certain types of broker-dealer orders. Accordingly, these broker-dealer orders will be eligible for placement into the electronic book against which they may be executed electronically. Finally, Hybrid also allows for the opportunity for broker-dealers to electronically access the limit order book (*i.e.,* buy or sell the book) in eligible classes. This feature will allow for the automatic execution of broker-dealer orders against resting limit orders in the book, whether they are public customer or broker-dealer orders in the book. Taken together, these features greatly enhance the handling of broker-dealer orders, thereby making the Exchange more broker-dealer friendly.

To implement Hybrid the Exchange proposes the adoption of several new rules (most notably CBOE Rules 6.13 and 6.45A) and the amendment of several existing rules. New CBOE Rule 6.13 replaces the Exchange's RAES Rule 6.8 for those classes in which Hybrid is operational and will govern the automatic execution of incoming electronic orders. Proposed CBOE Rule 6.45A is the new priority and allocation rule and codifies UMA. Together, these rules form the backbone of a trading system that will provide investors with deeper and more liquid markets, will provide market participants with substantially enhanced incentives to quote competitively, will greatly expand broker-dealer access, and will provide order entry firms with a trading platform CBOE believes is most conducive to satisfying their best execution and due diligence obligations.

This proposal will only apply to equity options. Accordingly, the Exchange proposes a rollout schedule that will see the introduction of equity option classes trading on Hybrid by May 30, 2003. New equity option classes will continue to be rolled out gradually as the Exchange and its membership become more familiar and acquainted with the operation of the system. The determination of which classes to roll

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[4] In this respect, in-crowd floor brokers may represent orders on behalf of members, broker-dealers, public customers, and the firm's proprietary account. Pursuant to Rule 6.75, floor brokers generally may not execute any orders for which they have been vested with the discretion to choose: the class of options to buy/sell, the number of contracts to buy/sell, or whether the transaction shall be one to buy or sell. Floor brokers may not stream quotes.

[5] Subparagraph IV.B.h(i)(aa) of the Commission's September 11, 2000 Order ("Order") requires the Exchange to "adopt new, or amend existing, rules concerning its automated quotation and execution systems which substantially enhance incentives to quote competitively and substantially reduce disincentives for market participants to act competitively." Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. Securities Exchange Act Release No. 43268 (September 11, 2000).

out, and when to roll them out, will be made by the Equity Floor Procedures Committee. The Exchange hopes to expand the rollout to the Top 200 classes by January 2004 and by the fourth quarter of 2004, to expand the rollout to the 500 most active equity options. The Exchange intends to implement Hybrid floor-wide in all classes by the fourth quarter of 2006.

Non-Hybrid Classes

For classes in which Hybrid is not yet operational, market makers will continue to be able to input manual quotes and receive allocations of incoming orders that execute against those quotes, as prescribed by existing CBOE Rule 6.8(d)(vi). Following is a descriptive summary of the new rules and the amended rules for the new Hybrid System.

Rule 6.13 CBOE Hybrid System's Automatic Execution Feature

This rule governs the automatic execution of incoming electronic customer and certain broker-dealer ("BD") orders. Just as CBOE Rule 6.8 has no application to classes trading on Hybrid, this Rule is only applicable to classes trading on Hybrid. The allocation of electronically executed orders in Hybrid shall be pursuant to new CBOE Rule 6.45A.

Proposed section (b) governs aspects of the automatic execution feature, including defining eligible orders and eligible order size, the process for automatic execution, split price executions, and executions against orders in the electronic book.

Eligible Orders and Order Size

This section clarifies that eligible orders may be automatically executed in accordance with the provisions of this Rule. Hybrid creates two broad categories of orders that will be eligible for automatic execution. First, orders from non-broker-dealer public customers and non-market maker broker-dealers will be eligible for automatic execution for the same number of contracts. Second, consistent with current CBOE Rule 6.8.01, the appropriate floor procedure committee ("FPC") may determine that orders from market makers and specialists may be eligible for automatic execution. Orders not eligible for automatic execution instead will route to PAR, BART, or to the order entry firm's booth printer.[6] All BD orders of a particular origin code

will be routed to the same location (*e.g.,* all orders designated by the "N" origin code (non-CBOE market makers) will route to the firm's booth). Any changes to the routing parameters of non-auto-ex eligible BD orders will be made by the appropriate FPC and announced to the membership via regulatory circular.

As is the case today, the appropriate FPC shall determine on a class-by-class basis the maximum size of orders entitled to receive automatic execution through Hybrid. If the eligible order size exceeds the disseminated size, incoming eligible orders shall be entitled to receive an automatic execution up to the disseminated size. Similarly, if the appropriate FPC determines to allow market makers to access the automatic execution feature of Hybrid, it may also determine to establish the maximum order size eligibility for such orders at a level lower than the maximum order size eligibility for non-broker-dealer public customers and non-market-maker broker-dealers.

Split-Price Executions

Eligible orders will be automatically executed. Eligible orders for a size greater than the disseminated size will be automatically executed in part, up to the disseminated size. The balance of the order if marketable will execute automatically at the revised disseminated price up to the revised disseminated size (provided it does not violate NBBO, in which case it will route to PAR or BART).[7] If not marketable, the balance of the order will book electronically.

Automatic Executions at Prices Inferior to NBBO

When CBOE is not the NBBO, eligible orders will not automatically execute and instead, shall route to the DPM's PAR terminal for non-automated handling. Alternatively, order entry firms will have the ability, at their discretion, to have these orders route to the firm's booth instead of PAR. Eligible orders received while the CBOE market is locked (*e.g.,* $1.00 bid—$1.00 offered) shall be eligible for automatic execution on CBOE at the disseminated quote, provided that CBOE's disseminated quote is not inferior to the NBBO, in which case the order will either route to the DPM's PAR terminal or the firm's booth.

