maintenance of a fair and orderly market are present.

In addition, the Commission believes that the IPSs proposal contains several provisions that will ensure that investors are adequately apprised of the terms, characteristics, and risks of trading IPSs. All investors in IPSs will receive a prospectus prior to or concurrently with the confirmation of a transaction therein, including investors purchasing in secondary market transactions on the Exchange. The prospectus should address the special terms and characteristics of the particular IPSs Fund, including a statement regarding their redeemability and method of creation, and a statement that the trading prices of IPSs on the Exchange may differ in varying degrees from their daily NAVs and can be affected by market forces such as supply and demand, economic conditions, and other factors.[17]

Furthermore, the Commission notes that prior to the commencement of trading of a series of IPSs, the Exchange will distribute to Exchange members an Information Circular calling attention to characteristics of the specific Fund and to applicable Exchange rules, such as trading halt rules. The circular will inform members of their responsibilities with respect to transactions in such IPSs and of their responsibility to deliver a prospectus to all investors purchasing IPSs. The circular will also note that IPSs are not individually redeemable, but must be redeemed in Creation Units only.

The Commission is approving in general the CBOE's proposed listing standards for IPSs, and, specifically, the listing of IPSs of a Fund based on the S&P 100. The Commission specifically notes that, notwithstanding approval of the listing standards for IPSs, other similarly structured products, including IPSs based on other indices, will require review by the Commission prior to being traded on the Exchange. Additional series cannot be listed prior to contacting Division staff. In addition, the CBOE may be required to submit a rule filing prior to trading a new issue or series on the Exchange.

The Commission finds good cause for approving the proposed rule change prior to the thirtieth day after the date of publication of notice thereof in the **Federal Register**. The Commission notes that the proposed rule change is based on Amex Rule 1000A *et seq.* and is similar to CBOE rules relating to IPRs, both of which the Commission approved in the past.[18] The Commission also observes that the proposed rule change concerns issues that previously have been the subject of a full comment period pursuant to section 19(b) of the Act.[19] The Commission does not believe that the proposed rule change raises novel regulatory issues that were not addressed in the previous filings. In view of these factors, the Commission believes it is appropriate to permit investors to benefit from the flexibility afforded by these new instruments by trading them as soon as possible. Accordingly, the Commission finds that there is good cause, consistent with section 6(b)(5) of the Act, to approve the proposal today.

V. Conclusion

It is Therefore Ordered, pursuant to section 19(b)(2) of the Act,[20] that the proposed rule change (SR–CBOE–00–11) is hereby approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[21]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–13954 Filed 6–2–00; 8:45 am]

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[17] Telephone conversation between Kevin An, Attorney, Schiff, Hardin & Waite, and Heather Traeger, Attorney, Division, Commission; Susie Cho, Attorney, Division, Commission, on May 22, 2000.

[18] *See supra* notes 3 and 4.

[19] 15 U.S.C. 78s(b)

[20] 15 U.S.C. 78s(b)(2).

[21] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42835; File No. SR–CBOE–99–10]

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

May 26, 2000.

I. Introduction

On March 18, 1999, the Chicago Board Options Exchange, Inc. (''CBOE'' or ''Exchange'') filed with the Securities and Exchange Commission (''Commission''), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (''Act'')[1] and Rule 19b–4 thereunder,[2] a proposed rule change to amend its rule governing the crossing of equity option orders by floor brokers, to give the member firm from which an order originates (''originating firm'' a participation right in trades that are proposed to be crossed in certain circumstances. Notice of the proposed rule change was published for comment in the **FEDERAL REGISTER** on July 16, 1999.[3] The Commission received four comment letters regarding the proposal.[4] On October 4, 1999, April 11, 2000, and May 25, 2000, the CBOE filed Amendment Nos. 1, 2, and 3, respectively, to the proposal.[5] This order approves the proposed rule change, accelerates approval of Amendment Nos. 1, 2, and 3, and solicits comments from interested persons on those amendments.

