

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50175; File No. SR-CBOE-2004-38)

August 10, 2004

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Incorporated Relating to the Exchange's Fee Schedule for Fiscal Year 2005

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4² thereunder, notice is hereby given that on July 1, 2004, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by CBOE. On July 15, 2004, CBOE filed Amendment No. 1 to the proposed rule change.³ On August 2, 2004, CBOE filed Amendment No. 2 to the proposed rule change.⁴ The proposed rule change, as amended, has been filed by CBOE as establishing or changing a due, fee, or other charge, pursuant to Section 19(b)(3)(A)(ii) of the Act⁵ and Rule 19b-4(f)(2)⁶ thereunder, which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended,

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter, dated July 9, 2004, from Christopher Hill, Senior Attorney, CBOE, to Nancy J. Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission. In Amendment No. 1, CBOE made technical corrections to the proposed rule text.

⁴ See letter, dated July 30, 2004, from Christopher Hill, Senior Attorney, CBOE, to Nancy J. Sanow, Assistant Director, Division, Commission. In Amendment No. 2, CBOE made additional technical corrections to the proposed rule text, clarified the applicability of the Prospective Fee Reduction Program, corrected references to member Market-Makers, detailed the discount for crossed orders, clarified the ETF and Structured Products transaction fee cap, and clarified the Index Order Book Official execution fee reduction. Amendment No. 2 superseded and replaced the proposed rule change and Amendment No. 1 in their entirety.

⁵ 15 U.S.C. 78s(b)(3)(A)(ii).

from interested persons.

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

CBOE proposes to make various changes to its Fee Schedule for Fiscal Year 2005. The text of the proposed rule change is available at CBOE and at the Commission.

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, Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to make certain fee reductions, additions and changes. The Exchange represents that the proposed rule change is the product of the Exchange's annual budget review, and that the fee changes were approved by the Exchange Board of Directors pursuant to CBOE Rule 2.22 and will take effect on July 1, 2004.

The Exchange proposes to amend the following fees.

a. Index Order Book Official Execution Fee Reduction and Simplification

For the second consecutive year, the Exchange proposes to reduce and simplify the rates it charges for execution of index orders from its public customer Order Book. Currently, these fees

⁶ 17 CFR 240.19b-4(f)(2).

per contract are \$0.60 for booked option contracts priced equal to or greater than \$2, and \$0.40 for those priced less than \$2. The Exchange proposes to reduce these fees to a flat \$0.25 per contract, regardless of the contract price.

b. Customer Index Large Trade Discounts Continued

The Exchange proposes to continue its current pilot plan providing a customer large trade discount in the form of a cap on customer transaction fees, to be in effect through December 31, 2004 for most CBOE index option products.⁷ The Exchange represents that it determined the contract size at which the cap would be implemented after reviewing recent trading activity in each of the index products. Floor brokerage fees are not subject to the cap on fees.

Regular customer transaction fees will continue to be charged up to the following quantity of contracts per order, for the following underlying indexes:

1. Dow Jones indexes (including DIA) – charge only the first 7,500 contracts;
2. SPX – charge only the first 5,000 contracts; and
3. OEX (including XEO & OEF), NDX & other indexes (not including MNX) – charge only the first 3,000 contracts.

c. Fee Cap on Dividend Spread Transactions

The Exchange proposes that Market-Maker, firm and broker-dealer transaction fees for dividend spread transactions will be capped at \$2,000 per dividend spread transaction. CBOE defines a dividend spread as any trade done to achieve a dividend arbitrage between any two deep-in-the-money options. The cap will be implemented through the Exchange rebating transaction fees for qualifying transactions. To qualify a transaction for the cap, a rebate request

⁷ The MNX option class will not be included in this program since MNX customer fees were reduced in June 2002 to a flat rate of \$0.15 per contract. See Securities Exchange Act Release No. 46045 (June 6, 2002), 67 FR 41284 (June 17, 2002) (noticing SR-CBOE-2002-28).

with supporting documentation will need to be submitted to the Exchange.

