

options traded in the U.S. Lastly, the Commission believes that settling options on the Russell Top 200 Indexes based on the opening prices of component securities is reasonable and consistent with the Act because it may contribute to the orderly unwinding of positions in options on the Indexes upon expiration.

F. Exclusive Licensing Agreement

As noted above, the ISE raised concerns about the CBOE's exclusive licensing agreement with the Frank Russell Company to trade options on the Russell Top 200 Indexes. The Commission notes that the ISE has filed a petition for rulemaking to amend Rule 19c-5 under the Act²² to prohibit options exchanges from entering into exclusive licensing agreements with respect to index option products.²³ The Commission believes that the issues raised by the ISE in its comment letter and in its petition for rulemaking regarding the exclusive licensing of index option products should be considered comprehensively rather than on an *ad hoc* basis in the context of a particular index option product or products, such as the Russell Top 200 Indexes. In addition, the Commission believes that investors will benefit from the availability of trading options on the Russell Top 200 Indexes because, as described above, they will provide investors with additional hedging and trading vehicles. Accordingly, the Commission believes that it is appropriate in the public interest to approve the current proposal in order to make options on the Russell Top 200 Indexes available to investors while the Commission considers the issues presented by the exclusive licensing of index options products in the context of the ISE's petition for rulemaking.

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,²⁴ that the proposed rule change (SR-CBOE-2003-51), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.²⁵

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 04-5949 Filed 3-16-04; 8:45 am]

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²² 17 CFR 240.19c-5.

²³ See Letter from David Krell, President and Chief Executive Officer, ISE, to Jonathan Katz, Secretary, Commission, dated November 1, 2002.

²⁴ 15 U.S.C. 78s(b)(2).

²⁵ 17 CFR 200.30-3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49387; File No. SR-CHX-2003-27]

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 by The Chicago Stock Exchange, Incorporated Relating to Execution of Limit Orders Following an Exempted ITS Trade-Through

March 10, 2004.

On August 7, 2003, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),¹ and Rule 19b-4 thereunder,² a proposed rule change to render voluntary a CHX specialist's obligation to fill limit orders for the Nasdaq-100 Index, the Dow Jones Industrial Average Index and the Standard & Poor's 500 Index (collectively "Exempt ETFs")³ resting in the specialist's book when the primary market is trading at the limit price, or when the bid or offering at the limit price has been exhausted in the primary market. On January 20, 2004, the Exchange filed Amendment No. 1 to the proposed rule change.

The proposed rule change, as amended, was published for comment in the **Federal Register** on February 3, 2004.⁴ The Commission received no comments on the proposal. This order approves the proposed rule change, as amended.

The CHX has represented that the proposed rule change is warranted because the Exchange believes that it is difficult, if not impossible, for a CHX specialist to obtain liquidity on behalf of his customers via the Intermarket Trading System in the case of Exempt ETFs given the dynamic and rapidly changing nature of the exchange-traded fund market.

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder that are applicable to a national securities exchange.⁵ Specifically, the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Commission notes that the Exchange has represented that to the extent the CHX Board of Governors designates subject issues other than or in addition to the Exempt ETFs identified in this proposed rule change, the Exchange will file those changes with the Commission as an interpretation of an existing rule pursuant to Section 19(b)(3)(A) of the Act and Rule 19b-4 thereunder.

⁴ See Securities Exchange Act Release No. 49130 (January 27, 2004), 69 FR 5227.

⁵ In approving the proposal, the Commission has considered the rule's impact on efficiency,

Commission finds that the proposal is consistent with the requirements of section 6(b) of the Act,⁶ in general, and section 6(b)(5) of the Act,⁷ in particular, which requires that the rules of an Exchange be designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

The Commission believes that the obligations on specialists to execute limit orders resting on the specialist book when the primary market is trading at the limit price, or when the bid or offer at the limit price has been exhausted in the primary market were obligations that the CHX assumed voluntarily in order to make its market more attractive to sources of order flow. The Commission believes that the business decision to potentially forego order flow by no longer requiring specialist to provide such protections to certain limit orders is a judgment the Act allows the CHX to make.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,⁸ that the proposed rule change, as amended, (File No. SR-CHX-2003-27) be, and hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 04-5948 Filed 3-16-04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49393; File No. SR-ISE-2003-26]

Self-Regulatory Organizations; Notice of Filing of a Proposed Rule Change and Amendments No. 1, 2 and 3 Thereto by the International Securities Exchange, Inc. To Amend Its Rules Governing Limits on the Entry of Orders of Less Than Ten Contracts and Revise the Quotation Size Requirements for Market Makers

March 10, 2004.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934

competition, and capital formation. See 15 U.S.C. 78c(f).

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

⁸ 15 U.S.C. 78s(b)(2).

⁹ 17 CFR 200.30-3(a)(12).

