

disseminated to vendors of financial data via the Exchange's Network B. With respect to base metals (*i.e.*, those traded on the LME), the value of the commodities will be continuously disseminated on Network B, but will be updated only once per day during U.S. market hours as the market for the relevant contracts does not trade in a continuous fashion when the U.S. securities markets are open.

Since commodity returns historically have been negatively correlated with financial assets, the Exchange believes that the ownership of ComPS (although their return is uncertain) will help to diversify a portfolio of financial instruments. The proposed ComPS also will benefit the producers, consumers and dealers of the underlying commodities by permitting them, through the issuance of ComPS, to raise low cost capital.

Returns to investors in ComPS are unleveraged with neither a cap nor a floor. There is an element of derivative pricing, however, with respect to the calculation of the final payment. The Exchange, accordingly, will require members, member organizations and employees thereof to make a determination with respect to customers whose accounts have not previously been approved to trade futures or options that a transaction in the proposed securities is suitable for such customer. In addition, members, member organizations or employees thereof recommending a transaction in ComPS would be required: (1) To determine that the transaction recommended is suitable for the customer and (2) to have a reasonable basis for believing that the customer can evaluate the special characteristics of, and is able to bear the financial risks of, the recommended transaction. The Exchange will distribute a circular to its membership prior to trading ComPS providing guidance with regard to member firm compliance responsibilities (including suitability recommendations) when handling transactions in such securities and highlighting the special risks and characteristics thereof.

ComPS will be subject to the equity margin and trading rules of the Exchange except that, where ComPS are issued as debt in denominations with a face value of \$1,000 or greater, they will be traded subject to the Exchange's debt trading rules.

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5) that an exchange have rules that are designed to prevent

fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and national market system, and, in general, to protect investors and the public interest.

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

The Exchange believes the proposed rule change will impose no burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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

The Exchange has not solicited, and does not intend to solicit, comments on this proposed rule change. The Exchange has not received any unsolicited written comments from members or other interested parties.

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

Within 35 days of the 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 the proposed rule change, or
- (B) Institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the

provisions of 5 U.S.C. § 552, will be available for inspection and copying at the Commission's Public Reference Section, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of such filing will also be available for inspection and copying at the principal office of the Amex. All submissions should refer to File No. SR-Amex-95-50 and should be submitted by January 24, 1996.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁷

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 96-35 Filed 1-2-96; 8:45 am]

BILLING CODE 8010-01-M

[Release No. 34-36635; File No. SR-CBOE-95-52]

Self-Regulatory Organizations; Order Approving a Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to the Suspension of the Ten Contract Firm Quote Requirement During Fast Markets

December 22, 1996.

I. Introduction

On September 5, 1995, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed a proposed rule change with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² to amend CBOE Rules 8.51, 6.6 and 6.20 Interpretation .09 to: (i) Remove the pilot status of Rule 8.51; (ii) conform Rule 8.51 to the existing practice of permitting, but not requiring, Floor Officials to suspend the ten contract firm quote requirement of Rule 8.51(a) during a fast market; (iii) expand the group of persons with authority to grant suspensions, exemptions or exceptions to Rule 8.51 (currently only the Market Performance Committee) to any two Floor Officials, (iv) specify that when a fast market is declared any two Floor Officials have the power to suspend the firm quote requirement of Rule 8.51 and turn off the Retail Automatic Execution System ("RAES"); (v) allow the senior person then in charge of the Exchange's Control Room to suspend the ten contract firm quote requirement under certain circumstances; and (vi) amend Rule 6.20 Interpretation .09 to clarify the instances

⁷ 17 CFR 200.30-3(a)(12) (1994).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19(b)-4.

where a member of the Market Performance Committee may perform the functions of a Floor Official.

Notice of the proposal was published for comment and appeared in the Federal Register on October 25, 1995.³ The Commission received one comment letter concerning the proposed rule change.⁴ This order approves the Exchange's proposal.