d. ETF and Structured Products Transaction Fee Cap

CBOE currently trades certain non-option products, including exchange traded funds ("ETFs"), such as index portfolio receipts or "IPRs"⁸ and index portfolio shares or "IPs",⁹ as well as structured products.¹⁰ CBOE represents that competition for order flow in some of these products is intense. The Exchange is proposing to implement a fee change to eliminate customer transaction fees and to cap market maker and member firm transaction fees at \$100 per side of a

⁸ As set forth in Interpretation .02 to CBOE Rule 1.1, the term index portfolio receipts or "IPRs" means securities that (a) represent an interest in a unit investment trust ("Trust") which holds the securities that comprise an index on which a series of IPRs is based; (b) are issued by the Trust in a specified aggregate minimum number in return for a "Portfolio Deposit" consisting of specified numbers of shares of stock plus a cash amount; (c) when aggregated in the same specified minimum number, may be redeemed from the Trust which will pay to the redeeming holder the stock and cash then comprising the Portfolio Deposit; and (d) pay holders a periodic cash payment corresponding to the regular cash dividends or distributions declared and paid with respect to the component securities of the stock index on which the IPRs are based, less certain expenses and other charges as set forth in the Trust prospectus. IPRs are "UIT interests" within the meaning of the Rules of the Exchange.

⁹ As set forth in Interpretation .03 to CBOE Rule 1.1, the term index portfolio shares or "IPs" means securities that (a) are issued by an open-end management investment company based on a portfolio of stocks designed to provide investment results that correspond generally to the price and yield performance of a specified foreign or domestic stock index; (b) are issued by such an open-end management investment company in a specified aggregate minimum number in return for a deposit of specified number of shares of stock and/or a cash amount with a value equal to the next determined net asset value; and (c) when aggregated in the same specified minimum number, may be redeemed at a holder's request by such open-end management investment company which will pay to the redeeming holder stock and/or cash with a value equal to the next determined net asset value.

¹⁰ Structured products currently traded at CBOE include the Salomon Smith Barney Holdings Inc. DJIASM Index Equity Linked Notes (DSB); Salomon Smith Barney Holdings Inc. S&P 500® Callable Equity Linked Notes (NSB); and the Salomon Smith Barney Holdings Inc. S&P 500® Equity Linked Notes (KSB). These products have an expiration date, are cash settled, have a limited number of outstanding shares, and trade like a stock pursuant to Chapter XXX of the CBOE Rules.

transaction in these non-option products. The Exchange believes this change will bring CBOE's fees for these products more in-line with fees charged by its competitors. As a result, the Exchange believes that the fee change will help the Exchange to compete more effectively for order flow in these products.

e. Reduced Floor Broker Fees for Crossed Orders

The Exchange proposes to reduce the current \$0.04 per contract floor brokerage fee by 50% when a floor broker crosses an order. Currently, in a crossed order, a floor broker is charged either \$0.04 or \$0.08 per contract, the lower amount if one side of the crossed order is an Equity or QQQ options customer (who is not assessed the floor brokerage fee). To be eligible for the discounted rate, the executing broker acronym, executing firm number and order ID data will need to be the same on both the buy and sell side of an order.

f. Fee Consolidation

To simplify parts of the Fee Schedule, the Exchange proposes to consolidate two sets of current fees. Neither consolidation will change the total fees paid.

(1) Technology Fee Consolidated with Member Dues

CBOE currently assesses a technology fee of \$200 per month and member dues of \$250 per month, billed separately on monthly invoices. The Exchange proposes to consolidate these charges as a combined member dues of \$450 per month. Neither fee will change, but the separate billing for the technology fee will be eliminated.

(2) Trade Match Fee Consolidated with Transaction Fee

Currently, Section 2 of the Fee Schedule imposes a \$.05 per contract trade match fee on all transactions other than equity and QQQ customer orders. This fee will not change, but to simplify the presentation of transaction fees in the Fee Schedule, the Exchange will now include

the \$.05 per contract trade match fees as part of the per contract transaction fees listed in the Fee Schedule. As a result of this consolidation, the Exchange is deleting references to trade match fee in the Fee Schedule.