("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 14, 2003, the International Securities Exchange, Inc. ("ISE" or "Exchange"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the ISE. On January 13, 2004, the ISE filed Amendment No. 1 to the proposed rule change ("Amendment No. 1").³ On January 30, 2004, the ISE filed Amendment No. 2 to the proposed rule change ("Amendment No. 2").⁴ On March 8, 2004, the ISE filed Amendment No. 3 to the proposed rule change ("Amendment No. 3").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 modify ISE Rules 717, 803-805 and 1614 to repeal the limits on the entry of orders and revise the quotation requirements of market makers. The text of the proposed rule change is set forth below. Proposed new language is in *italics*; proposed deletions are in [brackets].

* * * * *

Rule 717. Limitations on Orders

(c) *Reserved.* [Order Size.

(1) Electronic Access Members are prohibited from entering into the

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated January 12, 2004. In Amendment No. 1, the ISE made technical corrections to the text of the proposed rule change. In addition, in Amendment No. 1, the ISE corrected an omission in the original rule text, amending ISE Rule 1614(d)(5) to include ISE Rule 717(f) as a minor rule violation meriting the fines set forth in ISE Rule 1614(d)(5) (addressing violations of order-entry rules).

⁴ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated January 29, 2004. In Amendment No. 2, the ISE amended the text of the proposed rule change to clarify that Primary Market Makers must buy (sell) the number of contracts needed to maintain a firm quote for ten contracts when the disseminated ISE quotation is less than ten contracts for orders incoming from the Options Intermarket Linkage.

⁵ See letter from Michael Simon, Senior Vice President and General Counsel, ISE, to Nancy J. Sanow, Assistant Director, Division, Commission, dated March 5, 2004. In Amendment No. 3, the ISE amended the text of the proposed rule change to incorporate recently-approved changes to ISE Rule 804. See Securities Exchange Act Release No. 49278 (February 19, 2004), 69 FR 8716 (February 25, 2004) (SR-ISE-2003-34).

System, as principal or agent, multiple orders for a single trading interest if one or more orders is for fewer than ten (10) contracts.

(2) Non-Customer Orders for fewer than ten (10) contracts will be rejected or cancelled automatically if such orders would cause the size of the Exchange's best bid or offer to be fewer than ten (10) contracts.]

Rule 803. Obligations of Market Makers

(c) Primary Market Makers. In addition to the obligations contained in this Rule for market makers generally, for options classes to which a market maker is the appointed Primary Market Maker, it shall have the responsibility to:

(1) [Assure that each disseminated market quotation in each series of options is for a minimum of ten (10) contracts, or such other minimum number as the Exchange shall set from time to time. When the best bid (offer) on the Exchange represents one or more Public Customer Orders for less than a total of ten (10) contracts at that price, the Primary Market Maker is obligated to] *When the disseminated market quotation in a series of options is for less than ten (10) contracts, buy (sell) at that price the number of contracts needed to make the disseminated quote firm for ten (10) contracts to incoming linkage orders as provided in Rule 1900(7) and (8).*

(2) Address Public Customer Orders that are not automatically executed because there is a displayed bid or offer on another exchange trading the same options contract that is better than the best bid or offer on the Exchange.

(3) Initiate trading in each series pursuant to Rule 701.

Rule 804. Market Maker Quotations

(b) Size Associated with Quotes. A market maker's bid and offer for a series of options contracts shall be accompanied by the number of contracts at that price the market maker is willing to buy or sell upon receipt of an order or upon interaction with a quotation entered by another market maker on the Exchange. Unless the Exchange has declared a fast market pursuant to Rule 704, a market maker may not initially enter a bid or offer of less than ten (10) contracts. [Where the size associated with a market maker's bid or offer falls below ten (10) contracts due to executions at that price and consequently the size of the best bid or offer on the Exchange would be for less than ten (10) contracts, the market maker shall enter a new bid or offer for at least ten (10) contracts, either at the same or a different price.]

Rule 805. Market Maker Orders

(b) Options Classes Other Than Those to Which Appointed.

(1) A market maker may enter all order types permitted to be entered by non-customer participants under the Rules to buy or sell options in classes of options listed on the Exchange to which the market maker is not appointed under Rule 802, provided that:

(i) market maker orders are subject to the limitations contained in Rule 717[(c) and] (f) as [those] *that* paragraph[s] apply] *applies* to principal orders entered by Electronic Access Members;

(ii) the spread between a limit order to buy and a limit order to sell the same options contract complies with the parameters contained in Rule 803(b)(4); and

(iii) the market maker does not enter orders in options classes to which it is otherwise appointed, either as a Competitive or Primary Market Maker.

