

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-49916; File No. SR-CBOE-2004-35)

June 25, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. to Amend CBOE Rule 8.85 to Require the Immediate Display of Customer Limit Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on June 17, 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 CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to amend CBOE Rule 8.85 to require the immediate display of customer limit orders. The text of the proposed rule change follows. Additions are in italics. Deletions are in [brackets].

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**Rule 8.85 DPM Obligations**

(a) No change

(b) Agency Transactions. Each DPM shall fulfill all of the obligations of a Floor Broker (to the extent that the DPM acts as a Floor Broker) and of an Order Book Official under the Rules, and

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

shall satisfy each of the [following] requirements contained in this paragraph, in respect of each of the securities allocated to the DPM[:]. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b)(i) through (b)(vii) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b)(i) through (b)(vii) of this Rule shall govern.

[(i) place in the public order book any order in the possession of the DPM which is eligible for entry into the book unless (A) the DPM executes the order upon its receipt or (B) the customer who placed the order has requested that the order not be booked, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were a displayed order in the public order book;]

(i) Display Obligation: Each DPM shall display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. “Immediately” means, under normal market conditions, as soon as practicable but no later than 30-seconds after receipt (“30-second standard”) by the DPM. The term “customer limit order” means an order to buy or sell a listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall include an order transmitted by a broker or dealer on behalf of a customer.

(A) An order executed upon receipt;

(B) An order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed;

(C) An order delivered immediately upon receipt to another options exchange that is a participant in the Intermarket Options Linkage Plan;

(D) The following orders as defined in Rule 6.53: contingency orders; not-held orders; one-cancels-the-other orders; all or none orders; fill or kill orders; immediate or cancel orders; complex orders (e.g., spreads, straddles, combinations); and stock-option orders;

(E) Orders received before or during a trading rotation (as defined in Rule 6.2, 6.2A, and 6.2B), including Opening Rotation Orders as defined in Rule 6.53(l), are exempt from the 30-second standard, however, they must be displayed immediately upon conclusion of the applicable rotation; and

(F) Large Sized Orders: Orders for more than 100 contracts, unless the customer placing such order requests that the order be displayed.

(ii)-(v) No change

(vi) not represent discretionary orders as a Floor Broker or otherwise.

[To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b)(i) through (b)(vi) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b)(i) through (b)(vi) of this Rule shall govern.]

(vii) No change

[To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b)(i) through (b)(vi) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b)(i) through (b)(vii) of this Rule shall govern.]

(c) – (e) No change

**.... Interpretations and Policies**

No change

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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. CBOE 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

Rule 11Ac1-4 under the Act,<sup>3</sup> the Commission’s Limit Order Display Rule, requires that immediately upon receipt, equity market specialists and OTC market makers either display in their quotes qualified customer limit orders that improve the price or size or execute or re-route those orders to other market centers. Under the Commission’s Limit Order Display Rule, to comply with the requirement that display take place “immediately,” specialists and market makers must display (or execute or re-route) eligible customer limit orders “as soon as is practicable after receipt which, under normal market conditions, would require display no later

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<sup>3</sup> See 17 CFR 240.11Ac1-4.

than 30 seconds after receipt.”<sup>4</sup> The Commission’s Limit Order Display Rule currently does not apply to the options markets.

CBOE proposes to amend CBOE Rule 8.85(b)(i) to codify an immediate display requirement with respect to eligible customer limit orders (“Display Obligation”). As proposed, each DPM would be required to display immediately the full price and size of any customer limit order that improves the price or increases the size of the best disseminated CBOE quote. As proposed, CBOE defines “immediately” to mean, under normal market conditions, as soon as practicable but no later than 30-seconds after receipt by the DPM.<sup>5</sup> CBOE proposes to define the term “customer limit order” as follows: an order to buy or sell a listed option at a specified price that is not for the account of either a broker or dealer; provided, however, that the term customer limit order shall include an order transmitted by a broker or dealer on behalf of a customer.