g. Trading Floor Booth Fee Changes

The current Fee Schedule includes a different rate for the rental of certain booths depending upon whether the firm renting the booth is a member of the Options Clearing Corporation (OCC). The Exchange has determined that this fee differential should be eliminated. Therefore, the Exchange proposes to set the following booth rental fees for all CBOE member organizations, regardless of their OCC status. Perimeter booths, which are currently \$165 per month for OCC member firms and \$300 per month for non-OCC member firms, will be \$185 per month for all member organizations. Booths in the OEX pit, which are currently \$330 per month for OCC member firms and \$700 per month for non-OCC member firms, will be \$330 per month for all member organizations. CBOE is amending the Fee Schedule to reflect these changes, as well as the fact that CBOE no longer has a trading floor (or trading floor booths) on its second floor.

To increase booth space rentals, a booth rental incentive plan will continue to be in effect for the period July through December 2004. All members and member firms may lease additional perimeter booth space at a rate of \$100 per month per booth. The discounted price is applicable only to booths leased in excess of the quantity leased as of June 1, 2004. For new members and member firms, the first four booths will be assessed at the rate schedule effective July 1, 2004, and any additional booths in excess of the initial four will be assessed at the reduced lease rate during the incentive period. All booth fees discounted under the incentive plan will revert to regular rates on January 1, 2005.

h. Prospective Fee Reduction Program Continued

The Exchange proposes to modify and continue its Prospective Fee Reduction Program for fiscal year 2005, beginning on August 1, 2004. The Program is intended to limit fees in periods of high volume. CBOE represents that it has reviewed and adjusted the threshold for fee reductions, as it does each year, to account for the anticipated working capital needs of the Exchange for the coming year. Fee reductions will be in effect August 1, 2004 under the following scenarios:

If CBOE volume exceeds predetermined average contracts per day (CPD) thresholds at the end of any month on a fiscal year-to-date (YTD) basis, Market-Maker and DPM transaction fees, as well as floor brokerage fees, will be reduced in the subsequent month according to the schedule below:

FY05 YTD AVG. CPD	FEES DISCOUN T	EQUITIES MARKET- MAKER REDUCTIONS	QQQ/INDEXMARKET - MAKER REDUCTIONS	DPM TRANS. FEES REDUCTIONS	FLOOR BROKERAGE REDUCTIONS
1,300,000	10%	\$.022	\$.024	\$.012	\$.004
1,400,000	15%	\$.033	\$.036	\$.018	\$.006
1,500,000	20%	\$.044	\$.048	\$.024	\$.008
1,600,000	25%	\$.055	\$.060	\$.030	\$.010
1,700,000	30%	\$.066	\$.072	\$.036	\$.012
1,800,000	35%	\$.077	\$.084	\$.042	\$.014
1,900,000	40%	\$.088	\$.096	\$.048	\$.016
2,000,000	45%	\$.099	\$.108	\$.054	\$.018

A circular will be distributed notifying the Membership of any fee reduction that may be in effect.

i. Miscellaneous Non-Substantive Updates and Revisions

CBOE notes minor changes in this filing to Fee Schedule Sections 4, 12, and 18, as well as one subsection of the final section of the Fee Schedule, entitled "Member Transaction Fee Policies and Rebate Programs." CBOE represents that these revisions are made to reconcile minor discrepancies between the Fee Schedule language that was submitted to the Commission for

approval in previous rule change filings and the current Fee Schedule language. CBOE represents that the discrepancies appear to have been inadvertently made by Exchange staff who were trying to make the Fee Schedule more concise and easier to understand. The Exchange represents that in none of these cases was any change effected to the fees imposed under the Fee Schedule. Nevertheless, the Exchange represents that its Legal Division will formally remind Exchange staff that all future changes to the language of the Fee Schedule must be submitted to the Commission in the form of a rule change filing.

j. Transaction Fee Changes

In anticipation of changes to the Exchange's Hybrid Trading System (hereinafter referred to as "Hybrid 2.0"), the Exchange proposes the following changes to its transaction fees, which are all proposed to be effective as of July 1, 2004.¹¹