II. Description of the Proposal

The purposes of the proposal are: (1) To approve Rule 8.51 ("ten contract firm quote requirement") on a permanent basis, removing the current pilot program designation, (2) to conform Rule 8.51 to the existing practice of permitting, but not requiring, Floor Officials to suspend the ten contract firm quote requirement of Rule 8.15(a) during a fast market, (3) to expand the group of persons with authority to grant suspension, exemptions, or exceptions to the firm quote requirement from the Market Performance Committee members to any two Floor Officials, (4) to specify that when a fast market is declared pursuant to Rule 6.6, two Floor Officials have the power to suspend the firm quote requirement of Rule 8.51 and turn off RAES, (5) grant the senior person then in charge of the Exchange's Control Room the authority to suspend the ten contract firm quote requirement, if there is a system malfunction that affects the Exchange's ability to disseminate or update market quotes, and (6) to amend Rule 6.20 Interpretation .09 to clarify that the instances where a member of the Market Performance Committee may perform the functions of a Floor Official include enforcing policies and acting pursuant to rules related to RAES, fast markets, and the ten contract firm quote requirement.

Rule 8.51(a) requires a trading crowd to sell (buy) at least ten contracts at the offer (bid) which is displayed when a buy (sell) customer order reaches the trading crowd. Initially, this rule was

adopted as an Exchange pilot program to be monitored and enforced by the Exchange's Market Performance Committee.⁵ The ten contract firm quote requirement has been in effect since 1989, and the Exchange believes it is now time to remove the designation as a pilot program. The Exchange believes that the ten contract firm quote requirement has been beneficial to investors and has provided greater liquidity to the markets by requiring that the orders of non-broker dealer customer be filled for at least ten contracts at the displayed quote price. The Exchange further represents that trading crowds are aware of the requirements of Rule 8.51 and have generally been able to meet its requirements.⁶

Rule 8.51(a)(2) currently provides that the ten contract firm quote requirement will be in effect unless a fast market has been declared. Although not presently explicit in the rules, it is current practice not to automatically suspend this requirement when a fast market has been declared. The Exchange proposes to amend Rule 8.51(a)(2) and add Interpretation .07 to clarify that the ten contract firm quote requirement in paragraph (a) of Rule 8.51 is not automatically suspended when a fast market is declared. Instead, Interpretation .07 would provide that any two Floor Officials have the power, but are not required, to suspend this requirement when a fast market has been declared.

CBOE believes the interests of a fair and orderly market are better served when the rules allow Exchange officials the discretion to evaluate market conditions and circumstances and to exercise their judgment as to whether the ten contract firm quote requirement should be suspended in a fast market. This permits the firm quote requirement to remain in place for the benefit of non-broker dealer customers even when a fast market has been declared, except in those specific instances where two Floor Officials have determined that the ten contract firm quote requirement should be suspended.

As set forth in Interpretation .09 to Rule 6.20, members of the Market Performance Committee may perform the functions of Floor Officials for the purpose of enforcing trading conduct policies. As Rule 8.51 is presently written, only the Market Performance

Committee or Market Performance Committee members acting as Floor Officials may grant exemptions from, or make exceptions to, Rule 8.51. CBOE believes Floor Officials from the Floor Officials Committee are also qualified to make decisions regarding exemptions from, and exceptions to Rule 8.51. CBOE sees no reason to limit this power to members of the Market Performance Committee. CBOE also believes that the power to suspend Rule 8.51 once a fast market is declared should be granted to *any* two Floor Officials, whether they are members of the Market Performance Committee or members of the Floor Officials Committee.

CBOE's proposal would grant equal power to members of the Floor Officials Committee and members of the Market Performance Committee to act under Rule 8.51 regarding suspensions, exceptions to or exemptions from the firm quote requirement. It is important for a timely decision to be made once a fast market has been declared or other situations have arisen which warrant the suspension of the firm quote requirement, or an exemption or exception to this requirement. CBOE believes that it could be detrimental to a fair and orderly market to delay action until a member of the Market Performance Committee could be found to make such a decision when members of the Floor Officials Committee might already be present at the trading post. To implement CBOE's intention that *any* two Floor Officials may make decisions under Rule 8.51, including members of the Market Performance Committee acting as Floor Officials and members of the Floor Officials Committee, the proposal would amend Rule 6.20, Interpretation .09, amend Rule 8.51(a)(3), and add Interpretation .06 to Rule 8.51. In addition, the proposal would amend Rule 8.51 to clarify that in deciding whether to grant a suspension, exception to or exemption from the firm quote requirement, Floor Officials consider whether to do so would be in the interest of a fair and orderly market.

