practices for the key payment and settlement systems outlined in the Interagency Paper.

Specifically, the Commission expects each SRO Market and ECN to apply the following principles in its business continuity planning:

- Each SRO Market and ECN should have a business continuity plan that anticipates the resumption of trading, in the securities traded by that market, no later than the next business day following a wide-scale disruption.[6] The resilience of the SRO Market or ECN prescribed by such plans should reflect the extent of alternative trading venues for the securities traded by that market, including the number of sole listings on the market, the market share of the market, and the number of sole members or subscribers of the market. Business continuity plans may focus on strengthening the SRO Market's or ECN's own resilience, on backup arrangements with other markets, or both.
- Assuring resumption of trading activities by a market by the next business day generally requires geographic diversity between primary and backup sites.[7] To be fully resilient, backup sites should not rely on the same infrastructure components (*e.g.*, transportation, telecommunications, water supply, and electric power) used by the primary site, and the operation of such sites should not be impaired by a wide-scale evacuation at or the inaccessibility of staff that service the primary site.
- The SRO Markets also should assure the full resilience of important shared information systems, such as the consolidated market data stream generated for the equity and options markets. The market data collection and dissemination systems, for example, are critical to the functioning of the trading markets because of their reliance on accurate and current pricing information.
- The effectiveness of back-up arrangements in recovering from a wide-scale disruption should be confirmed through testing.
- Each SRO Market and ECN should implement plans reflecting these principles as soon as practicable and strive to do so no later than the end of 2004.

The Commission staff intends to engage in an ongoing and individualized dialogue with each SRO Market and ECN to discuss application of these principles in a manner most appropriate for the particular trading market.

The Commission believes every reasonable effort should be made to assure the prompt and smooth resumption of trading following a wide-scale disruption, and that application of the principles described above is a critical step in achieving that goal. Nevertheless, the Commission notes that, depending on the facts and circumstances of a given event, it may be prudent to defer the reopening of a particular market or markets even if, from a technical standpoint, the resumption of trading is possible. In the case of a disruption of the securities markets, the Commission has a fundamental regulatory interest in assuring the prompt—yet smooth—resumption of trading. Deciding when to reopen the markets will involve an assessment of the operational capabilities of the markets and major market participants, as well as the clearance and settlement system. In a given situation, difficult judgments may be required to strike the appropriate balance between the desire to resume trading as soon as possible, and the practical necessity of waiting long enough to minimize the risk that, when trading resumes, it will be of inferior quality or interrupted by further problems.

Finally, the Commission believes that the establishment of a next-business day resumption goal for the SRO Markets and ECNs should serve as a useful resumption benchmark for securities firms as well. The decision by a broker-dealer to risk capital or provide brokerage services on an ongoing basis is, in essence, a matter of business judgment. Given the competitive nature of the securities business, however, the Commission expects there to be incentives for broker-dealers to be prepared to participate in the markets following a wide-scale disruption as soon as the markets' trading facilities become available.

## III. Conclusion

The Commission believes it important for the SRO Markets and ECNs to take concrete steps to strengthen their resilience to address the continuing, serious risks to the U.S. financial system posed by the post-September 11 environment. To date, the trading markets have made significant progress in increasing the robustness of their business continuity plans. By applying the principles outlined in this Policy Statement, the Commission believes the SRO Markets and ECNs will better assure their own resilience and that of the U.S. financial system. In so doing, they will be promoting one of the paramount objectives of the U.S. securities laws—the maintenance of fair, stable, and orderly markets.

Dated: September 25, 2003.

By the Commission.

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010–01–P**

[6] Consistent with the approach taken in the Interagency Paper, the next-day resumption objective should provide a concrete goal to plan for and test against. This should not be regarded as a hard and fast deadline that must be met in every emergency situation. Various external factors, such as time of day, scope of disruption, and status of critical infrastructure—particularly telecommunications—can affect actual recovery times.

