

busted. Depending on the parties involved in the transaction, the adjustments would either be set according to pre-determined increments or by mutual agreement between the parties.

The proposed rule change would require that one or both parties contact the BOX Market Operations Center ("MOC"),<sup>5</sup> instead of the MRC, to request a review of a suspected erroneous transaction. The MOC would then be required to promptly notify the MRC, since the MRC would continue to be the body that makes adjust or bust decisions.

The proposed change also would provide an additional avenue of relief for non-BOX market makers, resulting in the Obvious Error Rules applying not only to BOX Market Makers, but also to market makers on other exchanges whose orders are designated with a market maker account type in the BOX Trading Host. Under current BOX Rules, only BOX Market Makers and non market maker Options Participants may request a review of a suspected erroneous transaction. Under the proposed rule change, non-BOX market makers also may request a review of a suspected erroneous transaction. Moreover, only BOX Market Makers involved in an erroneous transaction with another BOX Market Maker currently may avail themselves to the pre-determined obvious error Theoretical Price plus or minus adjustment levels. The proposed rule change would maintain and expand the choices available to a non-BOX market maker involved in an erroneous transaction. Specifically, a non-BOX market maker, like BOX Market Makers today, would have the choice of agreeing with the counter party to bust the transaction, agreeing to adjust to an agreed upon price for the transaction, or now having the transaction adjusted to the pre-determined levels.

Finally, the proposed rule change would establish an additional course of action if it is determined that an Obvious Error has occurred. The current BOX Rules allow for an adjustment in the transaction price to the pre-determined levels where both parties to the transaction are BOX Market Makers. If *at least* one party to the transaction is a market maker on BOX, the BOX rules

call for the transaction to be busted, unless both parties agree to an adjustment price and notify the MRC. The proposed rule change would: (1) provide that the transaction would be busted absent an agreement to an adjusted price only when neither party is a market maker; and (2) allow the non market maker party to elect to have the transaction busted or the price adjusted to a pre-determined level, when one party to the transaction is *not* a market maker and the other party *is* a market maker.

### III. Discussion

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<sup>6</sup> and, in particular, the requirements of Section 6(b) of the Act<sup>7</sup> and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>8</sup> in that the proposal 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, protect investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred should be based on specific and objective criteria and subject to specific and objective procedures.

The Commission believes that the proposed rule change is based on specific and objective criteria and subject to specific and objective procedures. Specifically, expanding the application of BOX's Obvious Error rule to non-BOX market makers would extend the specific and objective criteria and procedures applicable to BOX Market Makers to non-BOX market makers. In addition, under the proposed rule change, an obviously erroneous transaction that is not busted would be adjusted to objective, pre-established

numerical Obvious Error adjustment increments.

### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (SR-BSE-2008-05), as modified by Amendment No. 5, is hereby approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>10</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57610; File No. SR-CBOE-2008-14]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change To Establish a Solicitation Auction Mechanism and To Amend Its Automated Improvement Mechanism

April 3, 2008.

#### I. Introduction

On February 7, 2008, the Chicago Board Options Exchange, Incorporated ("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"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposal to establish a new automated mechanism for auctioning larger-sized orders and to modify its existing automated improvement mechanism ("AIM") to permit its use for the execution of complex orders. The proposed rule change was published for comment in the **Federal Register** on February 28, 2008.<sup>3</sup> The Commission received no comments regarding the proposed rule change. This order approves the proposed rule change.

#### II. Description of the Proposal

Under CBOE Rules 6.45A, *Priority and Allocation of Equity Option Trades on the CBOE Hybrid System*, and 6.45B, *Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System*, order entry

<sup>5</sup> This proposed rule change would also add the MOC to the definitions section of the BOX Rules. See Section 1 of Chapter I of the BOX Rules. The remainder of the changes to the definition section fall into two categories. The first is switching the current Sections 31 and 32 so that they are in alphabetical order. The second is, after inserting the MOC as a definition, renumbering the remaining definitions.

<sup>6</sup> 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).

