

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49687; File No. SR-CBOE-2004-05)

May 12, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Inc. Relating to the Relocation of an Entire Trading Station's Securities to Another Trading Station

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 28, 2004, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I, II and, III below, which Items have been prepared by the Exchange. CBOE filed Amendment No. 1 on March 15, 2004.³ CBOE filed Amendment No. 2 on May 6, 2004.⁴ The

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division of Market Regulation ("Division"), Commission, dated March 12, 2004 ("Amendment No. 1"). In Amendment No. 1, CBOE amended the proposal to further explain why it is transferring to the Modified Trading System Appointments ("MTS") Committee the authority to determine whether to relocate an entire trading station's securities to another trading station that is operated by the same Designated Primary Market Maker ("DPM"). CBOE also clarified the process the MTS Committee would follow in deciding whether to relocate securities. CBOE also noted in Amendment No. 1 that the MTS Committee would relocate securities in accordance with CBOE Rule 30.18, which allows for limited side-by-side trading and integrated market making, and that to the extent any person is aggrieved economically by any MTS Committee decision, such person may seek to have the decision reviewed under Chapter XIX of CBOE's Rules. Finally, CBOE also amended its proposed rule text in its entirety.

⁴ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division, Commission, dated May 5, 2004 ("Amendment No. 2"). In Amendment No. 2, CBOE clarified when the MTS Committee may forgo giving notice to a DPM organization and trading crowds prior to relocation because expeditious action is necessary.

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

CBOE proposes to amend CBOE Rules 8.84 and 8.95 to grant to the MTS Committee, and not the Allocation Committee, the authority to approve the relocation of an entire trading station’s securities to another trading station that is operated by the same DPM organization.

The text of the proposed rule change follows. Additions are in *italics*.

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Section C: Designated Primary Market-Makers (Rules 8.80-8.91)

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Rule 8.84. Conditions on the Allocation of Securities to DPMs

(a) The MTS Committee may establish (i) restrictions applicable to all DPMs on the concentration of securities allocable to a single DPM and to affiliated DPMs and (ii) minimum eligibility standards applicable to all DPMs which must be satisfied in order for a DPM to receive allocations of securities, including but not limited to standards relating to adequacy of capital and number of personnel.

(b) The MTS Committee has the authority under other Exchange rules to restrict the ability of particular DPMs to receive allocations of securities, including but not limited to, Rules 8.88(b) and 8.60, Rule 8.83(d), and Rule 8.90.

...Interpretations and Policies:

CBOE also stated that it anticipates that the relocation of securities under this proposal pursuant to the consideration of the appropriate factors, will have a positive impact on the

.01 (a) It shall be the responsibility of the MTS Committee, pursuant to this Rule, to determine whether or not to relocate all of the securities traded at a trading station operated by a DPM organization to another trading station operated by the same DPM. In making a determination pursuant to this Interpretation, the MTS Committee should evaluate whether the change is in the best interests of the Exchange, and the Committee may consider any information that it believes will be of assistance to it. Factors to be considered may include, but are not limited to, any one or more of the following: performance, operational capacity of the Exchange or the DPM, efficiency, number and experience of personnel of the DPM who will be performing functions related to the trading of the applicable securities, number of securities involved in the relocation, number of market-makers affected by the relocation of the securities, and trading volume of the securities.

(b) Prior to making a determination pursuant to this Interpretation, except when expeditious action is required, the MTS Committee shall notify the DPM organization and trading crowds affected by the relocation of the securities of the action the MTS Committee is considering taking, and shall convene one or more informal meetings of the Committee with the DPM and the trading crowds to discuss the matter, or shall provide the DPM and the trading crowds with the opportunity to submit a written statement to the Committee.

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Rule 8.95 Allocation of Securities and Location of Trading Crowds and DPMs

(a) The Allocation Committee shall be responsible for determining for each equity option class traded on the Exchange: (i) whether the option class should be allocated to a trading crowd or to

affected DPM's, market makers, and market participants.

a DPM and (ii) which trading crowd or DPM should be allocated the option class. The Allocation Committee shall also be responsible for determining the location on the Exchange's trading floor of each trading crowd, each DPM, and each security traded on the Exchange. The Special Product Assignment Committee shall be responsible for determining for each security traded on the Exchange other than an equity option (i) whether the security should be allocated to a trading crowd or to a DPM and (ii) which trading crowd or DPM should be allocated the security.