II. Description of the Proposal

CBOE Rule 6.74 sets forth the procedures by which a floor broker holding a customer order (''original order'') may cross it with either: (i) Another customer order or orders from the same originating firm: or (ii) a contra side order provided by the originating firm from its own proprietary account (''facilitation order'').[6]

Under CBOE Rules 6.74(a) and (b), a floor broker seeking to cross buy and sell orders for the same options series must first bring the transaction to the trading floor and request a market from the trading crowd. After receiving bids and offers from the crowd, the floor broker must propose a price at which to cross the original order that improves upon the price provided by the crowd. However, before the floor broker can effect the cross, the market makers in the crowd are given the opportunity to take all or part of the transaction at the proposed price.[7]

Under these rules, if the crowd does not want to participate in the trade, the floor broker may proceed with the cross. If the crowd wants to take part of the order, however, the crowd has precedence and the floor broker may cross only that amount remaining after

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 41609 (July 8, 1999), 64 FR 38494.

[4] *See* Section III below for a description of the comment letters.

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

[6] Under the CBOE's rules, facilitation orders may be provided only to cross the orders of public customers. *See* CBOE Rule 6.74(b). This same stipulation is retained under the proposed rule change.

[7] In the case where the floor broker is proposing to cross two customer orders, the crowd may take all or part of either customer order. In the case where the floor broker is seeking to effect a facilitation cross, the crowd may take all or part of the customer order.

the crowd has taken its portion. If the crowd wants to take the entire order, the floor broker will not be able to cross or facilitate any part of the order.

The proposed rule change, adding new paragraph (d) of Rule 6.74, will apply to transactions in equity options,[8] and will pertain to orders of a certain minimum size. The qualifying size of orders eligible for the proposal's new rule will be determined by the appropriate Floor Procedure Committee of the Exchange, but cannot be less than 50 contracts.[9] The proposed rule change will entitle the floor broker, under certain conditions, to cross a specified percentage of the original order on behalf of the originating firm, before market makers in the crowd can participate in the transaction. The percentage of the floor broker's guarantee will depend upon whether the price at which the order is ultimately traded is at the crowd's best bid or offer in response to the broker's initial request or at an improved price.

First, in contrast to the provisions of current rule 6.74, the floor broker will be granted a right to cross even at a price that does not improve upon the best bid or offer provided by the crowd in response to his initial request for a market. The proposed rule change provides that where the trade takes place *at* the market provided by the crowd, all public customer orders in the book and those represented in the trading crowd at the time the market was established [10] must first be satisfied. Once these public customer orders are satisfied, the floor broker will be entitled to cross 20% of the contracts remaining in the original order.

The proposed rule change further provides that if the original order is traded at a price *between* the best bid and offer provided by the crowd in response to the floor broker's initial request for a market—*i.e.,* where the floor broker proposes the cross at a price that improves the crowd's market, and the crowd then wants to take part or all of the order at the improved price—the floor broker will be entitled to priority over the crowd to cross 40% of the contracts.

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

Proposed paragraph (d)(i) provides, in addition, that once the trading crowd has provided a market, that market will remain in effect until (a) a reasonable amount of time has passed; (b) a significant change has occurred in the price of the underlying security of the option; or (c) the market is improved.[11] In case of a dispute, ''significant change'' will be determined on a case-by-case basis by two Floor Officials, based upon the extent of recent trading in the option and the underlying security and any other relevant factor.

In the case of a multi-part or spread order, one leg alone of the order will need to meet the eligible size requirement to qualify for the provisions of the proposed rule change.

In the case of a facilitation cross, the facilitating firm will be required to disclose on the order ticket for the public customer order all terms of the order, including any contingency involving, and all related transactions in, either options or underlying or related securities. The floor broker will be required to disclose all securities that are components of the public customer order before requesting bids and offers for the execution of all components of the order.[12]

If the same member organization of the Exchange is both the originating firm and the Designated Primary Market Maker (''DPM'') for the class of options in which the transaction takes place,[13] and the floor broker acting on behalf of the firm takes advantage of the crossing right provided by the proposed rule change, the firm will not be entitled to any participated in the trade on the guaranteed percentage ordinarily granted to DPMs pursuant to CBOE Rule 8.80 (''DPM participation rate'').[14] In this instance the firm will be limited to its guaranteed participation under Rule 6.74.