(1) Market-Makers

The Exchange represents that, in recognition of the role that Market-Makers will continue to play in providing depth and liquidity to the Exchange's Hybrid 2.0 markets, as well as to help offset the extra costs that Market-Makers are incurring to trade via the Hybrid 2.0 trading system, the Exchange proposes to reduce the combined total of Market-Maker transaction and trade match fees by \$.02 per contract, to a total of \$.22 per contract in equity option classes. Market-Makers who will not be trading via the Hybrid 2.0 Trading System (including Non-Member market makers and Market-Makers trading in Index option classes, where Hybrid 2.0 will not be

¹¹ The proposed rule change relating to the Exchange's Hybrid Trading System was recently approved by the Commission. See Securities Exchange Act Release No. 50003 (July 12, 2004), 69 FR 43028 (July 19, 2004).

in use) will not receive the \$.02 per contract reduction. For administrative reasons, the Exchange proposes to include in the fee reduction those equity option classes that will not initially trade on the Hybrid 2.0 platform, because it is anticipated that these equity option classes will eventually trade on the Hybrid 2.0 platform. In the meantime, given the small trading volume of these equity option classes, the Exchange represents that it would be logistically burdensome for the Exchange and its clearing members to distinguish these equity option classes for different fee treatment.

(2) DPM Fees

The Exchange proposes to reduce the transaction fees of current DPMs in Hybrid 2.0 option classes. DPMs who will not be trading via the Hybrid 2.0 Trading System (i.e., the DPMs in the QQQs and several other Index option classes, where Hybrid 2.0 will not be in use) will not receive the per contract reduction.

CBOE represents that there are several reasons why these proposed reductions in DPM fees are reasonable and equitable in this context. CBOE represents that DPMs, in addition to being required to fulfill all the responsibilities of Market-Makers under CBOE Rule 8.7, are also responsible for fulfilling numerous additional responsibilities specified in CBOE Rule 8.85 that regular Market-Makers are not required to fulfill.¹² CBOE represents that, notwithstanding the substantial additional responsibilities of DPMs, CBOE DPMs have traditionally paid the same transaction fees as those of CBOE Market-Makers. The Exchange respectfully submits that such equal fees in the past have been a product of Exchange policy, rather than a requirement of the Act or other applicable law. CBOE believes that, due to the additional responsibilities borne by

¹² See CBOE Rule 8.85, "DPM Obligations."

DPMs, it is reasonable and equitable under the Act for CBOE to assess lower transaction fees to DPMs than to Market-Makers.¹³

The Exchange believes that it is particularly appropriate to re-examine DPM fees at the present time, because parts of the Exchange's Hybrid 2.0 market structure initiative will effectively reduce the current compensation levels of DPMs in the future. CBOE believes that it is therefore equitable to reduce DPM transaction fees as a partial offset.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹⁴ in general, and furthers the objectives of Section 6(b)(4) of the Act,¹⁵ in particular, in that the proposed rule change provides for the equitable allocation of reasonable dues, fees, and other charges among CBOE members.

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

The Exchange does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of purposes of the Act.

C. Self-Regulatory Organization's Statement of 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.

¹³ At the same time, as noted above, the Exchange also proposes to reduce Market-Maker fees under this plan.

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(4).

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The Exchange has designated the foregoing proposed rule change, as amended, as a fee change pursuant to Section 19(b)(3)(A)(ii) of the Act¹⁶ and subparagraph (f)(2) of Rule 19b-4¹⁷ thereunder. Accordingly, the proposed rule change, as amended, will take effect upon filing with the Commission. At any time within 60 days of August 2, 2004, the Commission may summarily abrogate such proposed rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.¹⁸

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change 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. Please include File Number SR-CBOE-2004-38 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.

¹⁶ 15 U.S.C. 78s(b)(3)(A)(ii).

¹⁷ 17 CFR 240.19b-4(f)(2).

¹⁸ For purposes of calculating the 60-day period within which the Commission may summarily abrogate the proposed rule change under Section 19(b)(3)(C) of the Act, the

All submissions should refer to File Number SR-CBOE-2004-38. 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 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

Commission considers that period to commence on August 2, 2004, the date CBOE filed Amendment No. 2 to the proposed rule change. See 15 U.S.C. 78s(b)(3)(C).

should refer to File Number SR-CBOE-2004-38 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.¹⁹

Margaret H. McFarland
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).