<sup>7</sup> 15 U.S.C. 78f(b).

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 57357 (February 20, 2008), 73 FR 10837.

firms that electronically enter orders are required to expose an unsolicited agency order ("Agency Order") for at least 3 seconds before crossing it against an order that it has solicited from other broker-dealers.<sup>4</sup> Currently, an order entry firm can comply with this requirement by entering the Agency Order on the Exchange, waiting 3 seconds, and then entering the solicited order. According to the Exchange, because of the 3-second exposure requirement, order entry firms have no level of assurance that they will be able to electronically pair solicited orders against Agency Orders for executions. As an alternative, CBOE has developed AIM, which permits an Agency Order to be electronically executed against principal or solicited interest.<sup>5</sup>

CBOE has also developed an enhanced auction mechanism for larger-sized simple and complex Agency Orders that are to be executed against solicited orders (the "Auction"). The proposal would implement this functionality in options classes designated by the Exchange. Such orders would be required to be for at least 500 contracts, must be entered as all-or-none limit ("AON") orders,<sup>6</sup> and would be executed only if the price is at or better than the CBOE best bid or offer ("BBO").

When a proposed solicited cross is entered into the Auction, the Exchange would send a Request for Responses ("RFR") message to all members that have elected to receive such messages. Members would then have 3 seconds to respond with a price that would improve the proposed execution price for the Agency Order, except that responses would not be entered for the account of an options market maker from another options exchange. Responses may be entered and executed at prices that are in a multiple of the applicable minimum price increment that has been designated by the Exchange for the series, which increment may not be less than \$0.01. The Exchange believes this would allow for greater flexibility in pricing large-

sized orders and provide for a greater opportunity for price improvement.

The Auction will conclude at the sooner of various conditions.<sup>7</sup> At the conclusion of the Auction, the Agency Order would be executed against the solicited order unless there is sufficient size to execute the entire Agency Order at a price (or prices) that improves the proposed crossing price. In the case where there is one or more public customer orders resting in the book at the proposed execution price on the opposite side of the Agency Order, the solicited order would be cancelled and the Agency Order would be executed against other bids (offers) if there is sufficient size at the bid (offer) to execute the entire size of the Agency Order (size would be measured considering resting orders and quotes and responses).<sup>8</sup> If there is not sufficient size to execute the entire Agency Order, the proposed cross would not be executed and both the Agency Order and solicited order would be cancelled. Additionally, the proposed cross would not be executed and both the Agency Order and solicited order would be cancelled if the execution price would be inferior to the BBO.

The proposed rule would also require members to deliver to customers a written document, in a form approved by the Exchange, describing the terms and conditions of the Auction mechanism prior to executing Agency Orders using the Auction mechanism.

The proposed rule would also specify that members may not use the Auction mechanism to circumvent the Exchange's rules limiting principal

order transactions.<sup>9</sup> Additionally, the Exchange notes that for purposes of paragraph (e) to CBOE Rule 6.9, *Solicited Transactions*, which paragraph prohibits anticipatory hedging activities prior to the entry of an order on the Exchange, the terms of an order would be considered "disclosed" to the trading crowd on the Exchange when the order is entered into the Auction mechanism.

Finally, the Exchange is proposing to expand its existing AIM auction, which currently only applies to simple orders, to cover complex orders. Accordingly, complex orders would be eligible for execution through AIM at a net debit or net credit price provided the Auction eligibility requirements of the AIM rule are satisfied and the Agency Order is eligible for AIM considering its complex order type, order origin code (*i.e.*, non-broker-dealer public customer, broker-dealers that are not Market-Makers or specialists on an options exchange, and/or Market-Makers or specialists on an options exchange), class, and marketability as determined by the Exchange. Allocation of complex orders that are subject to AIM will be the same as the existing allocation procedures, provided that the complex order priority rules applicable to bids and offers in the individual series legs of a complex order contained in CBOE Rule 6.53C(d) or 6.53C.06, as applicable, will continue to apply. In addition, the Exchange is proposing to provide in its rules that it may determine on a class-by-class basis that orders of 500 or more contracts may be executed through AIM without considering prices that might be available on other options exchanges. All other aspects of the AIM auction will continue to apply unchanged.