Users, Order Entry Firms, and Prohibited Practices

CBOE Rule 6.13(c) defines "User" as any person or firm that obtains

electronic access to the automatic execution feature of the CBOE Hybrid System through an Order Entry Firm. The term "Order Entry Firm" ("OEF") means a member organization of the Exchange that is able to route orders to the Exchange's Order Routing System.

Order Entry Firms are required to comply with all applicable CBOE options trading rules and procedures. They are required to provide written notice to all Users regarding the proper use of the CBOE Hybrid System, including any automated execution features. The Rule also requires OEFs to Maintain adequate procedures and controls that will permit the OEF to effectively monitor and supervise the entry of electronic orders by all Users. OEFs must monitor and supervise the entry of orders by Users to prevent the prohibited practices set forth below. These requirements are identical to those contained in CBOE Rule 6.8(e).

This section also incorporates the provisions found in current CBOE Rules 6.8 and 6.8A regarding prohibited practices. In this respect, prohibited practices include but are not limited to the following:

1. Dividing an order into multiple smaller orders for the purpose of meeting the eligible order size requirements for automatic execution ("unbundling").

2. The electronic generation and communication of orders (and cancellations) in violation of CBOE Rule 6.8A by non-trading crowd participants.

3. Effecting transactions that constitute manipulation as provided in CBOE Rule 4.7 and Rule 10b–5 under the Act.

Trade Nullification Procedure

A trade executed on the CBOE Hybrid System may be nullified if the parties to the trade agree to the nullification. When all parties to a trade have agreed to a trade nullification, one party must contact the Help Desk, which will confirm the agreement and disseminate cancellation information in prescribed OPRA format.

Removal of Unreliable Quotes

The Exchange incorporates from existing CBOE Rule 6.8.02 language pertaining to the removal of unreliable quotes or markets from NBBO calculation. To summarize, floor officials may remove unreliable quotes in one or more options classes upon: (1) Direct communication from the affected market or the dissemination through OPRA of a message indicating that disseminated quotes are not firm; or (2) direct communication from the affected market that it is experiencing systems or

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[6] BART is the Booth Automated Routing Terminal that enables firms to maintain orders in electronic format. Orders routed to the firm's booth, as opposed to BART, will print at the booth and must be handled by the firm manually.

[7] The balance of the order will only route to BART if the order entry firm so requests.

other problems affecting the reliability of its disseminated quotes. Any decision to remove a market or its quotes from NBBO calculation will be promptly communicated to the affected market and duly recorded by the Exchange.

Rule 6.45A   Priority and Allocation of Trades for CBOE Hybrid System

This rule establishes the priority principles applicable to Hybrid and provides for the allocation of trades. The rules of priority and order allocation procedures set forth in this rule shall apply only to option classes designated by the Exchange for trading on the CBOE Hybrid System. For those classes not trading on the Hybrid System, CBOE Rule 6.45 will govern. This section has four main parts:

- Allocation of Incoming Electronic Orders
- Allocation of Orders Represented in the Trading Crowd
- Interaction of Market Participant's Quotes and/or Orders with Orders in Electronic Book
- Quotes Interacting with Quotes

A. Allocation of Incoming Electronic Orders

Electronic orders will be allocated using UMA, the Exchange's Ultimate Matching Algorithm. In UMA, any market participant (defined as an in-crowd market maker, in-crowd floor broker, or DPM for the class) who enters a quotation that is represented in the disseminated CBOE best bid or offer ("BBO") shall be eligible to receive allocations of incoming electronic orders for up to the size of its quote. If the number of contracts represented in the disseminated quote is less than the number of contracts in an incoming electronic order(s), the incoming electronic order(s) shall only be entitled to receive a number of contracts up to the size of the disseminated quote. The balance of the electronic order will be eligible to be filled at the refreshed quote either electronically or manually and, as such, may receive a split price execution (as provided in CBOE Rule 6.13).

Priority of Orders in the Electronic Book

Public customer orders in the electronic book have priority. Multiple public customer orders in the electronic book at the same price are ranked based on time priority. If a public customer order(s) in the electronic book matches, or is matched by, a market participant quote, the public customer order(s) shall have priority and, the balance of the electronic order, if any, will be allocated via UMA.

If pursuant to CBOE Rule 7.4(a) the appropriate FPC determines to allow certain types of broker-dealer orders to be placed in the electronic book, then for purposes of this rule, the cumulative number of broker-dealer orders in the electronic book at the best price shall be deemed one "market participant" regardless of the number of broker-dealer orders in the book. The allocation due the broker-dealer orders in the electronic book by virtue of their being deemed a "market participant" shall be distributed among each broker-dealer order comprising the "market participant" via UMA. For example, if there were five BD orders in the book for a cumulative 100 contracts, those five BD orders would be deemed "one market participant" for 100 contracts. The allocation of incoming orders among the five BD orders in the book would be done pursuant to UMA.

Operation of the Allocation Algorithm

When a market participant is quoting alone at the disseminated CBOE BBO and is not subsequently matched in the quote by other market participants prior to execution, it will be entitled to receive incoming electronic order(s) up to the size of its quote. In this respect, market participants quoting alone at the BBO have priority.

When more than one market participant is quoting at the BBO, inbound electronic orders shall be allocated pursuant to UMA. UMA is an algorithm that allocates orders based on two separate yet important aspects: parity (*i.e.,* multiple participants quoting at the best price) and depth of liquidity (*i.e.,* relative size of each market participant's quote).[8] Each of these components is described in greater detail below.