Rule 1614. Imposition of Fines for Minor Rule Violations

(d) Violations Subject to Fines. The following is a list of the rule violations subject to, and the applicable sanctions that may be imposed by the Exchange pursuant to, this Rule:

(5) *Order Entry (Rule 717).* Violations of Rule 717(a), [(c)-(e)] (d)-(f) regarding limitations on orders entered into the System by Electronic Access Members, as well as violations of Rule 805(b)(1)(i) regarding [restrictions on] orders entered by market makers, will be subject to the fines listed below. Each paragraph of Rule 717 subject to this Rule shall be treated separately for purposes of determining the number of cumulative violations.

* * * * *

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 ISE 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 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 rule change is to revise the ISE's restrictions on the entry of orders of less than 10 contracts, along with related market maker quotation requirements. Currently, ISE rules require that the Exchange's best bid and offer ("BBO") be at a size of at least 10 contracts at all times. To assure that the Exchange's BBO is at least 10 contracts, ISE rules contain several restrictions on orders of less than 10 contracts and certain market maker obligations.

First, ISE Rule 804 requires market makers to establish quotations of at least 10 contracts. That rule also provides that if there is partial execution against a quotation resulting in the size of the ISE BBO falling below 10 contracts, the market maker must refresh its quotation (either at the same or different price) so that it is firm for at least 10 contracts. Similarly, ISE Rule 717 prohibits Electronic Access Members ("EAMs") from submitting orders for non-customers of less than 10 contracts that would cause the ISE BBO to be for less than 10 contracts. If an EAM enters an order for a Public Customer at the BBO for less than 10 contracts, Rule 803 requires that the Primary Market Maker ("PMM") either trade that order or supplement the size of the order so that the displayed quotation is for at least 10 contracts. The Exchange refers to the supplemental quoting obligation as the need for the PMM to "derive" the additional size. Finally, to avoid manipulative practices related to the PMM's obligation to derive additional size, an EAM is prohibited under Rule 717 from entering multiple orders of less than 10 contracts for the same trading interest.⁶

This proposed rule change will not change the requirement that market makers enter all quotations with a size of at least 10 contracts. It will: (1) Remove the prohibition on EAMs entering non-customers orders that improve the ISE's BBO for less than 10 contracts, (2) repeal the obligation of the PMM either to "trade out" customer orders of less than 10 contracts or derive additional size to maintain a 10-contract displayed size, and (3) since there will no longer be an obligation for PMMs to derive additional size, remove the

⁶ The derived order obligation can lead to market manipulation called "small order baiting," where customers enter small orders seeking to induce a PMM to display greater size at that price, and then enter an order to execute against that derived size.

prohibition on EAMs entering multiple orders for the same trading interest if one or more orders are for less than 10 contracts. In addition, this proposed rule change will repeal the requirement that market makers refresh their quotations if there is a partial execution that results in the ISE's BBO size's falling below 10 contracts.⁷ However, pending possible future changes to the rules governing trading in the Linkage, the Exchange does not propose to change the obligations in ISE Rule 1900 that the ISE quotation be firm for at least 10 contracts for Principal Orders and Principal Acting as Agent Orders received through the Linkage. The PMM will continue to provide "derived" size when necessary for such Linkage orders.

Lastly, the Exchange is proposing to amend ISE Rule 1614(d)(5) to include ISE Rule 717(f) as a minor rule violation subject to the fines applicable to violations of order-entry rules.⁸ The Exchange proposes to include 717(f) as a minor rule violation harmonizes the treatment of EAMs and market makers pursuant to that rule.⁹

The Exchange believes that the proposed rule change will provide significant benefits. First, the Exchange believes that the proposed rule change will provide non-customers with more flexibility in the entry of orders by allowing them to enter orders of less than 10 contracts. It also will remove the burden on PMMs either to trade out small customer orders or derive size for such orders, which the Exchange believes will eliminate "small order baiting" manipulative conduct. At the same time, the Exchange will retain the obligation that market makers initially enter quotations for a size of at least 10 contracts. The Exchange believes that this is a necessary obligation for market makers to provide reasonable liquidity to the market place.

2. Statutory Basis

The ISE believes that the rule change is consistent with Section 6(b) of the Act in general¹⁰ and Section 6(b)(5) of the

⁷ The ISE represents, however, that their system makes it impossible for a market maker's quote ever to drop to zero, and that this proposed rule filing will not therefore change the obligation of a market maker to maintain a continuous quote for options in which they make a market. See ISE Rules 803(b) and 804(e). Telephone conversation between Katherine Simmons, Associate General Counsel, ISE, and John Roeser, Special Counsel and Elizabeth MacDonald, Attorney, Division, Commission, February 11, 2004.

⁸ Telephone conversations between Joe Ferraro, Assistant General Counsel, ISE, and Elizabeth MacDonald, Attorney, Division, Commission, February 18, 2004, and February 19, 2004.