### 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.<sup>10</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>11</sup> which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market

<sup>7</sup> The Auction shall conclude at the sooner of: (i) The end of the response period, (ii) upon receipt by the Hybrid Trading System ("Hybrid") of an unrelated order (in the same series as the Agency Order) that is marketable against either the Exchange's disseminated quote (when such quote is the NBBO) or the responses, (iii) upon receipt by Hybrid of an unrelated limit order (in the same series as the Agency Order and on the opposite side of the market as the Agency Order) that improves any response, (iv) any time a response matches the Exchange's disseminated quote on the opposite side of the market from the responses, or (v) any time there is a quote lock on the Exchange pursuant to CBOE Rule 6.45A(d) or 6.45B(d). See paragraph (b)(2) of proposed CBOE Rule 6.74B, *Solicitation Auction Mechanism*.

<sup>8</sup> When the Agency Order is executed at an improved price(s) or at the proposed execution price against electronic orders, quotes and responses, priority would be pursuant to the allocation algorithm in effect pursuant to CBOE Rule 6.45A or 6.45B, as applicable. The allocation for simple and complex orders would be the same, except that complex orders would also be subject to the complex order priority rules applicable to bids and offers in the individual series legs of a complex order contained in paragraphs (d) or .06 of CBOE Rule 6.53C, *Complex Orders on the Hybrid System*, as applicable.

<sup>9</sup> See CBOE Rules 6.45A.01, 6.45B.01, 6.74, *Crossing Orders*, and 6.74A.

<sup>10</sup> In approving the proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>11</sup> 15 U.S.C. 78f(b)(5).

<sup>4</sup> See CBOE Rule 6.45A.02 and 6.45B.02.

<sup>5</sup> See CBOE Rule 6.74A, *Automated Improvement Mechanism ("AIM")*.

<sup>6</sup> The Exchange's existing rules provide that an AON order may be crossed with another AON order if all bids or offers at the same price at which the cross is to be effected have been filled. See, e.g., Interpretation and Policy .01 to CBOE Rule 6.44, *Bids and Offers in Relation to Units of Trading*. The proposed Auction system is modeled after this principle, except that it would allow the crossing of large-sized AON orders to take place so long as there are no public customer orders at the proposed price and there is insufficient size at an improved price to accommodate the Agency Order.

and a national market system, and, in general, to protect investors and the public interest. The Commission believes that the proposal should allow for greater flexibility in pricing large-sized orders and may provide a greater opportunity for price improvement. The Commission also notes that the proposal is substantially similar to requirements set forth in the rules of another exchange.<sup>12</sup>

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-CBOE-2008-14), be, and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>14</sup>

**Florence E. Harmon,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57615; File No. SR-CBOE-2007-120]

### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving Proposed Rule Change and Amendments No. 1 and No. 2 Thereto Relating to Market-Makers and Remote Maker-Makers

April 3, 2008.

On October 11, 2007, the Chicago Board Options Exchange, Incorporated ("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")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change relating to Market-Makers and Remote Market-Makers ("RMMs"). On February 13, 2008, the Exchange submitted Amendment No. 1 to the proposed rule change.<sup>3</sup> The proposed rule change was published for comment in the **Federal Register** on February 29, 2008.<sup>4</sup> On April 2, 2008, the Exchange submitted Amendment No. 2 to the proposed rule change.<sup>5</sup> The Commission received no

comments regarding the proposal. This order approves the proposed rule change, as amended.