The UMA formula is as follows:

Allocation Algorithm

$$\text{Incoming Order Size} * \frac{\begin{array}{c}\text{(Equal Percentage based on number} \\ \text{of market participants quoting at BBO)} \\ \text{(Component A)}\end{array} + \begin{array}{c}\text{(Pro-rata Percentage based on size} \\ \text{of market participants quotes)} \\ \text{(Component B)}\end{array}}{2}$$

Component A: This is the parity component of UMA. In this component, UMA treats as equal all market participants quoting at the relevant best bid or best offer (or both). Accordingly, the percentage used for Component A is an equal percentage, derived by dividing 100 by the number of market participants quoting at the best price. For instance, if there were four market participants quoting at the best price, each is assigned 25% for Component A (or 100/4). This component rewards and incents market participants that quote at a better price than do their counterparts even if they quote for a smaller size.

Component B: This size pro-rata component is designed to reward and incent market participants to quote with size. As such, the percentage used for Component B of the Allocation Algorithm formula is that percentage that the size of each market participant's quote at the best price represents relative to the total number of contracts in the disseminated quote. For example, if the disseminated quote represents the quotes of market makers X, Y, and Z who quote for 20, 30, and 50 contracts respectively, then the percentages assigned under Component B are 20% for X, 30% for Y, and 50% for Z.

Final Weighting: The final weighting, which shall be determined by the appropriate FPC, shall be a weighted average of the percentages derived for Components A and B multiplied by the size of the incoming order. Initially, the weighting of components A and B shall be equal, represented mathematically by the formula: ((Component A Percentage +Component B Percentage)/2) * incoming order size. The final weighting shall apply uniformly across all options under the jurisdiction of the appropriate FPC.[9] Changes made to the weighting of Components A and B shall be announced to the membership in

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[8] UMA operates electronically and, as such, only market participants that are represented in the disseminated quote will participate in the allocation of incoming electronic orders. Multiple incoming orders will execute in accordance with CBOE Rule 8.51, Firm Disseminated Market Quotes.

[9] While the initial weighting of Components A and B will be equal, the rule allows the appropriate FPC to adjust the weighting percentages, which it would do if it believed such modifications would further enhance market participants' incentives to quote competitively or reduce disincentives to quote competitively, in accordance with the terms of the Order.

advance of implementation via Regulatory Circular.

DPM's Participation Entitlement

By virtue of their performance of additional obligations, DPMs generally are entitled to receive a participation entitlement for transactions that occur at the DPM's quote.[10] If a DPM is eligible for an allocation pursuant to the operation of the Algorithm described above, its allocation shall be either: [11]

(1) The greater of the amount it would be entitled to pursuant to the DPM participation right established pursuant to CBOE Rule 8.87 (and Regulatory Circulars issued thereunder) or the amount it would otherwise receive pursuant to the operation of the Algorithm described above; or

(2) The amount it would be entitled to pursuant to the DPM participation right established pursuant to CBOE Rule 8.87 (and Regulatory Circulars issued thereunder).

The appropriate FPC shall determine which of the above two formulas will be applicable to all classes over which it has jurisdiction.[12] Each pronouncement regarding which formula to be used will be made via Regulatory Circular.

B. Allocation of Orders Represented in the Trading Crowd

This section governs the allocation of orders that are represented in the trading crowd by floor brokers (including DPMs acting as agent under CBOE Rule 8.85(b)).

Priority of Orders in the Electronic Book

As an initial matter, public customer orders in the electronic book have priority. Multiple public customer orders in the electronic book at the same price are ranked based on time priority. If a public customer order(s) in the electronic book matches, or is matched by, an oral bid or offer provided by a member of the trading crowd, the public customer order(s) shall have priority and the balance of the order, if any, will be allocated in open outcry, as described below.

If pursuant to CBOE Rule 7.4(a) the appropriate FPC determines to allow broker-dealer orders to be placed in the electronic book, then for purposes of this rule, the cumulative number of broker-dealer orders in the electronic book at the best price shall be deemed one ''book market participant'' (or ''BMP'') regardless of the number of broker-dealer orders in the book. Any allocation due the broker-dealer orders in the electronic book by virtue of their being deemed a ''book market participant'' shall be distributed among each broker-dealer order comprising the BMP in accordance with UMA.

Allocation

The method for allocating orders that are represented in the trading crowd by floor brokers is dependent upon whether there are any book market participants quoting at the prevailing price.

1. *No BMP Present at the Prevailing Price.* If there is no BMP present at the prevailing price, allocation of open outcry orders shall be pursuant to existing CBOE Rule 6.45(a) and (b).

2. *BMP is Present at the Prevailing Price.* In an effort to ensure that BMPs receive at least partial allocations of orders received in open outcry, CBOE proposes to adopt an allocation rule that will limit market participants in the crowd to a predetermined percentage. If two or more bids (offers) represent the best price, priority shall continue to be afforded in the sequence in which the bids (offers) were made subject to the restriction that the first market participant to respond shall be entitled to 70% of the order. The second market participant to respond (if ascertainable) shall be entitled to 70% of the remainder of the order (*i.e.*, 70% of 30%). The balance of the order shall be apportioned equally among the remaining market participants bidding (offering) at the same price and the BMP. The portion allocated to the BMP shall be distributed amongst each book market participant pursuant to the allocation algorithm described in CBOE Rule 6.45A(a)(i)(B)(2) above.

If at any point the order in which market participants respond is not ascertainable, the balance of the incoming order, if any, shall be apportioned equally among the remaining market participants bidding (offering) at the same price and, if applicable, the book market participant. If a market participant declines to accept any portion of the available contracts, any remaining contracts shall be apportioned equally among the other participants who bid (offered) at the best price (including the book market participant, if applicable) at the time the market was established until all contracts have been apportioned.

Complex Order Exception

The CBOE Hybrid System will continue to utilize the exception to the general priority rules for complex orders. As such, the Exchange incorporates existing Rule 6.45(e). CBOE, however, takes this opportunity to shorten it considerably. The revisions do not change the substance of the rule.