Because Rule 8.51 requires that Exchange market makers honor non-broker dealer customer orders at the displayed quote for up to ten contracts, it is important that the displayed market quote be accurate. Otherwise, market makers would be forced to trade ten contracts at an inaccurate or "stale" quote price. Therefore, if there is a system malfunction or other circumstance which interferes with the Exchange's ability to disseminate the then current and accurate quote, it is important for the Exchange to be able to act quickly to suspend the market

³ See Securities Exchange Act Release No. 36391 (October 18, 1995), 60 FR 54737.

⁴ The Security Traders Association ("STA") supports the proposal to codify the Exchange's authority to suspend the ten contract firm quote requirement during a fast market because it will permit the market to react promptly to systems malfunctions, events in the market, or other circumstances which interfere with the Exchange's ability to disseminate current and accurate quotes. The STA believes that a self-regulatory organization must have the power and authority to modify, within limits, any technological or operational procedure immediately upon determining that it does not fulfill its intended purpose. See Letter from William R. Rothe, Chairman, and John L. Watson, III, President, STA, to Jonathan G. Katz, Secretary, Commission; dated November 15, 1995 ("Comment Letter").

⁵ See Securities Exchange Act Release No. 26924 (June 13, 1989), 54 FR 26284 (June 22, 1989).

⁶ See Letter from Michael Meyer, Attorney, Schiff Hardin & Waite, to John Ayanian, Attorney, Office of Market Supervision ("OMS"), Division of Market Regulation ("Market Regulation"), Commission, dated December 14, 1995 ("CBOE Letter").

maker's obligations under Rule 8.51 until the difficulty is resolved. To implement such a quick response, the proposal would further amend Rule 8.51 to grant to the senior person then in charge of the Exchange's Control Room the authority to suspend the ten contract firm quote requirement contained in Rule 8.51(a) if there is a system malfunction or other circumstance that affects the Exchange's ability to disseminate or update market quotes. After exercising such authority, the senior person would need to immediately seek approval of two Floor Officials, who would be empowered to confirm or overrule the suspension.

It is important for the Control Room to have this power to suspend the firm quote requirement, since the Control Room would most likely learn of the system malfunction before Floor Officials or other Exchange staff. Consequently, the Control Room could act in a timely manner to prevent market makers from having to trade at "stale" market quotes. If the Control Room does invoke its power to suspend the firm quote requirement, then the Control Room would disseminate a message notifying the public that the displayed quotes are not firm because of a data dissemination problem. This would inform non-broker dealer customers that their orders would not necessarily be filled at that displayed bid or offer. Once the system malfunction has been corrected and the market quotes have been updated, either the senior person then in charge of the Exchange's Control Room or two Floor Officials would be required to end the suspension of the firm quote requirement.

As it is presently written, Rule 6.6(b) provides that the two Floor Officials declaring a fast market have the power to take a number of specified actions and more generally to take such other actions as are deemed necessary in the interest of maintaining a fair and orderly market. When a fast market has been declared, pursuant to these general powers, Floor Officials will often, in the interest of maintaining a fair and orderly market, suspend the ten contract firm quote requirement of Rule 8.51. This decision to suspend the firm quote requirement is made often during a fast market because the displayed quote is not current or accurate due to the influx of orders or other unusual circumstances. Therefore, market makers should not be forced to trade ten contracts at an inaccurate quote. In order to notify members and the public that, during a fast market, Floor Officials may suspend the firm quote requirements, CBOE proposes to specify

in Rule 6.6(b) that when a fast market is declared, Floor Officials have the power to suspend the ten contract firm quote requirement of Rule 8.51.

For the same reasons, after a fast market declaration, another action Floor Officials may take in the interest of maintaining a fair and orderly market is to turn off RAES. When RAES receives an order, the system automatically will attach to the order its execution price, determined by the prevailing market quote at the time of the order's entry into the system. A buy order will pay the prevailing market quote for an offer and a sell order will sell at the prevailing market quote for the bid. A market maker who has signed on as a participant in RAES will be designated as a contra-broker on the trade. Trades are assigned to these participating market makers on a rotating basis. Therefore, by agreeing to participate in RAES, a market maker is automatically assigned trades based on the prevailing market quote that is then being disseminated. Consequently, it is important for the prevailing market quote to be accurate, because otherwise market makers participating in RAES may be assigned trades at prices other than the actual prevailing market quote. During a fast market, often the influx of orders is greatly increased or other unusual circumstances exist that affect the accuracy of the prevailing market quote. For this reason, Floor Officials, acting under the general powers of Rule 6.6(b), may turn off RAES to prevent market makers from being assigned trades based on inaccurate market quotes. In order to notify members and the public that such action may be taken in a fast market, CBOE proposes to amend Rule 6.6 to specify that Floor Officials have the power to turn off RAES after a fast market has been declared.

