and how to surveil order-taking activity conducted over floor telephones.<sup>7</sup>

## III. Discussion

The Committee 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, and, in particular, the requirements of section 6(b)(5),8 in that it is designed to promote just and equitable principles of trade, prevent fraudulent and manipulative acts and practices, and maintain fair and orderly markets. Specifically, the Commission believes the proposed rule change should help to promote improved relationships between the OEX trading crowds and the member firms and facilitate efficient access to underlying markets. Providing procedures whereby members in the OEX options crowd can readily communicate with the off-floor offices of member firms as well as other locations off of the Exchange's trading floor, will allow them to obtain and transmit information more efficiently which may result in benefits to investors by improving execution of orders.

Further, incorporating the procedures contained in the Regulatory Circular into the Rules of the Exchange will enable the Exchange to monitor better the use of the floor telephones and to discipline members for violations of those rules. As noted above, because the proposed telephone policy does not restrict where a member may call, the telephones may be used to place orders in underlying stocks and in futures markets.<sup>9</sup>

With respect to equity-related transactions, while the telephones may give options market makers more immediate access to the market in the underlying securities, the Commission believes that the CBOE's surveillance systems currently in place are adequate to detect and deter any such attempts at manipulation including frontrunning. It also should be noted that the S&P 100 Index, on which OEX options are based, is a capitalization-weighted index of 100 different blue chip stocks. The fact that the value of OEX options is derived from the value of these stocks, combined with the large number of

stocks included in the index, suggests that the type of information that may be available at the OEX trading post is not likely to be significant in predicting future changes in the index.

With respect to futures-related transactions, the Commission believes that the Exchange will be able to conduct adequately surveillance for improper activities as a result of the transaction information provided to the Exchange by the Chicago Mercantile Exchange ("CME") pursuant to the Exchange's surveillance sharing agreement with the CME. Although the surveillance information obtained by the Exchange would not indicate that the floor telephones were used to enter into a potentially improper futures transactions, the Exchange's ability to conduct surveillance for potential manipulation will not be hindered because of the existence of floor telephones at the OEX options posts on the floor of the Exchange. Additionally, the Commission also notes that surveillance information is shared through the Intermarket Surveillance Group ("ISG") 10 which the CME and the Chicago Board of Trade joined as affiliate members in 1990.

The Commission believes that the Exchange's prohibition on the use of telephones to receive incoming calls is justified by legitimate regulatory concerns. Specifically, issues such as the possible misuse of non-public information, the need to ensure compliance with rules designed to assure the qualifications of members who accept orders directly from public customers, and how to provide adequate surveillance over this activity need to be addressed.

The Exchange's proposal also prohibits the use of portable, cellular, and headset telephones on the OEX options trading floor. Prohibiting the use of portable telephones aids in ensuring that market makers will be physically present at the OEX options trading posts where the options classes to which they have been appointed are traded. It is not unreasonable for the CBOE to take measures to ensure the physical presence of market makers at the OEX trading post in order to

promote the maintenance of fair and orderly markets. The Exchange believes that the prohibition should enable it to monitor and control telephone usage at the trading post, and minimize disruption of trading at the post. In addition, the Exchange notes that currently available technology would not permit a large number of portable or cellular telephones to be used in the environment of the trading floor without significant deterioration or interruption of service. As a result, the Commission believes that this restriction is within the discretion of the Exchange and does not raise regulatory concerns.11

The Exchange has represented that since the Regulatory Circular was issued and telephones at the OEX options trading post have been installed, the Exchange has not received any complaints concerning their use, nor detected any violations of the procedures set forth in the Regulatory Circular.<sup>12</sup>

Finally, the Commission believes that the CBOE's proposed fees for the use of the telephones are consistent with the requirement under Section 6(b)(4) of the Act that the rules of an exchange provide for the equitable allocation of reasonable dues, fees, and other charges among its members. CBOE Rule 2.22 allows the Exchange to impose fees on members relating to the use of Exchange facilities or for any services or privileges granted by the Exchange. The Exchange has stated that the proposed fees generally will be the same as those charged for the use of telephones at the equity trading posts. 13

In summary, because the Commission believes that installing telephones at the OEX options post on the floor of the Exchange may result in benefits to investors by allowing market makers to hedge their options positions more efficiently through improved immediate access to underlying markets while not impairing or diminishing the ability of the Exchange to conduct surveillance for improper equity-related or futures-related trading activity, the Commission finds that the proposed rule change is

<sup>&</sup>lt;sup>7</sup> The Exchange states that it intends to consider these issues in the near future, and depending on its conclusions, the Exchange may determine to revise or eliminate these conditions pursuant to a subsequent rule filing under Section 19(b) of the Act.

<sup>8 15</sup> U.S.C. 78f(b)(5) (1988).

<sup>&</sup>lt;sup>9</sup>The proposed rule change also allows members to use the floor telephones for the purpose of providing quotations that have been publicly disseminated pursuant to CBOE Rule 6.43.

<sup>10</sup> ISG was formed on July 14, 1983 to, among other things, coordinate more effectively surveillance and investigate information sharing arrangements in the stock and options market. Because of potential opportunities for trading abuses involving stock index futures, stock options, and the underlying stocks and the need for greater sharing of surveillance information for these potential intermarket trading abuses, the Chicago Mercantile Exchange and the Chicago Board of Trade joined the ISG as affiliate members in 1990. See Intermarket Surveillance Group Agreement, July 14, 1983.

<sup>&</sup>lt;sup>11</sup>This does not imply that the Exchange is prohibited from allowing portable telephones on its floor, subject to appropriate safeguards. Rather, that it is not inconsistent with the Act for the CBOE to prohibit them for the reasons discussed above.

<sup>&</sup>lt;sup>12</sup> Telephone Conversation between Timothy Thompson, Senior Attorney, CBOE, and Francois Mazur, Attorney, Office of Market Supervision, Division of Market Regulation, Commission, on November 21. 1995.

<sup>&</sup>lt;sup>13</sup> Specifically, local calls over Exchange telephones will be charged at 10 cents per minute. Long distance calls over Exchange telephones will be charged at a rate 25% greater than the Exchange's direct costs. In addition, the Exchange will charge a \$5 monthly fee for the use of the phones.