C. Interaction of Market Participant's Quotes and/or Orders With Orders in Electronic Book

Under proposed CBOE Rule 6.45A(c), market participants may also submit orders electronically to trade with orders in the electronic book. If only one market participant submits an electronic order or quote to trade with an order in the electronic book, that market participant shall be entitled to receive an allocation of the order in the electronic book up to the size of the market participant's order. If, however, more than one market participant submits an order to trade with the book, each market participant that submits an order or quote to buy (sell) an order in the electronic book within a period of time not to exceed 5 seconds [13] of the first market participant to submit an order (''N-second group'') shall be entitled to receive an allocation of the order in the electronic book pursuant to the following allocation algorithm:

Allocation Algorithm

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[10] Among the obligations, which are codified in CBOE Rule 8.85, are: The requirement to quote continuously, the obligation to make legal width markets; the obligation to book eligible orders; the requirement to represent orders routed to the PAR station; the obligation under Linkage to handle all inbound linkage orders and to send satisfaction orders on behalf of customer orders in CBOE's book.

[11] In either case, the DPM's entitlement cannot exceed the size of the DPM's quote.

[12] Due to a systems limitation, the Exchange initially will use method two and set the DPM's participation entitlement at the amount it would be entitled to pursuant to CBOE Rule 8.87 (and Regulatory Circulars issued thereunder).

[13] This N-second period is configurable by the appropriate FPC but shall never exceed 5-seconds. Any reduction of this N-second period (or subsequent increase) shall be announced to the membership in advance of implementation via Regulatory Circular. Furthermore, this time period shall apply uniformly among all classes under the FPC's jurisdiction.

Electronic Book Order(s) Size	*	(Equal percentage based on number of members of "N-second group") (Component A)	+	(Size pro-rata percentage based on size of orders of N-second group members) (Component B)

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Component A: The percentage to be used for Component A shall be an equal percentage derived by dividing 100 by the number of market participants in the "N-second group."

Component B: Size Pro-rata Allocation: The percentage to be used for Component B of the Allocation Algorithm formula is that percentage that each participant of the "N-second group's" quote at the best price represents relative to the total number of contracts of all market participants of the "N-second group." [14]

Final Weighting: The final weighting, which shall be determined by the appropriate FPC, shall be a weighted average of the percentages derived for Components A and B, multiplied by the size of the order(s) in the electronic book. Initially, the weighting of components A and B shall be equal, represented mathematically by the formula: ((Component A Percentage + Component B Percentage)/2) * electronic book order size.

If a DPM is eligible for an allocation by virtue of being a member of the "N-second group" as described in paragraph (C)(2) above, the DPM shall be entitled to receive an allocation equal to the amount it would be entitled to pursuant to the DPM participation right established pursuant to CBOE Rule 8.87 (and Regulatory Circulars issued thereunder). The DPM's entitlement percentage is expressed as a percentage of the remaining quantity after all public customer orders in the electronic book have been executed.

The Exchange believes this process whereby all members of the "N-second group" receive an allocation of orders in the book will enhance competition. As discussed above, this process only applies when market participants attempt to access orders resting in the electronic book (*i.e.*, liquidity-taking). As such, this process has no effect on a market participant's liquidity-providing activities where he receives allocation of incoming orders. Thus, market makers

will always have an incentive to quote competitively (provide liquidity). Second, this process ensures that the market-making organization with the deepest pockets and fastest technology does not monopolize every order in the electronic book. This "arms race" scenario would create a situation where the fastest machine wins every time, even if it was faster by a number as miniscule as a few milliseconds.[15] This in turn would create a disincentive to other market participants who would be unable to interact with orders in the book. Creation of an "N-second group," conversely, gives these market participants an incentive to continue to submit orders and hence more of an incentive to remain on the floor of the exchange making markets, providing crucial liquidity.

D. Quotes Interacting With Quotes (Proposed Rule 6.45A(d))

Because Hybrid allows the simultaneous entry of quotes by multiple market makers,[16] there may be instances where quotes may become locked. If an in-crowd market maker's (including the DPM) disseminated quote interacts with the disseminated quote(s) of another in-crowd market maker (including the DPM), resulting in the dissemination of a "locked" quote (*e.g.,* $1.00 bid " 1.00 offer), the following shall occur:

(A) The Exchange will disseminate the locked market and both quotes will be deemed "firm" disseminated market quotes.

(B) The market makers whose quotes are locked will receive a quote update notification advising that their quotes are locked.

(C) A "counting period" will begin during which market makers whose quotes are locked may eliminate the locked market. Provided, however, that in accordance with subparagraph (A) above a market maker will be obligated to execute customer and broker-dealer orders eligible for automatic execution pursuant to CBOE Rule 6.13 at his

disseminated quote in accordance with CBOE Rule 8.51. During the "counting period" market makers will continue to be obligated for one contract in open outcry to other market makers, in accordance with CBOE Rules 8.51 and 6.48. If at the end of the counting period the quotes remain locked, the locked quotes will automatically execute against each other in accordance with the allocation algorithm described above in CBOE Rule 6.45A(a).

For the first 60 days after a class begins trading on the Hybrid System, the length of the "counting period" for that particular class may not exceed ten seconds. For the next 60 days thereafter (*i.e.*, days 61–120) the length of the "counting period" may not exceed seven seconds in that class. Commencing on the 121st day after a class begins trading on the Hybrid System, the length of the "counting period" may not exceed four seconds in that class. Beginning April 1, 2004, all classes trading on Hybrid will be subject to a counting period not to exceed four seconds. The appropriate FPC may shorten the duration of the "counting period."