If RAES is turned off because of the circumstances described above, the orders that would have been routed to RAES will be automatically re-routed to either the Public Automated Routing System ("PAR") workstation⁷ or floor broker printer in the trading crowd, or to the appropriate member firm booth. Where the order is re-routed will depend upon parameters set by member

⁷ A PAR workstation is an automated, computer-based workstation that provides users with the ability to execute trades, transmit trade reports, and enter other data and commands at the touch of a screen, thereby eliminating the delay inherent in a keyboard-based system. Telephone conversation between Anthony Montesano, Manager, Trading Operations, CBOE, and John Ayanian, Attorney, OMS, Market Regulation, Commission, on December 21, 1995.

firms for their customers' orders prior to entering the orders onto RAES.⁸

Furthermore, as Rule 6.6(b) is presently written, it could be interpreted that only the same two Floor Officials who declared the fast market have the power to take the other actions specified in Rule 6.6(b). CBOE's practice has been that any two Floor Officials have the powers specified in Rule 6.6(b), not just the specific two individuals who declared the fast market. Therefore, CBOE proposes an amendment to Rule 6.6(b) to clarify that any two Floor Officials have the powers specified in 6.6(b).

CBOE believes that members of the Market Performance Committee, who perform Floor Officials functions, as well as Floor Officials who are members of the Floor Officials Committee, are equally qualified to make decisions regarding Rule 6.6. To clarify that members of the Market Performance Committee may also act pursuant to Rule 6.6, the proposal would amend Rule 6.20 Interpretation .09 to specify that the Floor Official functions that Market Performance Committee members may perform include acting pursuant to rules related to fast markets and RAES. Again, when circumstances arise which might require the declaration of a fast market, it is important for timely decisions to be made regarding the declaration of a fast market and other related decisions specified in Rule 6.6. CBOE believes that it would be detrimental to a fair and orderly market to delay action until a Floor Official from the Floor Officials Committee is found to make such decisions when members of the Market Performance Committee might already be present at the trading post.

The Exchange believes that the proposal is consistent with and furthers the objectives of Section 6(b)(5) of the Act, in that the proposal is designed to perfect the mechanisms of a free and open market and to protect investors and the public interest by: (1) Enabling any two Floor Officials to evaluate and consider market conditions and circumstances in determining whether to suspend the firm quote requirement of Rule 8.51 during a fast market; (2) clarifying the powers of Market Performance Committee members and specifying the powers Floor Officials may invoke during a fast market; and (3)

⁸ According to CBOE, when determining order parameters for routing purposes, the member firms look to (1) the size of the order, (2) whether the series is on RAES, and (3) whether it is a market order or an immediately executable limit order. Telephone conversation between Edward Joyce, CBOE, and John Ayanian, OMS, Market Regulation, Commission, on December 21, 1995.

granting certain authority to the senior person then in charge of the Control Room to suspend the firm quote requirement when there has been a system malfunction affecting the dissemination or updating of quotes.

The Exchange also believes that the entire proposal is consistent with Section 6(b) of the Act in general and furthers the objectives of Section 6(b)(5) in particular in that it is designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of change, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, and to remove impediments to and perfect the mechanism of a free and open market and a national market system.

III. Commission Finding and Conclusions

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange, and, in particular, the requirements of Section 6(b)(5) of the Act.⁹ Specifically, the Commission finds that the Exchange's proposal strikes a reasonable balance between the Commission's mandates under Section 6(b)(5) to remove impediments to and perfect the mechanism of a free and open market and a national market system, while protecting investors and the public interest.

For purposes of the CBOE's proposal to permanently approve the ten contract firm quote pilot program, the Commission reasserts its initial position regarding the benefits of the rule on the CBOE.¹⁰ Specifically, the permanent approval of the ten contract firm quote requirement rule is consistent with Section 6(b)(5) of the Act in that the rule results in improved market quality and better market maker performance than would otherwise occur. The ten contract firm quote requirement should continue to result in better executions of small customer orders by ensuring greater depth of CBOE options markets.