(b)-(g) no change

...Interpretations and Policies:

.04 Notwithstanding paragraph (a) of this Rule, the MTS Committee shall have the authority to relocate all of the securities traded at a trading station operated by a DPM organization to another trading station operated by the same DPM organization pursuant to Interpretation .01 of Rule 8.84.

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II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, CBOE 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

CBOE Rule 8.95(a) currently provides that the Exchange's Allocation Committee is responsible for determining the location on the Exchange's trading floor of each trading crowd, each DPM, and each security traded on the Exchange. Moreover, Paragraph (c) of Rule 8.95 provides that any decision made by the Allocation Committee (or the Special Product Assignment Committee) may be changed if the committee concludes that a change is in the best interest of the Exchange based on operational factors or efficiency. Paragraph (d) of Rule 8.95 describes the process the Allocation Committee follows prior to taking any action under Rule 8.95(c), including giving notice to the DPM and trading crowd affected by the proposed committee action, and giving the DPM and the trading crowd an opportunity to appear before the committee or submit a written statement to the committee.

Recently, some DPM organizations, which operate as a DPM at more than one trading station on the Exchange's trading floor, have requested to relocate all of the securities traded at a particular trading station operated by that DPM organization to another trading station operated by the same DPM (sometimes referred to as consolidations of DPM trading stations). Pursuant to CBOE Rule 8.95, CBOE's Allocation Committee has considered these requests.

However, because these requests may impact the operational performance and market performance of the DPM organization, the Exchange believes that it would be appropriate for the MTS Committee to consider these types of requests.⁵ Indeed, the MTS Committee typically

⁵ In Amendment No. 1, CBOE clarified that the MTS Committee may determine whether to relocate an entire trading station's securities to another trading station that is operated by the same DPM, pursuant to a request from a DPM organization or on the Committee's own initiative. See Amendment No. 1, supra note 3.

reviews DPM transfer of interest proposals that involve, among other things, changes to a DPM's management structure. Further, under current CBOE's rules, the MTS Committee is vested with the authority to, among other things, approve member organizations to act as DPMs (CBOE Rule 8.83); establish restrictions applicable to all DPMs on the concentration of securities allocable to a single DPM and minimum eligibility standards applicable to all DPMs which must be satisfied in order for a DPM to receive allocations (CBOE Rule 8.84); review DPMs' operations and performance, including an evaluation of the extent to which a DPM has satisfied its obligations under CBOE Rule 8.85 – DPM Obligations (CBOE Rule 8.88); and approve the transfer of DPM appointments (CBOE Rule 8.89).⁶ Accordingly, CBOE believes that it is appropriate for the MTS Committee to determine whether or not to relocate an entire trading station's securities to another trading station that is operated by the same DPM.⁷ As a result, the Exchange proposes to add a new interpretation to CBOE Rule 8.84 which states that it shall be the responsibility of the MTS Committee to determine whether or not to relocate all of the securities traded at a trading station operated by a DPM organization to another trading station operated by the same DPM.⁸

Proposed Interpretation .01 to CBOE Rule 8.84 also states that in making a determination pursuant to the Interpretation, the MTS Committee should evaluate whether the change is in the

⁶ See Amendment No. 1, supra note 3.

⁷ Id.

⁸ CBOE also proposes to add a new interpretation to CBOE Rule 8.95 stating that notwithstanding paragraph (a) of CBOE Rule 8.95, the MTS Committee shall have the authority to relocate all of the securities traded at a trading station operated by a DPM organization to another trading station operated by the same DPM organization pursuant to Interpretation .01 of CBOE Rule 8.84.