The Exchange notes that the Hybrid System will not disseminate an internally crossed market (*i.e.*, the CBOE Bid is higher than the CBOE offer— $1.10 bid × $1.00 offer). If a market maker submits an incoming quote that would cross an existing quote, the Exchange will alter the incoming such that it locks the existing quote, at which point the locked quotes will be treated in accordance with the procedures described above. Correspondingly, the Exchange will notify the second market maker that its quote has been changed.[17]

The Exchange adds new Interpretations .01 and .02 to clarify that order entry firms may not bypass the crossing (CBOE Rule 6.74) and solicitation (CBOE Rule 6.9) rules without exposing orders they represent as agent for at least 30 seconds prior to electronically executing against those

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[14] As noted in Rule 6.45A(c)(ii), the appropriate FPC may determine that the maximum quote size to be used for each market participant in the Component B calculation shall be no greater than the cumulative size of orders resident in the electronic book at the best price market participants are attempting to buy (sell). This would prevent a market participant from "sizing out" competing market participants by, for example, submitting an order for 1,000 contracts to buy a book order for 10 contracts.

[15] The Exchange notes that customers or anyone else eligible to submit orders electronically may access the book ahead of market participants. In this instance, customers would have absolute priority and would not be required to share the order allocation with members of the N-second group.

[16] At the Exchange's request, the term "market participant" has been replaced with the term "market maker" throughout the discussion of proposed CBOE Rule 6.45A(d). Telephone conversation between Stephen Youhn, Senior Attorney, CBOE and Deborah Flynn, Assistant Director, Division of Market Regulation, Commission, on April 7, 2003.

[17] During the lock period, if the existing quote is cancelled subsequent to the changing of the incoming quote, the incoming quote will be restored to its original value. For example, assume MM A quotes 1.00–1.20 (which is the CBOE's disseminated quote) and MM B submits a 1.25–1.40 quote. Because MM B's quote would invert MM A's disseminated quote, MM B's quote will be changed to 1.20–1.40 and the disseminated quote will be 1.20–1.20. If during the lock period, MM A cancels its quote, MM B's quote (which is currently 1.20–1.40) will revert to its original value of 1.25–1.40.

orders through the auto-ex feature of Hybrid.

Rule 8.7. Obligations of Market Makers

CBOE Rule 8.7 governs market maker obligations. Market Makers on the CBOE Hybrid System will continue to be subject to the obligations imposed by this rule, as amended.

The proposed change to section (b)(ii) of CBOE Rule 8.7 clarifies that market makers will be obligated to honor their quotes for up to their disseminated size, in accordance with the Quote Rule. Under Hybrid, market makers will be deemed the ''responsible broker or dealer'' for quotes they cause to be disseminated. Currently, the entire trading crowd is considered the ''responsible broker or dealer.'' This represents a fundamental change and will also be reflected in CBOE Rule 8.51.

The proposed change to section (b)(iii) of CBOE Rule 8.7 imposes upon market makers an obligation to ensure that their quotes are accurate. This section also provides guidance as to the permissible methods by which market makers may quote. Under Hybrid, market makers will be able to quote verbally by open outcry in response to a request for a market or they may quote electronically (or submit orders electronically) by use of an exchange-approved quoting device. This rule also clarifies that market makers must be physically present in the trading crowd to quote and submit orders. This is designed to prevent remote market making.

The Exchange proposes to adopt new paragraph (d) to CBOE Rule 8.7 to govern market maker obligations in Hybrid classes. The proposed obligations in paragraph (d) will only apply to market makers trading classes on the CBOE Hybrid System and only in those Hybrid classes. As such, this section has no applicability to non-Hybrid classes. Proposed paragraph (d) to CBOE Rule 8.7 clarifies that unless otherwise provided in this Rule, market makers on the Hybrid System are subject to all obligations imposed by CBOE Rule 8.7. To the extent another obligation contained elsewhere in CBOE Rule 8.7 is inconsistent with an obligation contained in paragraph (d) of Rule 8.7, paragraph (d) shall govern.

The Exchange proposes an introductory rollout period with respect to the obligations contained in paragraph (d). Accordingly, for a period of ninety (90) days commencing immediately after a class begins trading on the Hybrid System, the provisions of proposed paragraph (d)(i) shall govern trading in that class. Upon completion of this 90-day rollout period, a market

maker's electronic trading volume will determine whether (d)(i) or (d)(ii) shall govern his trading activities, as described more fully below.

The Exchange notes that the requirements in proposed paragraph (d) to CBOE Rule 8.7 will be applicable on a per class basis depending upon the percentage of volume a market maker transacts electronically versus in open outcry. In making this determination, the Exchange will monitor market makers' trading activity every calendar quarter to determine whether they exceed the thresholds established below in paragraph (d)(i). If a market maker exceeds the threshold established below, the obligations contained in (d)(ii) will be effective the next calendar quarter.

Proposed Rule 8.7(d)(i) Market Maker Trades Less Than 20% Volume Electronically

If a market maker on the CBOE Hybrid System transacts 20% or less of his contract volume electronically in an appointed Hybrid class during any calendar quarter, the following provisions shall apply to that market maker in that class:

(A) Quote Widths: With respect to electronic quoting, the market maker will not be required to comply with the quote width requirements of CBOE Rule 8.7(b)(iv).

(B) Continuous Electronic Quoting Obligation: The market maker will not be obligated to quote electronically in any designated percentage of series within that class. If a market maker quotes electronically, its undecremented quote must be for at least ten contracts.

(C) Continuous Open Outcry Quoting Obligation: In response to any request for quote by a floor broker or DPM representing an order as agent, market makers must provide a two-sided market complying with the current quote width requirements contained in CBOE Rule 8.7(b)(iv) for a minimum of ten contracts.

(D) In-Person Quoting Requirement: Any volume transacted electronically will not count towards the market maker's in-person requirement contained in CBOE Rule 8.7.03(B).

