

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-50005; File No. SR-CBOE-2004-33)**

**July 12, 2004**

**Self-Regulatory Organizations; Order Granting Accelerated Approval of Proposed Rule Change by the Chicago Board Options Exchange, Inc. and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Thereto Relating to Frequency of Executions on the Hybrid Trading System**

**I. Introduction**

On May 19, 2004, the Chicago Board Options Exchange, Inc. (“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 governing the frequency with which orders for the account of market makers or specialists on an options exchange (“options market maker”), or for the account of a stock exchange specialist with respect to a security in which it acts as specialist, may be submitted for automatic execution in the Exchange’s Hybrid Trading System (“Hybrid”). The proposed rule change was published in the Federal Register on June 14, 2004.<sup>3</sup> On July 12, 2004, the Exchange submitted by facsimile Amendment No. 1 to the proposal.<sup>4</sup>

The Commission received no comments on the proposed rule change. This order approves the proposed rule change on an accelerated basis. Simultaneously, the Commission provides notice of filing and grants accelerated approval of Amendment No. 1.

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<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. 49814 (June 4, 2004), 69 FR 33090.

<sup>4</sup> See letter from Steve Youhn, Senior Attorney, Legal Division, CBOE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation (“Division”), Commission, dated July 12, 2004 (“Amendment No. 1”).

## II. Description of Proposal and Amendment No. 1

Currently, CBOE Rule 6.8(e)(iii) restricts the entry of certain orders into the Exchange's RAES system to one order within any 15-second period on the same side of the market in an option class, when such order is for an account or accounts of the same beneficial owner. The proposed rule change seeks to adopt a similar 15-second rule applicable to options market maker and stock exchange specialist orders entered into Hybrid, which would be implemented for a six-month pilot period.

Specifically, the Exchange has proposed to adopt new CBOE Rule 6.13(b)(i)(C)(iii), which would prohibit members from entering or permitting the entry of multiple orders on the same side of the market in an option class within any 15-second period for an account or accounts of the same beneficial owner with respect to those orders eligible for submission pursuant to CBOE Rule 6.13(b)(i)(C)(ii).<sup>5</sup> The proposed rule change also would allow the appropriate floor procedure committee ("FPC") to shorten the duration of this 15-second restriction by providing advance notice to the membership via a Regulatory Circular that is issued at least one day prior to implementation.

The Exchange also has proposed to limit to the scope of the rule. The Exchange has represented that while all of the floor-based options exchanges' rules, including CBOE Rule 6.8(e)(iii), broadly apply to all orders (i.e., orders from customers and broker-dealers), the proposed amendment to CBOE Rule 6.13 will apply only to orders from options exchange market makers and stock exchange specialists, as defined in CBOE Rule 6.13(b)(i)(C)(ii).<sup>6</sup>

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<sup>5</sup> See infra note 6.

<sup>6</sup> On June 17, 2004, the Commission approved a proposed rule change that modified this paragraph. See Securities Exchange Act Release No. 49880, 69 FR 35086 (June 23, 2004) (SR-CBOE-2004-15). CBOE Rule 6.13(b)(i)(C)(ii) currently provides as follows:

According to the Exchange, customers and broker-dealers (as described in CBOE Rule 6.13(b)(i)(C)(i)) will not be subject to the rule and as such will continue to be eligible to receive unlimited automatic executions.

The Exchange clarified the scope of the proposed rule change in Amendment No. 1. Amendment No. 1 confirmed that Linkage Orders will not be subject to the proposed rule. Moreover, Amendment No. 1 proposed to amend the rule text to clarify the type of orders that will be presumed to be for the account(s) of the same beneficial owner. Specifically, the Exchange proposed that orders will be presumed to be for the account(s) of the same beneficial owner if they are not independently originated by separate market makers (or stock exchange specialists) and such orders clear into the same account or accounts with common ownership. The Exchange also included language that explained that the term "independently originated" means that a market maker (or stock exchange specialist) makes an individual determination to trade and separately communicates its trading determination (i.e., order) to the Exchange.

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(ii) (A) Options Exchange Market Makers: The appropriate FPC may also determine, on a class-by-class basis, to allow orders for the accounts of market makers or specialists on an options exchange (collectively "options market makers") who are exempt from the provisions of Regulation T of the Federal Reserve Board pursuant to Section 7(c)(2) of the Securities Exchange Act of 1934 to be eligible for automatic execution. The appropriate FPC may establish the maximum order size eligibility for such options market maker orders at a level lower than the maximum order size eligibility available to non-broker-dealer public customers and non-market maker or non-specialist broker-dealers. Pronouncements pursuant to this provision regarding options market maker access shall be made by the appropriate FPC and announced via Regulatory Circular.