CBOE proposes to amend its rules relating to Market-Makers and RMMs. The Exchange notes that, since the time the RMM rules were adopted, the ability of Market-Makers to quote from a location outside of the trading crowd or trading floor has expanded. CBOE also states that the existing obligations of Market-Makers and RMMs are generally the same. CBOE therefore does not see a reason to maintain the RMM category of market participant and proposes to delete all references to RMMs in its rules. In connection with this change, CBOE's proposal also: (i) Amends the definition of Market-Maker to include member organizations; (ii) amends CBOE Rule 3.3 to clarify that the member organization membership statuses that are approved by the Membership Committee include Market-Maker; and (iii) deletes Interpretation and Policy .02 to CBOE Rule 3.8, and amends CBOE Rule 3.8(a)(ii), to allow any member organization that is the owner or lessee of more than one membership to designate one individual to be the nominee for all memberships utilized by the organization (except that, for each membership utilized for trading in open outcry on the trading floor, the organization must designate a different individual to be the nominee for each of the memberships).

CBOE also proposes to reorganize the text of two of the Exchange's pilot programs relating to the ability of e-DPMs, Off-Floor DPMs, and RMMs to have affiliated Market-Makers in the same class and clarify that they would no longer apply to RMMs.<sup>6</sup> The Exchange also is adding a new provision to CBOE Rule 8.3 that provides that there is no restriction on affiliated Market-Makers holding an appointment and submitting electronic quotations in the same class, provided CBOE uses an allocation algorithm in the class that does not allocate electronic trades, in whole or in part, in an equal percentage based on the number of market participants quoting at the best bid or offer.<sup>7</sup>

made in a subsequent rule filing that extended two of the Exchange's pilot programs. See Securities Exchange Act Release No. 57519 (March 18, 2008) 73 FR 15805 (March 25, 2008) ("Pilot Extension"). These changes are technical and are not subject to public comment.

<sup>6</sup> In the Notice, the Exchange indicated that it proposed extending these pilot programs for an additional year. This extension was subsequently made in a separate filing. See Pilot Extension in note 5, *supra*.

<sup>7</sup> CBOE's proposal also: (i) Amends CBOE Rule 8.3 to provide that the appointment of a Market-Maker to a certain option class can be made by the

The Commission finds that the proposal, as amended, is consistent with section 6(b)(5) of the Act,<sup>8</sup> which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, 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.<sup>9</sup> Specifically, the Commission finds that it is consistent with the Act for CBOE to clarify, update, and consolidate the Exchange's rules related to Market-Makers and their obligations on the Exchange.

*It is therefore ordered*, pursuant to section 19(b)(2) of the Act,<sup>10</sup> that the proposed rule change (SR-CBOE-2007-120), as amended, is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>11</sup>

**Florence E. Harmon,**  
*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-57586; File No. SR-FICC-2007-10]

### Self-Regulatory Organizations; Fixed Income Clearing Corporation; Order Approving Proposed Rule Change, as Modified by Amendment No. 1, To Replace the Mortgage-Backed Securities Division Clearing Fund Calculation Methodology With a Yield-Driven Value-at-Risk Methodology

March 31, 2008.

#### I. Introduction

On August 31, 2007, the Fixed Income Clearing Corporation ("FICC") filed with the Securities and Exchange Commission ("Commission") and on September 27, 2007, amended proposed rule change SR-FICC-2007-10 pursuant

Market-Maker's selection or by CBOE, consistent with certain criteria set forth in CBOE Rule 8.3; (ii) amends CBOE Rule 8.3 to delete the requirement that a Market-Maker may hold an appointment in an appropriate number of Hybrid option classes that are located at one trading station; (iii) amends CBOE Rule 8.7 to delete references to RMMs and other outdated references, and (iv) updates or deletes outdated provisions in other CBOE Rules, including CBOE Rule 8.3A relating to Class Quoting Limits.

<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 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).

<sup>10</sup> 15 U.S.C. 78s(b)(2).

<sup>11</sup> 17 CFR 200.30-3(a)(12).

<sup>12</sup> See paragraphs (d) and (e) of ISE Rule 716.

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

<sup>15</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment 1 replaced the original filing in its entirety.

<sup>4</sup> See Securities Exchange Act Release No. 57367 (February 21, 2008), 73 FR 11168 ("Notice").

<sup>5</sup> In Amendment No. 2, CBOE made minor revisions to the proposed rule text to reflect changes