Proposed Rule 8.7(d)(ii) Market Maker Trades More Than 20% Volume Electronically

If a market maker on the CBOE Hybrid System transacts more than 20% of his contract volume electronically in an appointed Hybrid class during any calendar quarter, beginning the next calendar quarter he will be subject to the following quoting obligations in that

class for as long as he remains in that class:

(A) Quote Widths: The market maker must comply with the quote width requirements contained in Rule 8.7(b)(iv).

(B) Continuous Quoting Obligation: A market maker will be required to maintain continuous two-sided quotes for at least ten contracts (undecremented size) in a designated percentage of series within the class, in accordance with the schedule below:

% of Overall Class Volume Transacted on CBOE During the Previous Quarter that was Transacted Electronically	Electronic Quoting % Requirement (Percentage of series)
50% or Below	20
51–75%	40
Above 75%	60

The Exchange will monitor on a calendar quarter basis the percentage of business transacted electronically on CBOE in each particular class for the purpose of adjusting the applicable electronic quoting percentage during the next succeeding calendar quarter. For example, if during the preceding calendar quarter 83% of the volume transacted on CBOE in a particular class is done electronically, market makers subject to paragraph (d)(ii) of CBOE Rule 8.7 will have an obligation to make continuous markets in 50% of the series trading in that class.

(C) Continuous Open Outcry Quoting Obligation: In response to any request for quote by a floor broker or DPM representing an order as agent, market makers must provide a two-sided market complying with the current quote width requirements contained in Rule 8.7(b)(iv) for a minimum of ten contracts.

The Exchange proposes minor non-substantive wording changes to Interpretation .02 to CBOE Rule 8.7. First, in Interpretation .02, the Exchange removes the first six words of the sentence ''although each pricing decision has many elements'' as they are superfluous.

The change to Interpretation .05 imposes a minimum quote size obligation upon market makers. Specifically, market maker quotes may not be for less than ten contracts. The Exchange notes that this size obligation only applies to a market maker's initial undecremented quote. Accordingly, if a market maker puts up a quote for 20 contracts and an incoming order executes against 15 of those contracts causing the market maker's disseminated size to decline to five

contracts, the market maker will not be in violation of any exchange rule. The CBOE Hybrid System will not accept any market maker quotes without an attached size. Closely related to this change is the proposed change to Interpretation .06 to CBOE Rule 8.7. Because the Hybrid System will not accept one-sided quotes, the current rule would have no applicability to electronic quotes. Accordingly, Interpretation .06 will now only apply to open outcry quotes.

The proposed change to Interpretation .07 to CBOE Rule 8.7 clarifies that this provision only applies in classes in which Hybrid is not operational. Because market makers will have the ability to submit their own quotes, this rule will not have any applicability.

The Exchange proposes to amend Interpretation .11 to clarify its applicability to different systems. New section (a) will only apply to classes on RAES while section (b) will apply to Hybrid classes. Section (b) for the most part is identical to section (a) except for the elimination of the reference to RAES, an elimination necessitated by the fact that RAES will not exist in the Hybrid environment.

Amendment of Additional Rules

The Exchange notes that to accommodate the introduction of Hybrid, it must amend numerous of its existing rules. While CBOE does not believe that the changes to these rules are as substantive as those made to the rules described above, they nevertheless are described below.

Rule 6.2   Trading Rotations

The Exchange amends existing CBOE Rule 6.2 to specifically reference the Hybrid Opening System ("HOSS") in order to indicate that trading rotations may occur via HOSS. The amendment to CBOE Rule 6.2.05 clarifies that the automatic execution feature of Hybrid may be disengaged during any closing rotation.

Rule 6.2A   Rapid Opening System

The Exchange amends its ROS rule to clarify it has no applicability to series trading on the CBOE Hybrid Opening System.

Rule 6.2B   Hybrid Opening System

This rule governs the opening procedures for the CBOE Hybrid System. HOSS is the Exchange's automated system for initiating trading at the beginning of each trading day. For each class of options contracts that has been approved for Hybrid trading, the System shall conduct an opening rotation, which shall be held promptly

following the opening of the underlying security in the primary market in accordance with the procedures contained in CBOE Rule 6.2B.

Rule 6.7   Exchange Liability

The Exchange amends this rule to clarify its applicability to Hybrid.

Rule 6.8   RAES Operations

The amendment clarifies that the RAES rule has no applicability to options classes traded on the CBOE Hybrid System. For classes not trading on Hybrid, Rule 6.8 will continue to be applicable.

Rule 6.20   Admission to and Conduct on the Trading Floor; Member Education

The Exchange proposes to amend Interpretations .04, .05 and .09 to make them applicable to Hybrid. In this respect, CBOE eliminates in Interpretation .04(i) the reference to CBOE Rule 6.43 as Hybrid allows market participants to effect transactions electronically. Thus, the prohibition against effecting a transaction without public outcry no longer violates CBOE Rule 6.43. The Exchange does not amend that portion of the rule referencing CBOE Rule 6.74.

The change to Interpretation .05 provides Floor Officials with the same authority to nullify transactions occurring in violation of proposed CBOE Rule 6.45A that they currently have with respect to CBOE Rule 6.45 (*i.e.,* non-Hybrid trades).

Current Interpretation .09 provides that Market Performance Committee members have Floor Official responsibilities with respect to enforcing rules relating to RAES. This amendment simply extends that authority to Hybrid.

Rule 6.43   Manner of Bidding and Offering

The proposed amendment to CBOE Rule 6.43(a) gives market participants the ability to enter quotes and orders electronically via Exchange-approved quoting devices. Previously, CBOE Rule 6.43(a) allowed only those bids and offers entered via open outcry. Proposed Rule 6.43(b) preserves the ability of trading crowd members to enter manual quotes in non-Hybrid classes. In classes trading on Hybrid, trading crowd members may enter their own quotes or orders through their own handhelds.[18]

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[18] An individual market maker may use the same handheld quoting device to enter both quotes and orders.

