(h) The Substitution will have no adverse tax consequences to contract owners and will in no way alter the tax benefits to contract owners.

Conclusion

Applicants request an order of the Commission pursuant to section 26(c) of the Act approving the Substitution. Section 26(c), in pertinent part, provides that the Commission shall issue an order approving a substitution of securities if the evidence establishes that it is consistent with the protection of investors and the purposes fairly intended by the policy and provisions of the Act. For the reasons and upon the facts set forth above, the requested order meets the standards set forth in section 26(c) and should, therefore, be granted.

For the Commission, by the Division of Investment Management, pursuant to delegated authority.

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49531; File No. SR–Amex–2003–105]

Self-Regulatory Organizations; Order Granting Approval of Proposed Rule Change by the American Stock Exchange LLC Relating to the Exceptions to the Exchange's Quote Rule

April 6, 2004.

I. Introduction

On December 1, 2003, the American Stock Exchange LLC ("Amex'' or "Exchange''), filed with the Securities and Exchange Commission ("SEC'' or "Commission'') a proposed rule change pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act'') [1] and Rule 19b–4 thereunder,[2] to amend Amex Rule 958A to clarify the application of the rule's exceptions to different series within the same option class. The proposed rule change was published for comment in the **Federal Register** on December 29, 2003.[3] The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description

Amex Rule 958A requires each responsible broker or dealer to promptly communicate its best bid, offer, and size, and to execute any order presented to it, at a price at least as favorable as its best bid or offer in any amount up to the size of that bid or offer, subject to certain exceptions. In this filing, Amex proposes to amend Amex Rule 958A to clarify that a transaction in one option series would enable a responsible broker or dealer to avail itself of the exception provided in Amex Rule 958A(c)(ii) for that same series of options only, rather than for the entire class of options.

III. Discussion

On November 17, 2000, the Commission adopted several amendments to Rule 11Ac1–1 under the Act ("Quote Rule'') to apply it to options exchanges and options market makers.[4] Under the Quote Rule, an options exchange must provide to quotation vendors the best bid and the best offer for each options series traded on the exchange, subject to certain exceptions. In addition, the Quote Rule requires responsible brokers and dealers to honor their bids and offers for each options series, subject to certain exceptions. One exception to the Quote Rule would relieve a responsible broker or dealer of its obligation to be firm for its bid or offer for a particular options series if, at the time an order sought to be executed is presented, such responsible broker or dealer is in the process of effecting a transaction in such options series and immediately revises its bid or offer after the completion of such transaction.[5]

The options exchanges, including the Amex, subsequently amended their rules for the purpose of conforming to the requirements of the Quote Rule.[6] The Amex amended its rules to, among other things, incorporate the exceptions to the requirement that a responsible broker or dealer be firm for its quotations set forth under Rule 11Ac1–1(c)(3) under the Act. Specifically, Amex Rule 958A(c)(ii)(A)(2) currently provides that a responsible broker or dealer shall not be obligated to execute a transaction for any listed option if, at the time an order is presented, the responsible broker or dealer was in the process of effecting a transaction in "such class and/or series'' of option and immediately thereafter communicates a revised quotation size. Similarly, Amex Rule 958A(c)(ii)(A)(4) provides that a responsible broker or dealer shall not be obligated to execute a transaction for any listed option if, at the time an order is presented, the responsible broker or dealer was in the process of effecting a transaction in "such class and/or series'' of option and immediately thereafter communicates a revised bid or offer. The Amex has misinterpreted these provisions as to relieve specialists and registered options traders of their obligations to execute orders in multiple series of an options class at the disseminated bid or offer. Accordingly, the Amex now proposes to amend Amex Rule 958A to clarify that a transaction in one series of an options class would enable a responsible broker or dealer to avail itself of the exception provided in Amex Rule 958A only for that same series of option.

The Commission believes that it was clear at the time the Amex amended its rules to conform to the requirements of the Quote Rule that the exceptions contained in paragraph (c)(3) of the Quote Rule apply to each option series individually and not to the entire option class. In approving the option exchanges' rules in June 2001, the Commission noted that the Amex and the Chicago Board Options Exchange, Inc. ("CBOE'') [7] incorporated into their own rules the exceptions from the Quote Rule regarding revised bids, offers and quotation sizes.[8] The Commission, however, approved Amex Rule 958A and the comparable CBOE rule, stating that it "believes that including such provisions in the exchanges' rules is consistent with the Exchange Act, provided that the Exchanges interpret them in a manner consistent with paragraph (c)(3) of Rule 11Ac1–1 under the Act.'' [9] The CBOE represents that it has correctly interpreted, and enforced compliance with, its rule in a manner consistent with the Quote Rule, namely, to treat

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

[2] 17 CFR 240.19b–4.