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

The proposed rule change makes clear, however, that it is not intended to prohibit either a floor broker or DPM from trading more than their percentage entitlements if the other members of the trading crowd do not choose to trade with the remainder of the order.[17]

The proposal further makes clear, in accordance with Rule 8.80, that if the trade takes place at a price other than that of the DPM's principal bid or offer, the DPM would not be entitled to any guaranteed participation.[18]

The proposed rule change also provides that the members of the crowd who establish the market in response to the floor broker's initial request will have priority over all other orders that were not represented in the crowd at the time that market was established, except for orders that improve upon those

[8] The CBOE has also filed a related rule change regarding facilitation crosses in index options. *See* Securities Exchange Act Release No. 41743 (August 13, 1999), 64 FR 45578 (August 20, 1999)(File No. SR–DBOE–99–35).

[9] *See* Amendment No. 2 to the proposed rule change, concerning proposed paragraph 1 of Rule 6.74(d). The original proposal would have restricted the eligible order size to 500 contracts or more.

[10] *See* Amendment No. 3, concerning subsection 6.74(d)(ii).

[11] *See* Amendment No. 2, concerning proposed subsection 6.74(d)(i).

[12] *See* Amendment No. 2, concerning proposed subsection 6.74(d)(iv).

[13] The same provision would apply if the originating firm or the DPM or both are nominees of the same member organization. Telephone conversation between Timothy Thompson, Assistant General Counsel, Legal Department, CBOE, and Gordon Fuller, Special Counsel, and Ira Brandriss, Attorney, Division of Market Regulation (''Division''), the Commission, on May 22, 2000.

[14] *See* CBOE Rule 8.80(c)(7); Securities Exchange Act Release No. 42190 (December 1, 1999), 64 FR 68706 (December 8, 1999) (establishing the DPM guarantee at 30% when the trade occurs at the DPM's principal bid or offer).

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

[16] *See* Amendment No. 2, concerning proposed subsection 6.74(d)(v).

[17] *Id.*, concerning proposed subsection 6.74(d)(vii).

[18] *Id.*, concerning proposed subsection 6.74(d)(v). Thus, the DPM participation right is not a concern where the originating firm receives a 40% crossing right, because that right is granted only when the trade occurs between the best bid and offer given by the crowd, which is by definition at a price other than the DPM's principal bid or offer.

quotes. Further, a floor broker holding a customer order and either a facilitation order or a solicited order and who makes a request for a market will be deemed to be representing both the customer order and either the facilitation order or solicited order, so that the customer order and the other order will also have priority over all other orders that were not being represented in the trading crowd at the time the market was established.[19]

III. Summary of Comments

The Commission received four comment letters regarding the proposed rule change. One commenter, the Amex Options Market Maker Association (''OMMA''),[20] opposed the proposal. Three commenters—Morgan Stanley & Co. (''Morgan Stanley''),[21] Goldman, Sachs & Co. (''Goldman Sachs''),[22] and Credit Suisse First Boston Corporation (''CSFB'') [23]—supported it.

The OMMA stated that the proposed rule change would harm investors because when floor brokers representing customer orders are guaranteed the right to cross a fixed percentage of those orders, they will no longer attempt to seek the best price possible for those orders. The OMMA further maintained that the auction market would be cut short under the proposed rule change, and that the participation guarantees granted to upstairs firms will remove the incentive for market makers to improve prices.

CSFB and Morgan Stanley stated that the proposal would contribute to more efficient markets and the narrowing of spreads for listed options. The guaranteed participation, they maintained, would provide an incentive for originating firms to find contraparty customers or to commit their own capital at a price between the spread. They also argue that it would correct an inequity under current rules that allows market makers to take 100% of a proposed cross away from an originating firm.

Goldman Sachs adds that, under the proposal, the crossing price would of necessity be fair to the customer, because the originating firm is guaranteed a participation right only for a cross at or better than the quoted market. Moreover, it noted, firms would have an incentive to bring liquidity to the market and market makers would have an incentive to quote tighter markets in order to increase their participation.

The commenters who supported the proposal also maintained that it would enable the CBOE to compete effectively with other exchanges.

The CBOE responded to OMMA's comments in Amendment No. 1 to the proposal. The CBOE stated that, contrary to suggestions made by the OMMA, market makers would always have an opportunity to improve the market under the proposed rule change, and a cross could never be executed outside the best quoted market.

