

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-49880; File No. SR-CBOE-2004-15)

June 17, 2004

Self-Regulatory Organizations; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. Relating to Automatic Executions for Underlying Specialists

On March 2, 2004, the Chicago Board Options Exchange, Inc. (“CBOE” or “Exchange”) filed with Securities and Exchange Commission (“Commission”) the proposed rule change, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² to amend CBOE Rule 6.13 relating to access to the automatic execution feature of its Hybrid System. On April 28, 2004, the CBOE submitted Amendment No. 1 to the proposed rule change.³ The proposed rule change, as amended, was published for comment in the Federal Register on May 13, 2004.⁴ The Commission received no comment letters on the proposal. This order approves the proposed rule change, as amended.

The Exchange currently trades equity options, as well as index and ETF options on the CBOE Hybrid System (“Hybrid”).⁵ Hybrid merges the electronic and open outcry trading models, offering CBOE market makers the ability to stream electronically their own market quotes.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Steve Youhn, Counsel, CBOE, to Deborah Flynn, Assistant Director, Division of Market Regulation (“Division”), Commission, dated April 27, 2004 (“Amendment No. 1”). Amendment No. 1 clarified the access to the Exchange’s automated execution system for stock exchange specialists’ orders in options classes overlying stocks in which they are not specialists.

⁴ See Securities Exchange Act Release No. 49659 (May 6, 2004), 69 FR 26627.

⁵ See Securities Exchange Act Release Nos. 47959 (May 30, 2003), 68 FR 34441 (June 9, 2003) (“Hybrid Release”), and 48953 (December 18, 2003), 68 FR 75004 (December 29, 2003).

CBOE Rule 6.13 governs Hybrid’s automatic execution (“auto-ex”) feature. Currently, CBOE Rule 6.13(b)(i)(C)(ii) allows the appropriate floor procedure committee (“FPC”) to determine whether to provide all market makers and specialists, whether on an options or stock exchange, with auto-ex access to CBOE’s markets. The Exchange proposes to amend CBOE Rule 6.13 to allow the FPC to provide different levels of auto-ex access to: (i) options exchange market makers and specialists (collectively, “options market makers”); and (ii) stock exchange specialists.

The appropriate FPC would have the ability to allow options exchange market makers to have auto-ex access while stock exchange specialists would not have auto-ex access.

Alternatively, the appropriate FPC may determine to set the auto-ex eligible order size level higher for options market makers than the corresponding order size level for stock exchange specialists. The proposal applies only to stock exchange specialists with respect to their options transactions in classes overlying stocks in which they are specialists. Further, the Exchange states that proposed CBOE Rule 6.13(b)(i)(C)(ii)(A) and (B) would enable the appropriate FPC to make the access determinations on a class-by-class basis.

Moreover, specialists’ orders in their non-specialty stocks would be treated in the same manner as orders of broker-dealers that are not market makers or specialists on an options exchange and thus would be eligible for automatic execution in accordance with CBOE Rule 6.13(b)(i)(C)(i).⁶ The proposed rule change would not affect a responsible broker-dealer’s firm quote obligations to broker-dealer orders (which includes options market makers and stock specialists), which will remain at one contract. Similarly, the proposal does not affect the auto-

⁶ See Amendment No. 1, supra note 3.

ex access currently available to public customer and non-market-maker/specialist broker-dealer orders, which is governed by CBOE Rule 6.13(b)(i)(C)(i).⁷

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of Section 6 of the Act,⁸ and the rules and regulations thereunder applicable to a national securities exchange.⁹ In particular, the Commission finds that the proposed rule change, which would allow the appropriate FPC to provide different levels of access to auto-ex to options market makers and to stock exchange specialists, is consistent with Section 6(b)(5) of the Act,¹⁰ which requires, among other things, that the Exchange's rules be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

The Commission believes that providing different levels of access to options market makers and stock specialists is not unreasonable. Specifically, providing no access or less access to stock specialists in stocks in which they are specialists is not inappropriate, given the superior market information available to stock specialists in the stocks in which they act as specialists.

⁷ At the request of the Exchange staff, the citation of CBOE Rule 6.13(b)(i)(B)(i) was amended to refer to CBOE Rule 6.13(b)(i)(C)(i). Telephone conversation between Steve Youhn, Counsel, CBOE, and Hong-Anh Tran, Special Counsel, Division, Commission, on April 28, 2004.

⁸ 15 U.S.C. 78f.

⁹ In approving the proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ 15 U.S.C. 78f(b)(5).

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-CBOE-2004-15), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland
Deputy Secretary

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).