[7] As in the Interagency Paper, however, the Commission does not believe it is necessary or appropriate to prescribe specific mileage requirements for geographically-dispersed backup sites.

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## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–48529; File No. SR–CBOE–2002–55]**

## Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. To Permanently Approve Its Rapid Opening System

September 24, 2003.

### I. Introduction

On September 16, 2002, 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 adopt its Rapid Opening System (''ROS'') on a permanent basis. On February 6, 2003, CBOE submitted Amendment No. 1 to the proposed rule change.[3] The proposed rule change, as amended, was published for comment in the **Federal Register** on August 14, 2003.[4] The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change, as amended.

### II. Description of the Proposal

On February 9, 1999, the Commission approved, on a pilot basis, the

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

[2] 17 CFR 240.19b–4.

[3] *See* letter from Jaime Galvan, Attorney II, Legal Division, CBOE, to Terri Evans, Assistant Director, Division of Market Regulation, dated January 17, 2003 (''Amendment No. 1'').

[4] *See* Securities Exchange Act Release No. 48293 (August 6, 2003), 68 FR 48650 (''ROS Notice'').

implementation of ROS.[5] ROS is a system developed by CBOE to open an entire options class, all series, as a single event, based on a single underlying value.[6] The ROS pilot program is due to expire on September 30, 2003.[7]

## III. Discussion

After careful review, 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.[8] In particular, the Commission believes that the proposed rule change is consistent with section 6(b)(5) of the Act,[9] in that it is designed to promote just and equitable principles of trade, 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. The Commission notes that ROS has successfully operated since 1999 and since that time, has facilitated expedited openings of options classes on CBOE.

In the Pilot Program Approval Order, the Commission required CBOE to satisfy three conditions prior to seeking permanent approval of the ROS pilot. The first condition required CBOE to develop standards to ensure that market makers satisfy their obligation to price options fairly and to surveil for such compliance. In the Pilot Program Approval Order, the Commission recognized that certain aspects of ROS may require heightened scrutiny by the CBOE to ensure that market-makers are not permitted to use the flexibility they have to set an opening price to the disadvantage of investors and other market participants. In particular, ROS provides market-makers discretion to set certain thresholds and the AutoQuote[10] value that drives the ROS algorithm. CBOE has represented that market makers generally have set the contract and delta thresholds at a level that ensures that an options class that has orders to trade will not auto-open, to avoid openings based on erroneous prints in the underlying security or delayed updates to bid/ask information on underlying securities. CBOE further represented that it was still able to open classes within seconds of the opening of the underlying class, because ROS can open classes very quickly even if they are not set to auto-open.[11]

CBOE has also submitted surveillance procedures designed to ensure, among other things, that market-makers exercise their discretion to set certain AutoQuote values consistent with their obligation to price options fairly.[12] The Commission believes the surveillance procedures submitted by the CBOE are reasonably designed to ensure that market makers do not abuse their discretion when setting AutoQuote values in setting the ROS opening price. Furthermore, these surveillance procedures should allow CBOE to better monitor market maker adjustments to AutoQuote and enable CBOE to bring sanctions for violative conduct when appropriate. However, because CBOE market makers set the contract and delta thresholds at levels that ensure that an options class that has orders to trade will not auto-open, giving CBOE market makers an opportunity to adjust AutoQuote at most openings, the Commission expects CBOE to aggressively surveil to ensure that market makers properly adjust AutoQuote values. The Commission also expects the Exchange to assess its surveillance procedures from time to time to determine whether they are adequate to ensure that market makers do not engage in manipulative or improper trading practices. Further, the Commission expects CBOE to consider whether any additional surveillance procedures are necessary to prevent manipulative or other improper practices.

