

## **SUMMARY OF INTENDED TESTIMONY**

**William J. Brodsky**

**Chairman & Chief Executive Officer, Chicago Board Options Exchange**

The Chicago Board Options Exchange is pleased to testify regarding the Commission's recently proposed Regulation NMS. As the nation's oldest options exchange, we have been involved in many market structure initiatives over the years, including the development of a comprehensive linkage system, creation of the Options Price Reporting Authority, the conversion to decimal pricing, the introduction and application of a firm quote rule to options, and various other intermarket initiatives. As the Commission grapples with the important issues of the Trade Through Rule and market access in the equities markets, our recent experience in converting to a hybrid trading system, which increases intramarket competition, may be illuminating as to the ability of an exchange to offer the benefits of a floor-based auction combined with screen-based electronic technology. CBOE's plan for an enhanced market model for options seeks to combine advanced technology with the broadest possible base of liquidity providers to create the optimal marketplace of choice.

### **1. CBOE Has Successfully Converted From a Floor-Based Exchange to a Hybrid Model.**

Up until several years ago CBOE primarily employed a floor-based auction system that was supplemented by RAES, our automatic execution system for small-sized customer orders. The advent of new and robust technology, the expansion of full-scale multiple trading, and the introduction of a new competing exchange that was fully electronic changed the competitive landscape of the options markets and caused CBOE to redesign the structure of our exchange. For example, CBOE was the first floor-based exchange to disseminate dynamic quotes with size. More recently, CBOE introduced its Hybrid Trading System which combines features of the open outcry market with an electronic, competing dealer model. The hybrid platform enables market makers and designated primary market makers ("DPMs") to submit their individual quotes and floor brokers to submit customer orders to an electronic system. The best bid or offer among these quotes or orders and the bid's or offer's size is disseminated publicly as CBOE's quote and is accessible electronically. The introduction of the hybrid system greatly expanded the amount of intra-market competition on the Exchange and led to a dramatic narrowing of quoted and effective spreads.

CBOE is now in the process of obtaining regulatory approval for an enhanced hybrid system. The enhanced hybrid would create competing, remote electronic DPMs and competing, remote market makers who would stream quotes into the Exchange's hybrid system. In-crowd market makers would be able to submit quotes to the enhanced hybrid as well.

### **2. CBOE's Structure Allows Both Floor-Based Interaction and Immediate Access to the Best Quotes**

Even with the implementation of the advanced hybrid system CBOE would continue to operate an open outcry market on the floor for firms seeking the liquidity and dynamics associated with a physical trading crowd. The premise of CBOE's hybrid structure is simple.

For those market participants who desire immediacy of execution against displayed quotes with size, the hybrid trading system provides an electronic means to access the best quotes of competing market makers on the Exchange. For those participants who have certain orders, such as complex or large orders, that could benefit from trading crowd information and interaction, the Exchange maintains a floor-based trading crowd where such orders can be worked. In this manner, CBOE is able to provide the best of both types of trading systems. A market participant can obtain access to CBOE's best quote in through the hybrid system or on the floor, while a competing exchange can access CBOE's best quote through the intermarket linkage.

### **3. An Effective Intermarket Linkage is Crucial to Enabling Different Options Exchange Structures**

Over a year ago the options markets implemented an inter-exchange linkage to facilitate the routing of orders between exchanges. The linkage allows broker-dealers on one exchange to access a better price on an away market electronically while containing trade through rules to prevent one exchange from trading through a better price disseminated on another exchange. The key to the success of the linkage is the ability of market makers on an exchange to access another exchange's better displayed price automatically. Thus, CBOE's best *displayed* quote is accessible virtually instantly by other exchanges, but we still offer a market participant the ability to try to improve upon that quote by sending an order to the open outcry auction on our floor. In other words, the open outcry auction does not slow down other market participants that want to access the best displayed quote. At the same time, a market participant trying to work an order on CBOE's floor has the comfort that another market should not trade through CBOE's best displayed quote.

\* \* \* \* \*

Despite the differences in options and equity market structures, I hope that CBOE's experience proves instructive as the SEC addresses equity market structure issues on the Trade Through Rule, market access, and how to accommodate the needs of automated and manual markets.