[3] *See* Securities Exchange Act Release No. 48948 (December 18, 2003), 68 FR 74989 ("Notice'').

[4] *See* Securities Exchange Act Release No. 43591 (November 17, 2000), 65 FR 75439 (December 1, 2000) (the "Adopting Release'').

[5] *See* SEC Rule 11Ac1–1(c)(3).

[6] *See* Securities Exchange Act Release Nos. 44145 (April 2, 2001), 66 FR 18662 (April 10, 2001) (notice and order granting partial accelerated approval for a pilot program with respect to File Nos. SR–Amex–2001–18; SR–CBOE–2001–15; SR–ISE–2001–07; SR–PCX–2001–18; and SR–Phlx–2001–37) ("SRO Rules Pilot Program Approval Order''); and 44383 (June 1, 2001), 66 FR 30959 (June 8, 2001) (approval of File Nos. SR–Amex–2001–18; SR–CBOE–2001–15; SR–ISE–2001–07; SR–PCX–2001–18; and SR–Phlx–2001–37) ("SRO Rules Final Approval Order'').

[7] The language in the Amex rule and the CBOE rule were similar in that the CBOE rule also included the language "such class and/or series.''

[8] *See* SRO Rules Final Approval Order, *supra* note 6.

[9] *See* Securities Exchange Act Release No. 44383 (June 1, 2001), 66 FR 30959 (June 8, 2001) (approving File Nos. SR–Amex–2001–18; SR–CBOE–2001–15; SR–ISE–2001–07; SR–PCX–2001–18; and SR–Phlx–2001–37).

each options series as a separate security and to apply the exception on a series basis.[10] Moreover, the CBOE amended its rule to clarify that the exceptions to the Quote Rule apply to each options series and not to an entire options class.[11] The Amex, however, interpreted its rule in a manner inconsistent with the Quote Rule.

In the instant proposal, the Amex suggests that, "[t]he exceptions to the Quote Rule as set forth in Rule 11Ac1–1(c)(3) apply to 'subject security' and it was unclear at the time the Amex amended Rule 958A whether the exceptions [to the Quote Rule] applied to an option class, option series or both." [12] In support of its assertion, the Amex notes that the term, "subject security," is defined in SEC Rule 11Ac1–1(a)(25) under the Act as an "exchange-traded security" meeting certain executed volume thresholds. The Amex then notes that the term, "exchange traded security," is defined in SEC Rule 11Ac1–1(a)(10) under the Act as any "covered security" or "class of covered securities" listed or registered on an exchange. Finally, the Amex states that the term, "covered security," is defined in SEC Rule 11Ac1–1(a)(20) under the Act as any "reported security," which means any security or class of securities. Accordingly, the Amex appears to believe that it is unclear from the use of these definitions whether the exceptions in paragraph (c)(3) of the Commission's Quote Rule would apply to an entire options class or to individual options series, because the definitions in the Quote Rule refer to the phrase "class of securities," instead of the phrase "series of securities."

The Commission, however, believes that it is clear that the obligations and exceptions to those obligations under the Quote Rule are intended to apply to each option series listed on an exchange. For example, in several places in the Adopting Release, the Commission stated that, "an options exchange would be required to establish by rule and periodically publish the size for which its best bid or offer in each option series that is listed on the exchange is firm." [13] In addition, the Commission understood that the options exchanges, including the Amex, would be applying the Quote Rule to each options series individually. For example, in the purpose section of the SRO Rules Pilot Program Approval Order, the Amex stated that it proposed to define the term, "responsible broker or dealer," to mean the specialist and any registered options traders constituting the trading crowd in "a given options series." [14] These examples demonstrate that an option series is a separate security for which a responsible broker or dealer must communicate a separate bid, offer, and size, and be firm for such quotation.

The plain language of the Commission's Quote Rule further indicates that the exceptions to the Quote Rule apply on an individual options series basis. When amending the Quote Rule to apply it to options exchanges and options market makers, the Commission set forth its expectations with respect to the application of the Quote Rule to listed options in paragraph (d) of the Quote Rule.[15] Specifically, paragraph (d) of Rule 11Ac1–1 under the Act provides that an options exchange may "establish[] by rule and periodically publish[] the quotation size for which such responsible brokers or dealers are obligated to execute an order to buy or sell an *options series that is a subject security* at its published bid or offer under paragraph (c)(2) of this section." [16] The use of phrase "options series" in the Quote Rule, in conjunction with the reference to paragraph (c)(2), provides additional clarity that the obligations of a responsible broker or dealer under paragraph (c)(3) of the Commission's Quote Rule apply on a series-by-series basis, because paragraph (c)(3) of the Quote Rule provides that the exceptions to the Quote Rule apply to "any subject security as provided in paragraph (c)(2)" and, as discussed above, the term "subject security" in paragraph (c)(2) refers to an options series that is a subject security.[17]