The second condition required CBOE to develop a workable plan for the electronic incorporation of non-bookable orders in ROS. On CBOE, non-bookable orders include broker-dealer and customer contingency orders. CBOE stated that few, if any, non-bookable orders are present at the open and that, based in its observations, firms consistently wait until after the ROS opening has been completed to represent non-bookable orders.[13] CBOE has developed a procedure, albeit not an electronic one, for including non-bookable orders into the opening process. This procedure has been incorporated into CBOE Rule 6.2A and has been detailed in two regulatory circulars.[14] CBOE argues a systems change to electronically incorporate non-bookable order in the ROS opening would have very little impact on ROS trading due to the few non-bookable orders present before the open.[15] Furthermore, Phase V of the Consolidated Options Audit Trail (''COATS'') Plan would require that all non-electronic orders be captured electronically for audit trail purposes.[16] CBOE represents that this will facilitate its Regulatory staff's ability to investigate with more speed and efficiency any complaint regarding the execution received by a non-bookable order on the opening, in that the Exchange will now have an electronic record of the time of receipt of the order, in addition to the order information and the execution price of the order.[17] The Commission has determined at this time to waive the requirement that CBOE develop a workable plan for the electronic incorporation of non-bookable orders in ROS based on the limited number of non-bookable orders that are present at the open and CBOE's ability to record information on non-bookable orders in COATS. The Commission also expects that CBOE will use COATS to respond to complaints about non-bookable orders, as well as to actively monitor the quality of executions received by non-bookable orders. The Commission also expects CBOE to continue to explore methods to electronically incorporate non-bookable orders in the event that non-bookable

[5] *See* Securities Exchange Act Release No. 41033 (February 9, 1999), 64 FR 8156 (February 18, 1999) (''Pilot Program Approval Order''). ROS is governed by CBOE Rule 6.2A. CBOE Rules 6.2, 6.45, and 8.60 also reference ROS.

[6] For a detailed description of how ROS operates, *see* Pilot Program Approval Order, *supra* note 5.

[7] The Commission has extended the ROS pilot program five times. *See* Securities Exchange Act Release Nos. 42596 (March 30, 2000), 65 FR 18397 (April 7, 2000) (extending the pilot program until September 30, 2000); 43395 (September 29, 2000), 65 FR 60706 (October 12, 2000) (extending the pilot program until September 30, 2001); 44891 (October 1, 2001), 66 FR 51483 (October 9, 2001) (extending the pilot program until September 30, 2002); 46572 (September 30, 2002), 67 FR 62508 (October 7, 2002) (extending the pilot program until March 31, 2003; and 47573 (March 26, 2003), 68 FR 15780 (April 1, 2003) (extending the pilot program until September 30, 2003).

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

[9] 15 U.S.C. 78f(b)(5).

[10] Under Interpretation .02 to CBOE Rule 6.2A, the term ''AutoQuote'' means either the Exchange's AutoQuote system or a proprietary autoquote system operated by a member of the trading crowd where the particular ROS class is traded.

[11] *See* ROS Notice, *supra* note 4.

[12] *See* letter from Jaime Galvan, Attorney II, Legal Division, CBOE, to Terri Evans, Assistant Director, Division of Market Regulation, dated August 13, 2003. CBOE requested confidential treatment for these surveillance procedures pursuant to 17 CFR 200.83.

[13] *See* ROS Notice, *supra* note 4.

[14] *See* CBOE Rule 6.2A(ii), and Regulatory Circulars RG99–35 (February 10, 1999) and RG00–40 (March 13, 2000).

[15] *See* ROS Notice, *supra* note 4.

[16] The COATS Plan is a plan that the options exchanges are required to submit to the Commission in order to comply with Section IV.B.e. of the *Order Instituting Public Administrative Proceedings Pursuant to section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions. See* In the Matter of Certain Activities of Options Exchanges, Securities Exchange Act Release No. 43268, September 11, 2000; Administrative Proceeding File No. 3–10282.

[17] *See* Amendment No. 1, *supra* note 3.

orders are more actively represented in the opening.