IV. Discussion

After careful review, the Commission finds that the proposed rule change is consistent with the provisions of the Act applicable to a national securities exchange, particularly those of section 6(b)(5) [24] and section 6(b)(8) [25] of the Act, and the rules and regulations thereunder.[26] The Commission believes that the proposal will enable the CBOE to better compete with other options exchanges in attracting the order flow of broker-dealer firms seeking to cross and facilitate customer orders, without adversely impacting the prices those orders receive.

The Commission finds that the CBOE's proposal to grant participation rights, under certain conditions, to member firms that execute crossing transactions on the Exchange is reasonable. Currently, CBOE market makers have priority rights for the full size of a customer order over the firm that brings a crossing transaction to the CBOE floor, as long as the market makers are willing to trade at the proposed price.

While the proposal entitles the originating firm to a specified percentage of a crossing transaction when executed at the trading crowd's best bid or offer, it does not eliminate the crowd's ability to trade with a portion of the order proposed to be crossed, or even so substantially reduce that ability so as to raise serious concern that the proposal would reduce price competition by the crowd. Moreover, the Commission believes that the proposal may contribute to better prices for crossing transactions. Specifically, it provides an incentive for upstairs firms to improve on the prices quoted by the crowd by offering these firms a greater participation in the trade when they better the crowd's price. In addition, as the CBOE represents, market makers will always have an opportunity to improve the market and compete for a greater portion of the trade.

In evaluating the proposed rule change, the Commission considered, among other matters, whether the CBOE's proposal to guarantee that an originating firm could cross up to 40% of an order would reduce the incentive of crowds to compete for orders, and thus impair the price discovery mechanism of the Exchange's market.

In its recent approval of the application of the International Securities Exchange (''ISE'') for registration as a national securities exchange, the Commission discussed the same concern with respect to the ISE's proposed ''facilitation mechanism,'' a system designed to effect a type of facilitation guarantee in an electronic context. The Commission wrote:

> It is difficult to assess the precise level at which guarantees may begin to erode competitive market maker participation and potential price competition within a given market. In the future, after the Commission has studied the impact of guarantees, the Commission may need to reassess the level of these guarantees. For the immediate term, the Commission believes that 40% is not clearly inconsistent with the statutory standards of competition and free and open markets.[27]

By the same token, the Commission believes that the CBOE's proposed rule change, which allocates no more than 40% of an order to the firm seeking to effect a cross, is not inconsistent with the statutory standard. The Commission notes, moreover, that for those crossing transactions in which a DPM is entitled to an allocation in addition to the proposed allocation for the originating firm, the CBOE has included a provision

[19] *See* Amendment Nos. 2 and 3, concerning proposed subsection 6.74(d)(vi).

[20] Letter from Daniel Mintz, Chairman, Amex Option Market Makers Association, to the Securities and Exchange Commission, dated May 28, 1999 (resubmitted with technical clarification, August 19, 1999).

[21] Letter from Robin Roger, Principal and Legal Counsel, Morgan Stanley & Co., to Jonathan G. Katz, Secretary, Commission, dated August 9, 1999.

[22] Letter from Mark A. Zurack, Managing Director, Goldman, Sachs & Co., to Jonathan G. Katz, Secretary, Commission, dated August 27, 1999.

[23] Letter from Raymond J. Dorado, Director and Counsel, Legal and Compliance Department, Credit Suisse First Boston Corporation, to Jonathan G. Katz, Secretary, Commission, dated September 30, 1999.

[24] 15 U.S.C. 78f(b)(5). Section 6(b)(5) requires that the rules of a national securities exchange be designed to, among other things, promote just and equitable principles of trade, remove impediments to and perfect the mechanism of a free and open market, and, in general, to protect investors and the public interest. It also requires that those rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

[25] 15 U.S.C. 78f(b)(8). Section 6(b)(8) requires that the rules of the exchange do not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

[26] In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[27] See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000).

to limit the combined allocations awarded to the originating firm and the DPM an aggregate of no more than 40% of the order.