best interest of the Exchange and may consider any information that it believes will be of assistance to it.⁹ Factors to be considered may include, but are not limited to, any one or more of the following: performance, operational capacity of the Exchange or the DPM, efficiency, number and experience of personnel of the DPM who will be performing functions related to the trading of the applicable securities, number of securities involved in the relocation, number of market-makers affected by the relocation of the securities, and trading volume of the securities. CBOE believes that the various factors identified under proposed Interpretation .01 to CBOE Rule 8.84 that the MTS Committee may consider when evaluating whether to relocate an entire trading station's securities are generally intended to relate to and be more descriptive of the factors that the Allocation Committee previously utilized when making such relocation decisions under CBOE Rule 8.95.¹⁰ CBOE further believes that if, after reviewing the appropriate factors and determining that a relocation of securities is in the best interests of the Exchange in accordance with Interpretation .01(a) to CBOE Rule 8.84, the MTS Committee determines to relocate an entire trading station's securities to another trading station that is operated by the same DPM organization, that such relocation would have a positive impact on the DPM trading those option classes, the market-makers choosing to trade those options classes, and other market

⁹ CBOE believes that this requirement is consistent with the requirement of current CBOE Rule 8.95(c). See Amendment No. 2, supra note 4. Paragraph (c) of CBOE Rule 8.95 provides that any decision made by the Allocation Committee may be changed if the Committee concludes that a change is in the best interest of the Exchange based on operational factors or efficiency.

¹⁰ See Amendment No. 1, supra note 3.

participants.¹¹

Similar to paragraph (d) of CBOE Rule 8.95, the proposed new Interpretation .01 to CBOE Rule 8.84 also includes a provision requiring the MTS Committee to notify the DPM organization and trading crowds affected by the relocation of the securities of the action the MTS Committee is considering taking, and shall convene one or more informal meetings of the Committee with the DPM and the trading crowds to discuss the matter, or shall provide the DPM and the trading crowds with the opportunity to submit a written statement to the Committee.¹²

This proposed change maintains the authority of the Allocation Committee (under CBOE Rules 8.95(a) and (c)) to determine whether or not to relocate less than all of the securities at a particular trading station to another trading station that is operated by the same DPM organization.

¹¹ See Amendment No. 2, supra note 4. CBOE trading crowd members, including market makers, are able to move freely around CBOE's trading floor among the trading crowds to which they are appointed. Therefore, market makers would continue to be able to trade their assigned option classes if those options classes were moved to another trading station due to the consolidation of a DPM's options classes. Specifically, CBOE market makers are able to move freely around the trading floor, if the market makers execute at least 75% of their total contract volume in their appointed classes. See Interpretation .03A to CBOE Rule 8.7. Telephone conversation between Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division, Commission, on April 30, 2004.

¹² In Amendment No. 1, CBOE clarified that proposed Interpretation .02 to CBOE Rule 8.84 allows the MTS Committee to forego giving notice to the DPM organization and trading crowds affected by the relocation of the securities when expeditious action is required. CBOE noted that this is consistent with existing CBOE Rule 8.95(d), which states that the Allocation Committee similarly may forego giving notice when expeditious action is required. See Amendment No. 1, supra note 3. CBOE clarified, however, that the MTS Committee would do this only in unusual circumstances, such as extreme market volatility or some other situation requiring urgent action. Any determination by the MTS Committee in this regard could be, but would not be required to be, temporary. See Amendment No. 2, supra note 4.

Finally, CBOE notes that (i) nothing in this proposal is intended to amend CBOE's rules which allow for limited side-by-side trading and integrated market making (CBOE Rule 30.18), and (ii) to the extent any person is aggrieved in an economic sense by any decision made by the MTS Committee, such person may seek to have the decision reviewed under Chapter XIX of the Exchange's Rules.¹³

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act¹⁴ in general and furthers the objectives of Section 6(b)(5)¹⁵ in particular in that it will 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.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will impose a burden on competition that is not necessary or appropriate in furtherance of purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

No written comments were solicited or received with respect to the proposed rule change.

¹³ See Amendment No. 1, supra note 3. The appeal process continues to be available in event the MTS Committee forgoes giving notice to the affected trading crowd because expeditious action is required. Telephone conversation between Patrick Sexton, Assistant General Counsel, CBOE, to Christopher Solgan, Attorney, Division, Commission, on April 27, 2004.

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

(A) by order approve such proposed rule change, or,

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number CBOE-2004-05 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 450 Fifth Street, NW, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2004-05. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post

all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Section, 450 Fifth Street, NW, Washington, DC 20549. Copies of such filing also will be available for inspection and copying at the principal office of the Exchange. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-CBOE-2004-05 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁶

Margaret H. McFarland
Deputy Secretary

¹⁶ 17 CFR 200.30-3(a)(12).