Lastly, the third condition required CBOE to study issues related to the Commission's concerns and report back to the Commission. In response, CBOE submitted a report to the Commission addressing each of the Commission's concerns. The Commission believes that CBOE has satisfied this condition.

In conclusion, the Commission notes that ROS has successfully operated since 1999 and since that time, has facilitated expedited openings of options classes on CBOE. The Commission hereby approves the ROS pilot on a permanent basis.

**IV. Conclusion**

For the foregoing reasons, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and rules and regulations thereunder.

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[18] that the proposed rule change (SR–CBOE–2002–55) and Amendment No. 1 thereto, are approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[19]

**Margaret H. McFarland,**

*Deputy Secretary.*

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**BILLING CODE 8010–01–P**

## SECURITIES AND EXCHANGE COMMISSION

**[Release No. 34–48539; File No. SR–ISE–2003–03]**

## Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by International Securities Exchange, Inc., Relating to Market Maker Obligations

September 25, 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 February 19, 2003, the International Securities Exchange, Inc. (''Exchange'' or ''ISE'') 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 self-regulatory organization. On September 15, 2003, the Exchange amended the proposed rule change.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange is proposing to amend ISE Rule 803 to clarify the obligations of the ISE's Primary Market Makers (''PMMs'') if they receive orders from persons who are not brokers or dealers in securities (''Public Customers'') when there is a better price available on another exchange. The text of the proposed rule change, as amended, is set forth below. Proposed new language is in *italics;* proposed deletions are in [brackets].[4]

* * * * *

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 buy (sell) at that price the number of contracts needed to make the disseminated quote firm for ten (10) contracts.

(2) *As soon as practical,* [A]*a*ddress 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, *either (i) by executing a Public Customer Order at a price that matches the better price displayed or (ii) by sending to any other exchange(s) displaying a better price a Linkage Order(s) according to the Rules contained in Chapter 19.*

* * * * *

Supplementary Material to Rule 803

.01 No change.

*.02 A Primary Market Maker must act with due diligence in handling orders of Public Customers and must accord priority to such orders addressed pursuant to paragraph (c) of this Rule over the Primary Market Maker's principal orders.*

* * * * *

**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 rule change is to clarify the obligations of PMMs when they receive orders from Public Customers and there is a better price available on another exchange. When the ISE receives a Public Customer order in this situation, the ISE does not provide immediate execution of that order. Rather, the PMM is informed that the order is pending, and ISE Rule 803 requires that the PMM ''address'' such order. In practice, the PMM historically either has executed the order at the better price or has attempted to use whatever means the PMM had available to access the better market on behalf of the customer.

On January 31, 2003, the intermarket linkage (''Linkage'') between the ISE and the other options exchanges became operational. Among other things, the Linkage permits PMMs to send Principal Acting as Agent Orders (''P/A Orders'') to other exchanges. This is a

[18] 15 U.S.C. 78s(b)(2).

[19] 17 CFR 200.30–3(a)(12).

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

[2] 17 CFR 240.19b–4.

[3] *See* letter from Michael J. Simon, Senior Vice President and General Counsel, Exchange, to Nancy Sanow, Assistant Director, Division of Market Regulation (''Division''), Commission, dated September 12, 2003 (''Amendment No. 1''). In Amendment No. 1, the Exchange amended the proposed rule change to be more specific in the obligations of Primary Market Makers in handling customer orders.

[4] At the request of the Exchange, Commission staff has revised the text of the proposed rule change set forth in Amendment No. 1 to (i) correct a typographical error; and (ii) make a non-substantive technical change correcting the numbering of the Supplementary Material to Rule 803. The Exchange plans to submit an amendment to the Commission to make these technical corrections. Telephone conversation among Michael J. Simon, Senior Vice President and General Counsel, Exchange, Jennifer Colihan, Special Counsel, Division, Commission, and Ann E. Leddy, Attorney, Division, Commission on September 24, 2003.