Rule 6.45   Priority of Bids and Offers— Allocation of Trades

The Exchange proposes two changes to CBOE Rule 6.45. The first change clarifies that the rules of priority in CBOE Rules 6.13 and 6.45A shall operate independent of the priority rules contained in CBOE Rule 6.45. Second, the Exchange amends CBOE Rule 6.45(e) for the purpose of making it easier to read. This section, as amended, is identical to proposed CBOE Rule 6.45A(b)(iii).

Rule 6.47   Priority on Split Price Transactions Occurring in Open Outcry

The changes to CBOE Rule 6.47 clarify that split price priority only applies to those transactions effected in open outcry. There will be no split price priority for electronic transactions.

Rule 6.54   Accommodation Liquidations

The Exchange proposes to add new Section (b) to allow for accommodation liquidations to occur in Hybrid. Given current system limitations, cabinet trades may only occur in open outcry trading and thus will not be eligible for placement into the limit order book.

Rule 7.4   Obligations for Orders

The Exchange proposes to amend CBOE Rule 7.4(a) to expand the types of orders eligible for entry into the electronic book.[19] Proposed paragraph (a)(1) gives the appropriate FPC the ability to determine the categories of orders eligible for entry into the book. This paragraph authorizes market participants to place orders in the book (in those classes in which Hybrid is operational.)[20] Additionally, this section enables the FPC to allow all BD orders to be book eligible or, as with current RAES access rules for BDs, to allow orders from those BDs that are not market makers or specialists to enter the book. Both methods substantially enhance book access for non-customers.

This proposed rule also preserves that section of the current rule that allows the FPC to determine the manner and form in which orders are submitted.[21] Similarly, the Exchange deletes the last sentence of current CBOE Rule 7.4(a)(2)

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[19] Currently only public customer orders are eligible for entry in the book.

[20] In this respect, market participants may place orders in the book. Regarding the entry of orders into the book from market participants in non-designated classes, they will not have "market participant" status and thus will be eligible for book entry only if the FPC has determined that all BD orders are eligible for book entry in that particular class.

[21] This, for example, would allow the FPC to require orders be submitted electronically into the book.

regarding the non-eligibility of BD orders for entry into the book.

The changes to proposed section (b) clarify that orders from market participants may be placed in the book (whether the order first routes to the OBO or directly into the book). The Exchange proposes to limit the applicability of paragraph (g) to non-Hybrid classes because ''live ammo'' functionality will not be available in Hybrid.

The Exchange proposes to delete existing Interpretation .05 to CBOE Rule 7.4 as obsolete. The Order Support System has been absent from the Exchange for more than ten years. Finally, the Exchange amends current Interpretation .07 by renumbering it as .06 and by adding reference to the automatic execution provisions of new CBOE Rules 6.13 and 6.45A.

Rule 7.7   Displaying Bids and Offers in the Book

The exchange also amends CBOE Rule 7.7 regarding the display of orders in the book. Specifically, the Exchange removes as obsolete the section of the rule that allows the OBO to display indications of book size when the book contains orders for at least 25 contracts. Because the Exchange currently disseminates the actual size of orders in the book, this section is obsolete. The Exchange also deletes Interpretation .01 in its entirety as obsolete.[22]

Rule 8.51   Firm Disseminated Market Quotes

The Exchange proposes to amend CBOE Rule 8.51(a)(1) to clarify that in Hybrid classes, the market participant who submits a quote that is disseminated shall be the responsible broker or dealer for that quote. In paragraph (c)(1), the Exchange removes the sentence indicating it will periodically publish the firm quote requirement for both BD and public customer orders. In this respect, the Exchange notes that in new subparagraph (c)(1(a)(i) to CBOE Rule 8.51 the firm quote requirement for customer orders shall be the size disseminated to vendors. In subparagraph (a)(ii), the Exchange clarifies that the firm quote requirement for BD orders will be the lesser of the size it disseminates to vendors or publishes in a different manner. This is almost identical to the current rule except that it provides flexibility to

[22] Exchange quote display systems automatically incorporate into the disseminated market quote all booked orders that improve the market (price or size). For this reason, the OBO does not have any ability to display the full (or less than full) size of an order.

allow the Exchange to disseminate its BD firm quote size (rather than publish it).

The Exchange also strikes existing Rule 8.51(c)(2)(a) as obsolete. In this respect, the Exchange disseminates actual size regardless of whether that size represents autoquote, an order in the book, or both. In any instance, the Exchange is firm for its disseminated size, as required by proposed CBOE Rule 8.51(c)(1)(a)(i).

The Exchange proposes to delete current Interpretation .01 and replace it with the definition of ''Responsible broker or dealer''contained in Rule 11Ac1–1(a)(21) under the Act. The Exchange deletes the existing portion of Interpretation .01 as obsolete. In this respect, the Exchange disseminates the actual size of its firm quote obligation that, intuitively, can never be less than the disseminated size. The Exchange also amends Interpretation .02 to replace reference to the terms floor broker, DPM, or OBO with the term market participant. Because under Hybrid, the market participant will be the responsible broker or dealer, it will be responsible for removing its quote.

The proposed amendment to Interpretation .08 does not change the intent of the rule: that the responsible broker or dealer not be required to honor quotes that are erroneous as the result of a third party. Because the trading crowd will not be the responsible broker or dealer in Hybrid, however, the Exchange amends the rule to remove reference to the trading crowd.