The Commission finds good cause for approving Amendment Nos. 1, 2, and 3 to the proposal prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 provides additional representations concerning the operation of the proposal and its rationale, and responds to concerns raised by the OMMA. Amendment No. 1 made only a minor change in the text of the proposed rule change for purposes of clarification.[28]

Amendment No. 2, among other things, modifies the proposed rule change by reducing the minimum size of orders to which it will be applicable, from 500 to 50 contracts. The Commission has already approved the facilitation mechanism of the ISE, which guarantees 40% of orders to facilitating firms for order sizes of 50 or more contracts.[29] Thus, the reduction in the size requirement in the CBOE proposal raises no new regulatory issues. Further, it will benefit options market participants by allowing for substantially consistent treatment of crossing mechanisms under the rules of the ISE and the CBOE, and will allow the CBOE to compete without disadvantage for facilitation orders.[30]

Amendment No. 2 further adds the stipulation that the combined guarantees of the firm and the DPM may not exceed 40% of the order, thus limiting allocations to a percentage that the Commission has previously found consistent with the Act.

Amendment No. 2 also clarifies the period that the market established by the crowd in response to the floor broker's initial request will remain in effect.[31] It further established the priority of crowd members who responded to the initial request for a quotation over orders that were not represented in the crowd at the time the market was established (unless those orders improve the price), as well as the priority of any unfilled portion of the crossing order held by the floor broker. These aspects of the amendment constitute appropriate and necessary clarifications of procedures and priority rights under the proposed rule change.

Amendment No. 2 further adds disclosure requirements for facilitation crosses transacted under the proposed rule change, consistent with disclosure requirements for facilitation crosses transacted under current rules. These provisions strengthen the proposed rule change and raise no new regulatory issues.

Amendment Nos. 2 and 3 set forth explicitly that the crossing guarantee applies only after all public customer orders on the limit order book and those represented in the trading crowd at the time the market was established have been satisfied. This aspect of the amendment thus limits the new entitlement granted to floor brokers under the proposed rule change, preserving priority for public customer orders.

Amendment No. 3 additionally adds language to the proposed rule text to clarify that public customer orders on the limit order book will always have priority over members of the trading crowd who established the market; that those members of the crowd will have priority over non-customer orders as well as public customer orders on the floor that were not represented at the time the market was established; and that the crowd will not have priority over any order—customer or non-customer—that improves the market. These changes were made for the purposes of clarity and consistency and thus strengthen the proposed rule change.

Amendment No. 3 also provides that the Floor Procedure Committee will determine the size requirement for orders to be subject to the crossing guarantee on a class by class basis. In the Commission's view, this provision will afford the Exchange greater flexibility in determining when it is appropriate to provide participation rights to firms seeking to cross orders, and thus strengthens the proposed rule change.

Accordingly, the Commission finds good cause, consistent with Sections 6(b)(5)[32] and 19(b)(2)[33] of the Act to accelerate approval of Amendments No. 1, 2, and 3 to the proposed rule change.

V. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment Nos. 1, 2, and 3, including whether Amendment Nos. 1, 2, and 3 are consistent with the Act. Persons making written submissions should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, NW., Washington, DC 20549–0609. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the CBOE. All submissions should refer to File No. SR–CBOE–99–10 and should be submitted by June 26, 2000.

VI. Conclusion

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

It is therefore ordered, pursuant to section 19(b)(2) of the Act, that the proposed rule change (SR–CBOE–99–10), as amended, be and hereby is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[34]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 00–13955 Filed 6–2–00; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–42823; File No. SR–ISE–00–05]

Self-Regulatory Organizations; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change by the International Securities Exchange LLC Relating to Authority to Grant Exemptions From ISE Rule 805

May 25, 2000.

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 May 24, 2000, the International Securities Exchange LLC (''ISE'' or ''Exchange'')

[28] The change was intended to clarify when the provisions of subparagraphs (a) and (b) of CBOE Rule 6.74 apply, and when new paragraph (d) applies. The language was subsequently modified further to the same end by Amendment No. 2.

[29] See Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000).

[30] Although the ISE mechanism operates only for facilitation crosses, the Commission's grounds for approving the ISE's facilitation cross guarantee apply equally to the CBOE's proposal, which applies to both customer-to-customer and facilitation crosses.

[31] *See* text accompanying note 9, *supra.*

[32] 15 U.S.C. 78f(b)(5).

[33] 15 U.S.C. 78s(b)(2).

[34] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.