CBOE proposes to exempt, or partially exempt, certain order types from the Display Obligation. CBOE also proposes to exempt an order executed upon receipt and an order where the customer who placed it requests that it not be displayed, and upon receipt of the order, the DPM announces in public outcry the information concerning the order that would be displayed if the order were subject to being displayed. CBOE further proposes that orders delivered immediately upon receipt to another options exchange that is a participant in the Intermarket Options Linkage Plan be exempted from the Display Obligation.

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<sup>4</sup> See Securities Exchange Act Release No. 37619A (September 6, 1996), 61 FR 48290 (September 12, 1996).

<sup>5</sup> In this respect, CBOE states that “receipt by the DPM” means receipt on the PAR terminal in the DPM trading crowd, which is consistent with the firm quote definition of “time of receipt.” This means that the time of receipt is when the order is received on PAR, even if the DPM or PAR operator does not happen to see it for several seconds.

CBOE also proposes to exempt the following types of orders from its Display Obligation:

### **Contingency Orders**

#### **Market-if-Touched (CBOE Rule 6.53(c)(i)) and Stop (stop-loss) Orders (CBOE Rule**

**6.53(c)(iii))** – These orders are not executable until the market reaches a specified

‘trigger’ price, at which point each converts to a market order. As such, they are not

available to trade and have no standing in the quoted markets until the specified price

trigger is reached. A trade must be the triggering event for a Market-if-Touched order; a

trade or a quote can be the triggering event for a Stop order. Because they convert to

market orders upon the triggering event, these order types cannot then be subject to the

display requirement. Instead, they are subject to the firm quote requirements.

#### **Market on Close Orders (“MOC”) (CBOE Rule 6.53(c)(ii))**– While an MOC may

have a limit price attached, it is not eligible for representation until the close of trading is

imminent. Regardless of the time at which an MOC order is entered, the DPM is required

to hold such order, and is precluded from representing, displaying or booking it, until as

near as possible to the close of trading. Furthermore, because representation and

execution of these orders must occur on or as near to the close of trading as possible, it

would be difficult if not impossible to determine whether members met an appropriate

display standard for such orders.

#### **Stop Limit Order (CBOE Rule 6.53(c)(iv))** – A Stop-Limit order is not “triggered”

until the option contract trades or is bid (offered) at or above (below) the stop price, at

which point it converts to a limit order. As such, a Stop-Limit order has no standing in

the quoted markets until the specified price trigger is reached. The limit price on such an

order is not required to be the same as the stop price. The resulting new limit order is subject to the current and proposed display requirement if routed to a DPM. Currently, these orders are not eligible for electronic routing and are generally handled by non-DPM agents.

**Not Held Orders (CBOE Rule 6.53(g))** – A Not Held order is a discretionary order with instructions granting the agent flexibility as to the price and or time of execution. CBOE Rule 8.85(b)(vi) prohibits DPMs from representing discretionary orders, including Not Held orders.

**One-Cancels-the Other Orders (“OCO”) (CBOE Rule 6.53(h))** – An OCO order is comprised of two or more orders designated for treatment as a collective unit. The execution of any one of the component orders cancels the other(s). If the DPM cannot execute any of the orders upon receipt, then none can be displayed or booked as doing so could result in the approximate simultaneous execution of more than one component order, in direct contravention of the primary order condition. Such a result would place the agent and/or customer at undue risk. OCO orders are generally not handled by a DPM agent due to the specialized nature of the order handling required.

**All or None Orders (“AON”) (CBOE Rule 6.53(i))** – While an AON can be a limit order, instructions require the order be executed in its entirety or not at all. The Commission’s Limit Order Display Rule also provides an exception for AON orders.<sup>6</sup>

**Fill or Kill Orders (“FOK”) (CBOE Rule 6.53(j))** – While a FOK order can be a limit order, instructions require it be executed in its entirety immediately upon representation and, if not executed, the order is to be treated as cancelled. CBOE Rule 6.44.04 currently specifies that

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<sup>6</sup> See 17 CFR 240.11Ac1-4(c)(7).