Finally, CBOE proposes a change to Interpretation .10 to clarify the timing of when firm quote obligations attach. Currently, firm quote obligations attach to an order received on a PAR station at the time the order is received on PAR. This interpretation remains intact for non-Hybrid classes. For Hybrid classes, firm quote obligations will attach to an order received on a PAR station depending upon who is the responsible broker or dealer. If the responsible broker or dealer is not the DPM, firm quote will attach when the order is announced to the trading crowd. If, however, the DPM is a responsible broker or dealer for that order, firm quote obligations attach at the time of receipt of that order on PAR. The Exchange notes that in instances when an order is received on PAR when the disseminated quote represents the DPM and other market makers, there will be two separate firm quote obligations: the DPM's firm quote obligation will attach at the time the order is received on PAR while the market makers' firm quote

obligations will attach when the order is announced to the crowd.[23]

Rule 8.85   DPM Obligations

To accommodate Hybrid, the Exchange proposes to amend CBOE Rule 8.85 regarding DPM obligations. First, the Exchange proposes to amend CBOE Rule 8.85(a)(i) to indicate that a DPM has a continuous quoting obligation with respect to its assigned classes. This ensures the DPM will quote at all times. Second, the Exchange clarifies subsection (ii) to indicate that the DPM must assure that each of its quotations is honored in accordance with the requirements of the Quote Rule. This change clarifies that DPMs must ensure their own compliance with the Quote Rule. Finally, the Exchange restricts the applicability of subparagraph (x) to non-Hybrid classes. In Hybrid, all market participants will have their own proprietary quoting systems. It would be anticompetitive to require the DPM to disclose its pricing formula to other members. In non-Hybrid classes, because there is only one autoquote that binds the entire crowd, this requirement remains.

2. Statutory Basis

The CBOE Hybrid System will provide investors with deeper and more liquid markets, will provide market participants with substantially enhanced incentives to quote competitively, and will provide order entry firms with a trading platform the exchange believes is most conducive to satisfying their best execution and due diligence obligations. For these reasons, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.[24] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[25] requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative

[23] Market makers in the crowd have no control over PAR and no access to PAR. They will be completely unaware that an order resides on PAR until that order is announced to them. Contrast this to the present situation where even though a market maker may be unaware of the receipt of an order on PAR, because the disseminated quote represents the entire trading crowd, the entire crowd is deemed to receive the order upon receipt of the order on PAR. In Hybrid, each quote represents a completely different entity and not the crowd.

[24] 15 U.S.C. 78f(b).

[25] 15 U.S.C. 78f(b)(5).

acts and, in general, to protect investors and the public interest.

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

CBOE does not believe that the proposed rule change will impose any burden on competition 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 has engaged in a substantial and extensive educational program to apprise members of the features of the CBOE Hybrid System. During this two-month long process, members and staff of the Exchange conducted weekly seminars for CBOE members to provide guidance as to how the CBOE Hybrid System would operate. To date, the Exchange received one comment letter.[26] The Arciero Letter primarily expressed concern regarding the future of the trading floor in the hybrid environment when the Exchange allows electronic quoting. The Arciero Letter indicated that largely capitalized market making organizations would have sufficient competitive advantages in Hybrid by virtue of their larger capitalization structures. In response to the Arciero Letter, the Exchange scheduled additional educational seminars identical to those previously conducted during September and October of this year. The Exchange notes that most, if not all, of the Arciero Letter concerns were addressed in those educational seminars.

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 self-regulatory organization 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.

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[26] Letter from Tony Arciero, CBOE Member, to Ed Tilly, Chairman, Equity Floor Procedure Committee, CBOE, dated November 7, 2002 ("Arciero Letter").

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 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 Section, 450 Fifth Street, NW., Washington, DC 20549. Copies of such filing will also be available for inspection and copying at the principal office of CBOE. All submissions should refer to File No. SR–CBOE–2002–05 and should be submitted by May 13, 2003.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[27]

Margaret H. McFarland,
Deputy Secretary.
[FR Doc. 03–9885 Filed 4–21–03; 8:45 am]
BILLING CODE 8010–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–47680; File No. SR–CHX–2003–10]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Stock Exchange, Inc. To Amend Its Membership Dues and Fees Schedule To Confirm the Amount of Consolidated Tape Association Credits Available to Its Members

April 15, 2003.

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 March 31, 2003, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule

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[27] 17 CFR 200.30–3(a)(12).

[1] 15 U.S.C. 78s(b)(1).

[2] 17 CFR 240.19b–4.

change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal pursuant to Section 19(b)(3)(A) of the Act,[3] and Rule 19b–4(f)(2) thereunder,[4] which renders the proposal effective upon filing with the Commission. The Exchange amended the proposal on April 14, 2003.[5] 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 Exchange proposes to amend its membership dues and fees schedule ("Schedule") to confirm the amount of Consolidated Tape Association ("CTA") credits available to members. The text of the proposed rule change is available upon request from the Office of the Secretary, the Commission, and the Exchange.

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 purpose of the proposed change to the Schedule is to clarify the amount of CTA credits available to CHX member firms. The Exchange, like other national

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[3] 15 U.S.C. 78s(b)(3)(A).

[4] 17 CFR 240.19b–4(f)(2).

[5] *See* letter from Ellen J. Neely, Senior Vice President and General Counsel, CHX, to Joseph P. Morra, Special Counsel, Division of Market Regulation, Commission, dated April 10, 2003 ("Amendment No. 1"). In Amendment No. 1, the Exchange submitted a revised Exhibit A, which replaced in its entirety, the Exhibit A submitted with the initial filing. Specifically, in the revised Exhibit A, the Exchange made technical corrections to the proposed rule text contained in the Exhibit A submitted with the initial filing. For purposes of calculating the 60-day abrogation period, the Commission considers the period to have commenced on April 14, 2003, the date the Exchange filed Amendment No. 1. 15 U.S.C. 78s(b)(3)(C).