

Regulatory Circular 97-17

Date: February 7, 1997
To: Members and Member Organizations
From: Operations Planning Division
Re: SEC Order Execution Rules

The membership was previously advised in Regulatory Circular 97-08 (dated January 14, 1997) of new rules adopted by the Securities and Exchange Commission ("SEC") concerning the market making obligations and order handling responsibilities of market makers and specialists in stocks and other securities underlying listed option classes. **It was noted that although these rules do not directly apply to the trading of listed options, implementation of these new rules might have a significant impact on the displayed market quotations for securities underlying CBOE option classes.**

The new changes include the adoption of a new rule known as the Limit Order Display Rule (Rule 11Ac1-4 under the Securities Exchange Act of 1934) and amendments to the Quote Rule (Rule 11Ac1-1 under the Act). The changes became effective in all listed stocks and fifty OTC/Nasdaq stocks on January 20, 1997. Based upon information available to the Exchange, it appears that the impact of these rules on the displayed market quotation for stocks which have become subject to the new rules has been significant in some cases and insignificant in other cases. The rules will become applicable to an additional fifty Nasdaq stocks on Monday, February 10, 1997. Twenty-three of the fifty stocks that will become subject to the rules on that day are stocks which underlie CBOE option classes. CBOE members should be aware that the implementation of these rules may result in a change in the historical spreads and quoted size of the displayed markets for these stocks.

The Limit Order Display Rule

The Limit Order Display Rule requires stock exchange specialists and OTC market makers to immediately include in their market quotation both the price and the full size of each customer limit order which they represent as agent if the order would improve their quoted bid or offer, or increase the size of such bid or offer. Although there are various interpretations and exceptions to this new rule, customer limit orders which were previously not required to be reflected in the displayed market quotation must now be displayed. The new Limit Order Display Rule and related NASD rule changes (which have reduced the minimum quote size requirements for Nasdaq market makers) may result in the displayed market for certain underlying stocks being narrower and for smaller size than previously existed. **As an example, stock ABCD, which was previously quoted 19 - 19½ (1000 x 1000), may now be quoted 19½ - 19½ (100 x 1000), followed by a quote of 19 - 19½ (1000 x 100).** Since the mid-point of the stock bid-ask is normally used to drive autoquote, market makers and DPMs in option classes overlying Nasdaq stocks should be aware of this possible change in the character of the displayed market for these stocks when determining autoquote parameters and when making markets in the overlying options generally.

Amendment to the Quote Rule

The Quote Rule has been amended to require stock exchange specialists and OTC market makers to include in their disseminated market quotation any limit order they enter into an electronic communication network (“ECN”) if the limit order they placed in the ECN would improve their own market quote or the size of their quote. An ECN has been defined by the SEC as “an electronic system that widely disseminates to third parties orders entered therein by a market maker or specialist, and permits such orders to be executed against in whole or in part”. The most well known and most utilized ECN is Instinet. Under a provision of the amendment, the stock exchange specialist or OTC market maker may comply with the new requirement by manually including the terms of the ECN order in his own quotation, or by using a linkage established between the ECN and an exchange or Nasdaq.

We understand that Instinet (the ECN most utilized by CBOE market makers and DPMs) is electronically linked with Nasdaq and that, when requested, Instinet will transmit the limit prices of orders that it holds to Nasdaq for inclusion in the Nasdaq quote. CBOE members should contact their stock execution firms regarding possible changes that may occur in the processing of their stock orders as a result of the implementation of the Limit Order Display Rule and the amendment to the Quote Rule.

Implementation Dates

The following are the fifty Nasdaq stocks that will become subject to the the Limit Order Display Rule and the Quote Rule on Monday, February 10, 1997:

ABRX	ABR Information Services, Inc.	MDRX	Medicis Pharmaceutical Corporation*
ANET	ACT Networks, Inc.*	NSCP	Netscape Communications Corporation*
ADBE	Adobe Systems Incorporated	OAKT	Oak Technology, Inc.*
ACCOB	Adolph Coors Company	OCAI	Orthodontic Centers of America, Inc.
ATLI	Advanced Technology Laboratories, Inc.	OXHP	Oxford Health Plans, Inc. *
ALTR	Altera Corporation	PHYN	Physician Reliance Network, Inc.
ABIG	American Bankers Insurance Group, Inc.	PTEK	Premiere Technologies, Inc. *
AMAT	Applied Materials, Inc.	QNTM	Quantum Corporation
ATML	Atmel Corporation*	QTRN	Quintiles Transnational Corp.*
ADSK	Autodesk, Inc.	RACF	RAC Financial Group, Inc.
BMCS	BMC Software, Inc.*	RAPT	Raptor Systems, Inc.
CLFY	Clarify, Inc.*	RGBK	Regions Financial Corporation
XRAY	DENTSPLY International Inc.*	SDLI	SDL Inc.
DIGI	DSC Communications Corporation	SMED	Shared Medical Systems Corporation
ENCD	ENCAD, Inc.*	SPLS	Staples, Inc.
FATN	First American Corporation	TLAB	Tellabs, Inc.
FTEN	First Tennessee National Corporation	TLTN	Teltrend, Inc.
GATE	Gateway 2000, Inc.*	OFIS	U.S. Office Products Company *
GYMB	Gymboree Corporation (The)*	USSB	United States Satellite Broadcasting Co., Inc.*
HBAN	Huntington Bancshares Incorporated*	UWST	Untied Waste Systems, Inc.
IDXX	IDEXX Laboratories, Inc.*	VKNG	Viking Office Products, Inc.
IFMX	Informix Corporation*	WAMU	Washington Mutual, Inc.
INSO	INSO Corporation	WCOM	WorldCom, Inc.
ERICY	LM Ericsson Telephone Company*	XLNX	Xilinx, Inc.*
MCAF	McAfee Associates, Inc.*		
MCIC	MCI Communications Corporation*		

*Stocks underlying CBOE option classes

An additional fifty Nasdaq stocks are scheduled to become subject to the Limit Order Display Rule and the Quote Rule on February 24, 1997.

Questions concerning the SEC Order Execution Rules may be directed to Edward L. Provost, Senior Vice President at 312-786-7717. Questions regarding autoquote parameters should be directed to Tim Watkins at 312-786-7172.