⁹ *Id.*

¹⁰ 15 U.S.C. 78f(b).

Act in particular.¹¹ The Exchange believes that the proposed rule change is intended to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. Specifically, the Exchange believes that allowing EAMs to enter non-customer orders of less than 10 contracts will provide non-customers with greater flexibility to improve the ISE's BBO. Also, the Exchange believes that by allowing market makers to maintain quotations of less than 10 contracts, they can continue to provide investors with liquidity at their stated prices without having to refresh their quotations for 10 contracts at a potentially inferior price. Finally, the Exchange believes that eliminating the need for PMMs to "derive" quotations will eliminate opportunities for manipulative practices, such as "small order baiting."

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

The proposed rule change does not impose any 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 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.

IV. Solicitation of Comments

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

¹¹ 15 U.S.C. 78f(b)(5).

including whether the amended proposal 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. Comments may also be submitted electronically at the following e-mail address: *rule-comments@sec.gov*. All comment letters should refer to File No. SR-ISE-2003-26. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, comments should be sent in hard copy or by e-mail, but not by both methods. 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 ISE. All submissions should refer to File No. SR-ISE-2003-26 and should be submitted by April 7, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

J. Lynn Taylor,

Assistant Secretary.

[FR Doc. 04-5950 Filed 3-16-04; 8:45 am]

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-49404; File No. SR-NASD-2003-159]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the National Association of Securities Dealers, Inc. to Permit Nasdaq to Append a New Modifier to Trade Reports of Pre-Open and After-Hours Trades Not Submitted to Nasdaq's Automated Confirmation Transaction Service, and Other Changes Regarding Trade Reporting

March 11, 2004.

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 October 16, 2003, the National Association of Securities Dealers, Inc. ("NASD"), through its subsidiary, The Nasdaq Stock Market, Inc. ("Nasdaq"), filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by Nasdaq. On February 5, 2004, Nasdaq amended the proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

Nasdaq proposes changes to permit it to append a new modifier to trade reports of pre-open and after-hours trades not submitted to Nasdaq's Automated Confirmation Transaction Service ("ACT") within 90 seconds after execution, and to require members to: (1) Include the time of execution on all reports submitted to ACT; (2) append the .W modifier to reports of "stop stock transactions;" (3) append the .W modifier, as appropriate, to reports submitted to ACT after 5:15 p.m.,⁴ and (4) append the .PRP modifier to reports of transactions in listed securities that are executed at a price that is based on a prior point in time.

The proposal to implement a new trade report modifier for pre-open and after hours trades that are reported late must be approved by the respective members of the Consolidated Tape Association and the Nasdaq Unlisted Trading Privilege Plan. In addition, the proposal to require members to append the .PRP modifier, as appropriate, to reports of listed securities must be approved by the members of the Consolidated Tape Association.

The amendments contained in this filing will be implemented as soon as practical, should the Commission approve the filing, taking into consideration the system changes required to be made by members and

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See February 4, 2004 letter from Peter R. Geraghty, Associate Vice President and Associate General Counsel, Nasdaq, to Katherine A. England, Assistant Director, Division of Market Regulation, Commission and attachments ("Amendment No. 1"). Amendment No. 1 completely replaced and superseded the original proposed rule change.

⁴ Nasdaq also is proposing to clarify that members must append the .W modifier to a trade report if a trade can be properly reported with both a .T modifier and a .W modifier. This clarification is necessary because ACT can accept only one modifier per trade report. See *infra* note 14.

vendors.⁵ If the Commission approves the proposed rule change, Nasdaq will announce an implementation schedule soon after Commission approval, but in no case would the changes be implemented in less than 90 days after approval.

The text of the proposed rule change is available at Nasdaq 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, Nasdaq 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. Nasdaq 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

Market participants make trading and investment decisions based, in part, on information disseminated by Nasdaq about trades executed in its market. Nasdaq is proposing several changes that are designed to improve the quality of the information disseminated. The proposed changes will permit Nasdaq to append a new modifier to trade reports of pre-open and after-hours trades not submitted to ACT within 90 seconds after execution, and to require members to: (1) Include the time of execution on all reports submitted to ACT; (2) append the .W modifier to reports of "stop stock transactions;" (3) append the .W modifier, as appropriate, to reports submitted after 5:15 p.m.; and (4) append the .PRP modifier to reports of transactions in listed securities that are executed at a price that is based on a prior point in time.

Late Pre-Open and After-Hours Trade Reports

To provide market participants with more accurate information about the prices at which a security is trading outside normal market hours, Nasdaq is proposing to create a new trade

⁵ The NASD Small Firm Advisory Board ("SFAB") requested that the change to require the time of execution on all trade reports be implemented one year from the date of Commission approval so that small members would have sufficient time to make the necessary system modifications.