The Commission also believes that the ten contract firm quote requirement encourages market makers to become more competitive in making size markets, thereby facilitating transactions in securities, contributing to a more free and open market, and improving the quality of the CBOE's public customers' options markets.

The Commission also believes that it is appropriate for the Exchange to conform its rules to the current practice not to automatically suspend the ten contract firm quote requirement when a fast market has been declared.¹¹ Accordingly, the Commission believes that it is appropriate to add Interpretation .07 to Rule 8.51 to grant any two Floor Officials the authority, but not require them, to suspend the ten contract firm quote requirement during a fast market. The Commission agrees with the CBOE that, during a fast market, Exchange officials should have the discretion to evaluate market conditions and circumstances and to exercise their judgment as to whether the ten contract firm quote requirement should be suspended. Both amended Rule 8.51(a)(2) and proposed Interpretation .07 to Rule 8.51 adequately address these issues and should help minimize adverse impact on non-broker dealer customers during a fast market when two Floor Officials determine that market conditions and circumstances do not warrant such action.

The Commission also believes it is appropriate to allow the Exchange to allow any two Floor Officials, including members of the Market Performance Committee acting as Floor Officials and members of the Floor Officials Committee, to grant suspensions, exemptions, or exceptions to the ten contract firm quote requirement under Rule 8.51. Specifically, proposed rule change will (i) allow members of the Market Performance Committee to retain authority to grant exemptions from, or to suspend, the ten contract firm quote requirement under Rule 8.51, and grant Floor Officials that same authority; and (ii) clarify that the authority of Market Performance Committee members under Interpretation .09 under Rule 6.20 includes enforcing policies and acting pursuant to rules related to RAES and fast markets.¹² The Commission believes that the Exchange adequately addresses these issues by amending (1) Rule 8.51(a)(3), (2) Interpretation .06 to Rule 8.51, (3) Interpretation .09 to Rule 6.20, and (4) Rule 6.6(b)(iv) as set forth above in Section II.

In regard to RAES orders during a fast market, the Commission believes that it is appropriate to grant any two Floor Officials, pursuant to proposed Rule 6.6(b)(v), the express authority to turn off RAES after a fast market declaration if in the interest of maintaining a fair and orderly market. Floor Officials have the general authority to turn off RAES

during unusual market conditions pursuant to current Rule 6.6(b)(v). Current Rule 6.6(b)(v) allows Floor Officials to "[t]ake such other actions as are deemed necessary in the interest of maintaining a fair and orderly market." The Commission agrees with the Exchange that by expressly granting its Floor Official the discretion to turn off RAES during a fast market, Exchange members and the public will be properly notified that such action may be taken when a fast market has been declared.

The Commission also believes that it is appropriate to allow the senior person then in charge of the Exchange's Control Room the authority to suspend the ten contract firm quote requirement if there is a systems malfunction or other circumstance that affects the Exchange's ability to disseminate or update market quotes. The type of circumstances that might impair the Exchange's ability to disseminate or update market quotes in a timely and accurate manner, include, but are not limited to, outages of the Exchange's autoquote system, communication disruptions between the Exchange and the Processor for the Options Price Reporting Authority, and the unavailability of market data from the underlying market and the CBOE.¹³ The Commission notes that the proposed rule change requires the senior person in charge of the Exchange's Control Room to immediately seek approval from two Floor Officials after exercising such authority. The Commission believes that this proposed rule change provides a reasonable mechanism for the CBOE to suspend the market maker's obligations under Rule 8.51 when the Exchange is unable to disseminate the then current and accurate quote.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁴ that the proposed rule change (File No. SR-CBOE-95-52) is approved.

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

Jonathan G. Katz,

Secretary.

[FR Doc. 96-00020 Filed 1-2-96; 8:45 am]

BILLING CODE 8010-01-M

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ See Securities Exchange Act Release No. 26924 (June 13, 1989), 54 FR 26284 (June 22, 1989).

¹¹ See CBOE Rule 8.51(a)(2).

¹² See CBOE Letter, *supra* note 6.

¹³ See CBOE Letter, *supra* note 6.

¹⁴ 15 U.S.C. 78s(b)(2).

¹⁵ 17 CFR 200.30-3(a)(12).