(B) Stock Exchange Specialists: The appropriate FPC may determine, on a class-by-class basis, to allow orders for the account of a stock exchange specialist, with respect to a security in which it acts as a specialist, to be eligible for automatic execution in the overlying option class. The appropriate FPC may establish the maximum order size eligibility for such specialist orders at a level lower than the maximum order size eligibility available to options exchange market makers. Stock exchange specialists, with respect to orders in securities in which they do not act as specialist, will be treated as broker-dealers that are not market makers or specialists on an options exchange and will be eligible to submit orders for automatic execution in accordance with subparagraph (i) above.

Also in Amendment No. 1, the Exchange made representations regarding its members' ability to comply with the proposed rule. In this regard, the Exchange stated that it had contacted the large national market making firms, as well as the primary vendors used by the majority of market makers to submit quotes and orders, to gauge their ability to comply with the proposed rule. CBOE represented that, based on those discussions, it has determined that its members would be able to enforce compliance with the proposed rule upon implementation either through electronic or manual means.

Lastly, in Amendment No. 1, the Exchange requested approval of the proposed rule change for a six-month pilot period.

### **III. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change**

After careful consideration, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>7</sup> Specifically, the Commission believes the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>8</sup> which requires among other things, that the rules of the Exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to remove impediments to perfect the mechanism of a free and open market and national market system, and, in general, to protect investors and the public interest.

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<sup>7</sup> The Commission has considered the proposed rule's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

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

The Commission believes that prohibiting members from causing the entry of more than one order from options market makers or stock exchange specialists for the same beneficial account within a 15-second period into Hybrid should help reduce the risk exposure of CBOE market makers. The Commission believes that 15 seconds is a sufficient time period to allow market makers to change their quotations following an execution, without placing an undue burden on market participants seeking to execute transactions on the Exchange.<sup>9</sup> The Commission notes, however, that market participants subject to the 15-second restriction will still be permitted to send orders to the Exchange for execution through the Intermarket Options Linkage pursuant to the terms of the Plan for the Purpose of Creating and Operating an Intermarket Options Linkage.

The Commission finds good cause for approving the proposed rule change prior to the 30<sup>th</sup> day of the date of publication of notice of filing thereof in the Federal Register. The Exchange has represented that, upon approval of the proposed rule change, orders electronically submitted to CBOE's order routing system in Hybrid classes by options market-makers will be eligible for automatic execution through the Hybrid System.<sup>10</sup> The Commission believes that permitting such access is an important development in that it will improve the efficiency with which such orders will be executed. By providing efficient executions for additional types of orders, more options orders may be attracted to the Exchange, and thus help improve the depth and liquidity of the Exchange's market.

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<sup>9</sup> The Commission notes that the Exchange may not take punitive action against any non-member options market maker or stock exchange specialist who submits an order to a CBOE member for entry into Hybrid in the event that the CBOE member violates CBOE Rule 6.13(b)(i)(C)(iii).

<sup>10</sup> See letter from Joanne Moffic-Silver, General Counsel, CBOE, to Annette Nazareth, Director, Division, Commission, dated July 9, 2004.

Further, the Exchange is proposing to implement the proposed rule change for a pilot period of six months so that the Exchange and the Commission may review the impact of the proposed rule change in light of greater options market maker access to Hybrid. Therefore, the Commission finds that there is good cause, consistent with Section 19(b)(2) of the Act,<sup>11</sup> to approve the proposed rule change on an accelerated basis.

The Commission finds good cause for approving Amendment No. 1 to the proposed rule change prior to the 30<sup>th</sup> day after the date of publication of notice of filing thereof in the Federal Register. In Amendment No. 1, the Exchange proposed to revise the rule text to provide greater clarity with respect to the definition of beneficial owner. The Exchange also proposed to implement the proposed rule change as a six-month pilot program and clarified that the proposed rule change would not affect the frequency with which markets may submit Linkage Orders to the CBOE. Because Amendment No. 1 did not affect the substance of the proposed rule change, made clarifying changes to the scope of the proposal, and proposed that the new rule be operated on a pilot basis, the Commission finds good cause, consistent with Section 19(b)(2) of the Act, to approve Amendment No. 1 on an accelerated basis.

#### **IV. Solicitation of Comments**

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 1 to the proposed rule change, including whether the Amendment 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

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<sup>11</sup> 15 U.S.C. 78s(b)(2).

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include SR-CBOE-2004-33 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 SR-CBOE-2004-33. 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 CBOE. 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 SR-CBOE-2004-33 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

**V. Conclusion**

IS IT THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>12</sup> that the proposed rule change (SR-CBOE-2004-33) and Amendment No. 1 thereto are hereby approved on an accelerated basis for a pilot period to expire on January 12, 2005.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.<sup>13</sup>

Jill M. Peterson  
Assistant Secretary

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<sup>12</sup> 15 U.S.C. 78o-3(b)(6) and 78s(b)(2).

<sup>13</sup> 17 CFR 200.30-3(a)(12).