FOK bids or offers be treated as AONs and specifies that such bids and offers will not be disseminated by CBOE in its quotes.

**Immediate or Cancel Orders (“IOC”) (CBOE Rule 6.53(k))** – An IOC order is a market or limit order which is to be executed in whole or in part as soon as such order is represented in the trading crowd. Any portion not executed is to be cancelled, which means it can not be displayed. An IOC order, like an FOK order, shares most of the same characteristics of an AON order, which are exempt from the Commission’s Limit Order Display Rule.<sup>7</sup> Given the similarity between these order types, CBOE believes that IOC orders should also be exempt.

**Complex Orders: Spread (CBOE Rule 6.53(d))<sup>8</sup>, Combo (CBOE Rule 6.53(e)), Straddle (CBOE Rule 6.53(f)), Stock-option (CBOE Rule 1.1(ii))** – These orders specify instructions to trade more than one options series or product as a package, typically at a specified net debit or credit, as opposed to a specific limit price for each leg involved. Therefore, there is no specified limit price for each series involved to display in the quotes. Moreover, the Options Price Reporting Authority (“OPRA”) does not accept complex order quotes at net prices. Each component of the complex order is, in essence, itself a contingency on the ability to execute the other components of the order. Since there is no guarantee that all components will become executable at the same time, if at all, forced dissemination could result in the execution of less than all components of the order. Such a ‘legged’ execution would put the customer at undue

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<sup>7</sup> See 17 CFR 240.11Ac1-4(c)(7).

<sup>8</sup> This definition of spread order includes an inter-regulatory spread order, as defined in CBOE Rule (1.1(II)).

risk. Further, the complicated nature of these types of orders dictates they take longer to represent and negotiate.

**Orders Received During a Trading Rotation:** Orders received before or during a trading rotation (as defined in CBOE Rules 6.2, 6.2A, and 6.2B) would be exempt from the 30-second standard. During a rotation, CBOE systems attempt to find the opening price and until the opening price is established, there is no disseminated market. Once the trading rotation ends and regular trading begins, orders received before or during the trading rotation will be subject to the display requirement.<sup>9</sup>

**Large Sized Orders:** The Commission's Limit Order Display Rule provides a general exclusion for block size orders of at least 10,000 shares.<sup>10</sup> CBOE proposes to adopt a similar exception for large sized orders. Accordingly, there will be no obligation to display orders for more than 100 contracts, unless the customer placing such order requests otherwise.

Finally, CBOE proposes to relocate the last paragraph of CBOE Rule 8.85(b) to the introductory paragraph of CBOE Rule 8.85(b).<sup>11</sup> Nothing in the rule text changes other than its location within the rule.

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<sup>9</sup> CBOE Rule 6.53(l) provides that orders may be designated as Opening Rotation orders. An opening rotation order is a market order that requires execution in whole or in part only during the opening rotation. Orders received before or during an opening rotation must be designated as opening rotation orders, otherwise the unexecuted portion automatically will be treated as an unexecuted limit order and will be displayed after the rotation ends.

<sup>10</sup> See 17 CFR 240.11Ac1-4(c)(4).

<sup>11</sup> This paragraph states, "To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (b)(i) through (b)(vii) of this Rule and the general obligations of a Floor Broker or of an Order Book Official under the Rules, subparagraphs (b)(i) through (b)(vii) of this Rule shall govern." This paragraph actually

## 2. Statutory Basis

The Exchange believes the proposal is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>12</sup> Specifically, CBOE believes the proposed rule change is consistent with the Section 6(b)(5) requirements that the rules of an exchange 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.<sup>13</sup> Furthermore, CBOE believes that the proposed changes are consistent with the Act's requirement that an exchange's rules not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

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

CBOE 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.

## 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

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appears in two locations in Rule 8.85(b). The Exchange proposes to eliminate the second reference.

<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2004-35 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-2004-35. 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-2004-35 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.<sup>14</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>14</sup> 17 CFR 200.30-3(a)(12).