In its suggestion that the exceptions under paragraph (c)(3) of the Commission's Quote Rule are unclear, the Amex makes the illogical assertion that the definition of the term "subject security" could have a different meaning in paragraph (c)(3) than it has in all of the other provisions of the rule. In an earlier proposal to amend Amex Rule 958A,[18] the Amex describes paragraph (c)(i)(A) of Amex Rule 958A, which was intended to conform to the requirements of paragraph (c)(2) of the Quote Rule. In that proposal, the Amex states that, "[t]he operation of Exchange Rule 958A in paragraph (c)(i)(A) requires that each responsible broker or dealer execute customer orders in *an options series* in an amount up to its published quotation size." [19] However, in the instant proposal, the Amex asserts that the exceptions to the Quote Rule, which Amex codified in Amex Rule 958A(c)(ii), "should apply to the entire class as well as each individual series in a given options class." In effect, the Amex asserts that the same term, "subject security," in the Quote Rule should have different meanings in interrelated and contiguous paragraphs of the same rule. Accordingly, the Commission rejects Amex's assertion that it is unclear whether the term, "subject security," in the Commission's Quote Rule applies to an options class, options series, or both.

Moreover, the Commission considered a proposal by the CBOE that generally would have provided that when multiple orders for the *same class* from the same beneficial owner are represented at the trading station at approximately the same time, only the first of such orders would be entitled to an execution.[20] At the same time, the Commission considered a similar proposal by the Philadelphia Stock Exchange, Inc. ("Phlx").[21] These proposals would have relieved a responsible broker or dealer of its obligation to be firm for its quotation for all series within a class because of a transaction within the same options class. In the SRO Rules Pilot Program Approval Order, which also approved

[10] The CBOE stated that, "it has always interpreted CBOE Rule 8.51(d)(6) such that each series of option was deemed a separate security." *See* Securities Exchange Act Release No. 48525 (September 23, 2003), 68 FR 56355 (September 30, 2003) (notice and immediate effectiveness of File No. SR–CBOE–2003–38).

[11] *Id.*

[12] *See* Notice, *supra* note 3.

[13] *See* Adopting Release, *supra* note 4.

[14] *See* Securities Exchange Act Release Nos. 44145 (April 2, 2001), 66 FR 18662 (April 10, 2001) (approving pilot program regarding File Nos. SR–Amex–2001–18; SR–CBOE–2001–15; SR–ISE–2001–07; SR–PCX–2001–18; and SR–Phlx–2001–37).

[15] 17 CFR 240.11Ac1–1(d).

[16] *Id.* (emphasis added).

[17] 17 CFR 240.11Ac1–1(c)(3).

[18] *See* Securities Exchange Act Release No. 48957 (December 18, 2003), 68 FR 75294 (December 30, 2003) (SR–Amex–2003–24) (amending Amex Rule 958A to provide that, with respect to a customer limit order representing the best bid or offer, responsible brokers or dealers would no longer be required to disseminate a quotation size of at least 10 contracts when the actual size is less than 10 contracts, but would be permitted to disseminate the actual size of such customer limit orders).

[19] *Id.* (emphasis added).

[20] *See* SRO Rules Pilot Program Approval Order and SRO Rules Final Approval Order, *supra* note 6.

[21] *Id.* The Phlx proposal would have prohibited a customer from "unbundling" an order for the primary purpose of availing upon the requirement that responsible brokers and dealers execute the order up to a minimum of the disseminated size. Prohibiting "unbundling" would have prevented entry of multiple orders for different series within the same options class that would cumulatively exceed the firm quote size for one such series. Thus, a responsible broker or dealer would have been relieved of its obligations to be firm for its quotation for all series within a class because of a transaction within the same options class.

Amex Rule 958A on a pilot basis, the Commission stated that the provisions proposed by the CBOE and the Phlx would be inconsistent with the Commission's Quote Rule and could not be used to relieve exchange members from their obligations under the Quote Rule.[22] The Commission, however, specifically solicited comment on whether to grant an exemption from the Quote Rule that would allow such relief, and noted that neither the CBOE nor the Phlx provided a basis for why such proposals would be consistent with the Quote Rule.[23] Ultimately, in the SRO Rules Final Approval Order, the Commission declined to grant exemptive relief in this regard.[24]

Accordingly, 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.[25] In particular, the Commission finds that the proposed rule change is consistent with section 6(b)(5) of the Act, which requires that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices and to promote just and equitable principles of trade.[26] The Commission believes that the proposed rule change is necessary to conform the exceptions in Amex Rule 958A more closely to the exceptions in the Quote Rule set forth in Rule 11Ac1–1(c)(3) under the Act. The Commission also believes that the proposed rule change should help to ensure that the Amex refrains from interpreting its rules in a manner that is inconsistent with Commission rules, including Rule 11Ac1–1 under the Act.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,[27] that the proposed rule change (SR–Amex–2003–105) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[28]

Margaret H. McFarland,

Deputy Secretary.

