

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-49699; File No. SR-CBOE-2003-42)**

**May 13, 2004**

**Self-Regulatory Organizations; Chicago Board Options Exchange, Inc.; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 1 Relating to the Retail Automatic Execution System**

On October 1, 2003, 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 regarding the execution of certain broker-dealer orders. The proposed rule change was published for comment in the Federal Register on November 7, 2003.<sup>3</sup> The Commission received no comment letters on the proposal. On May 5, 2004, the CBOE filed Amendment No. 1 to the proposed rule change.<sup>4</sup> This order approves the proposed rule change, as amended. The Commission also seeks comment on Amendment No. 1 from interested persons.

**I. Description of the Proposal**

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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. 48721 (October 30, 2003), 68 FR 63158.

<sup>4</sup> See letter from Angelo Evangelou, Attorney, CBOE, to Kelly Riley, Assistant Director, Division of Market Regulation, Commission, dated May 4, 2004 (“Amendment No. 1”). In Amendment No. 1, the CBOE modified the proposed rule change by providing that neither proprietary orders of an Order Entry Firm that submitted a customer order for placement on the limit order book, orders from any firm affiliated with the Order Entry Firm, nor orders solicited by the Order Entry Firm from members or non-member broker-dealers may execute (automatically or otherwise) against the customer limit order unless the customer limit order is exposed on the book for at least thirty (30) seconds. In addition, the CBOE amended the proposed rule change to provide that it be adopted as a pilot program ending on November 30, 2004.

The CBOE proposes to amend CBOE Rule 6.8, Interpretation and Policy .01, to allow broker-dealer orders that are eligible for execution on CBOE's Retail Automatic Execution System ("RAES") to execute automatically against limit orders on the CBOE book in classes designated by the appropriate Floor Procedure Committee. The proposed rule change would permit broker-dealer orders to execute automatically against customer limit orders on the book provided that such customer orders are at the national best bid or offer ("NBBO"). However, the proposed rule change provides that proprietary orders of an Order Entry Firm or its affiliates, or orders solicited by the Order Entry Firm from members or non members (collectively, "Order Entry Firm Orders"), may not automatically execute against a customer limit order on the limit order book that was placed on the book by the Order Entry Firm unless the customer order has been exposed on the book for at least thirty seconds. Finally, the proposed rule change specifies that it shall be a violation of the proposed rule for any Exchange member or member organization to be a party to any arrangement designed to circumvent the proposed rule by allowing a customer, member, member organization or non-member broker-dealer to execute immediately against agency orders delivered to the Exchange whether such orders are delivered via the CBOE ORS system or represented in the trading crowd.

## **II. Discussion**

The Commission finds that the proposed rule change, as amended by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange<sup>5</sup> and, in particular, the requirements of Section 6 of the Act<sup>6</sup> and the rules and regulations thereunder. Specifically, the Commission believes that the

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<sup>5</sup> In approving this proposed rule change, the Commission considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>6</sup> 15 U.S.C. 78f.

proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>7</sup> which, among other things, requires that the CBOE's rules be designed to 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.

The Commission anticipates that the ability for broker-dealer orders on RAES to execute against customer limit orders on the book should help to provide faster execution of both eligible broker-dealer orders and eligible customer limit orders, while reducing the burden on the Exchange's members to manually execute these orders. The Commission believes that the proposal should benefit customers using the RAES system, as well as customers whose orders are residing in the Exchange's customer limit order book. Moreover, the Commission finds that the proposed rule change that requires a customer limit order to be exposed on the book for 30 seconds before an Order Entry Firm Order can execute against it addresses the concern that Order Entry Firms could use this proposed rule change to internalize or cross orders. The Commission notes that CBOE represented that it has developed a surveillance procedure to enforce compliance with this provision by its members.

The Commission finds good cause for approving Amendment No. 1 prior to the thirtieth day after the date of publication of notice of filing thereof in the Federal Register. Amendment No. 1 contains the proposed language relating to the thirty-second exposure of customer limit orders on the book. In addition, Amendment No. 1 requests that the proposed rule change be approved as a pilot until November 30, 2004. The thirty-second exposure of customer limit orders, contained in Amendment No. 1, is intrinsic to the proposed rule change's safeguards against internalization. Further, Amendment No. 1 provides that it shall be a violation of CBOE

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<sup>7</sup>

15 U.S.C. 78f(b)(5).

Rule 6.8 to circumvent the exposure requirement set forth in the proposed rule change, thereby providing CBOE with a means for addressing inappropriate executions prior to the expiration of the thirty-second exposure requirement, consistent with the protection of investors and the public interest. Accordingly, the Commission believes that there is good cause, consistent with Section 19(b) of the Act,<sup>8</sup> to approve Amendment No. 1 to the proposal on an accelerated basis.

### **III. 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 Amendment No. 1 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2003-42 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-2003-42. 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 Amendment

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

No. 1 to the proposed rule change that are filed with the Commission, and all written communications relating to Amendment No. 1 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 20549-0609. 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 File Number SR-CBOE-2003-42 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

**IV. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>9</sup> that the proposed rule change (File No. SR-CBOE-2003-42) is hereby approved, and Amendment No. 1 is approved on an accelerated basis, on a pilot basis until November 30, 2004.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

J. Lynn Taylor  
Assistant Secretary

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<sup>9</sup> 15 U.S.C. 78s(b)(2).

<sup>10</sup> 17 CFR 200.30-3(a)(12).