[FR Doc. 04–8204 Filed 4–9–04; 8:45 am]

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[22] *See* SRO Rules Pilot Program Approval Order, *supra* note 6.

[23] *Id.*

[24] *See* SRO Rules Final Approval Order, *supra* note 6.

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

[26] 15 U.S.C. 78f(b)(5).

[27] 15 U.S.C. 78s(b)(2).

[28] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–49530; File No. SR–CHX–2003–21]

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Chicago Stock Exchange, Inc., Relating to the Price Improvement of Orders Executed Automatically on the Exchange

April 6, 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 July 17, 2003, the Chicago Stock Exchange, Inc. ("CHX" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CHX. The CHX filed Amendment No. 1 to the proposal on March 30, 2004.[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 CHX proposes to amend CHX Article XX, Rule 37, to revise its rules governing price improvement for orders executed automatically by the CHX's MAX® execution system. The text of the proposed rule change appears below. Additions are *italicized*; deletions are bracketed.[4]

ARTICLE XX

Regular Trading Sessions

* * * * *

Guaranteed Execution System and Midwest Automated Execution System

Rule 37

* * * * *

(d) Super MAX [2000]

[SuperMAX 2000 shall be a voluntary automatic execution program within the MAX System. SuperMAX 2000 shall be available for any security trading on the Exchange in decimal price increments.] A specialist may *elect, on a security-by-security basis, to enable the SuperMAX program, which will provide automated price improvement to orders automatically executed within the MAX System* [choose to enable this voluntary program within the MAX System on a security-by-security basis].

(1) Pricing

[(a) In the event that an order to buy or sell at least 100 shares is received in a security in which SuperMAX 2000 has been enabled, such order shall be executed at the ITS Best Offer or NBO (for a buy order) or the ITS Best Bid or NBB (for a sell order) if the spread between the ITS Best Bid and the ITS Best Offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is received is less than $.02.

(b) In the event that an order to buy or sell 100 shares is received in a security in which SuperMAX 2000 has been enabled, and the spread between the ITS Best Bid and the ITS Best Offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is received is $.02 or greater, such order shall be executed *(subject to the short sale rule)* at a price at least $.01 lower than the ITS Best Offer or NBO (for a buy order) or at least $.01 higher than the ITS Best Bid or NBB (for a sell order).

(c)] In the event that an order to buy or sell *100 shares or more* [more than 100 shares] is received in a security in which SuperMAX [2000] has been enabled, such order shall be executed *(subject to the short sale rule)* at the ITS Best Offer *(or NBO for Nasdaq/NM securities)*, or better (for a buy order) or the ITS Best Bid (or NBB *for Nasdaq/NM securities*), or better (for a sell order) as the specialist may designate and as is approved by the Exchange.

[(d) Odd Lot Market Orders. In the event that a market order to buy or sell less than 100 shares (or a market order otherwise deemed an odd lot by the Exchange) is received in a security in which SuperMAX 2000 has been enabled, and the spread between the ITS Best Bid and the ITS Best offer (or NBB and NBO, for Nasdaq/NM issues) in such security at the time the order is received is (A) less than $.05, such order shall be executed at the ITS Best Offer or NBO (for a buy order) or the ITS Best Bid or NBB (for a sell order); or (B) $.05 or greater, such order shall be executed at a price at least $.01 lower than the ITS Best Offer or NBO (for a buy order) or at least $.01 higher than the ITS Best Bid or NBB (for a sell order)].

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

[2] 17 CFR 240.19b–4.

[3] Amendment No. 1 replaces the original filing in its entirety. See letter from Kathleen M. Boege, Vice President and Associate General Counsel, CHX, to Nancy J. Sanow, Division of Market Regulation ("Division"), Commission, dated March 29, 2004.

[4] With the CHX's consent, the Commission made minor technical changes to indicate language being added to the text of the proposed rule. Telephone conversation between Kathleen M. Boege, Vice President and Associate General Counsel, CHX, and Yvonne Fraticelli, Special Counsel, Division, Commission, on March 31, 2004.