

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-50542; File No. SR-CBOE-2004-50)

October 14, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Inc. to Amend its Rules Regarding Limitations on Designated Primary Market-Makers Putting Into Effect Stop and Stop-Limit Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 29, 2004, the Chicago Board Options Exchange, Inc. (“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. CBOE amended the proposal on October 8, 2004.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

CBOE proposes to amend its rules regarding limitations on Designated Primary Market-Makers (“DPMs”) putting into effect stop and stop-limit orders. New text is in italics.

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Chicago Board Options Exchange, Incorporated

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from Angelo Evangelou, Managing Senior Attorney, Legal Division, CBOE, to John Roeser, Senior Special Counsel, Division of Market Regulation, Commission, dated October 6, 2004 (“Amendment No. 1”). In Amendment No. 1, CBOE amended the text of CBOE Rule 8.85(a)(viii) to clarify its proposed scope and application. Amendment No. 1 is incorporated in this notice.

Rules

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8.85 DPM Obligations

(a) Dealer Transactions. Each DPM shall fulfill all of the obligations of a Market-Maker under the Rules, and shall satisfy each of the following requirements 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 (a)(i) through (a)(x) of this Rule and the general obligations of a Market Maker under the Rules, subparagraphs (a)(i) through (a)(x) of this Rule shall govern. Each DPM shall:

(i)-(vii) No change.

(viii) not initiate a transaction for the DPM's own account that would result in putting into effect any stop or stop limit order which may be in the book or which the DPM represents as Floor Broker except with the approval of a Floor Official and when the DPM guarantees that the stop or stop limit order will be executed at the same price as the electing transaction. The restrictions set forth in this paragraph do not apply to stop or stop limit orders received through the Hybrid System unless the terms of such orders are visible to the DPM, or unless such orders are handled by the DPM;

(ix)-(xi) No change.

(b)-(e) No change.

...Interpretations and Policies:

.01-.04 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

CBOE Rule 6.53 defines a stop order as a contingency order to buy (sell) that becomes a market order to buy (sell) when the option contract trades or is bid (offered) at or above (below) the stop price on CBOE. The sender of the stop order determines the stop price. Similarly, a stop-limit order becomes a limit order when the stop price is triggered.

CBOE Rule 8.85(a)(viii) currently prohibits DPMs from initiating a transaction for the DPM's own account that would result in putting into effect any stop or stop-limit order which may be in the book or which the DPM represents as Floor Broker except with the approval of a Floor Official and when the DPM guarantees that the stop or stop-limit will be executed at the same price as the electing transaction.

Currently, stop and stop-limit orders route to PAR terminals in the trading station for representation by the DPM as Floor Broker. This is the case for classes on CBOE's Hybrid trading system and for classes that are not on Hybrid. Thus, DPMs need to monitor for quotes and/or trades at the stop price to ensure that stop orders are properly elected when the stop price is triggered.

CBOE proposes to automate the handling of stop and stop-limit orders as an enhancement to CBOE's Hybrid trading system. According to CBOE, this will involve routing any electronic (non-paper) stop order to the Hybrid system (not to a PAR terminal) which will, in turn, elect the stop or stop-limit order when the stop price is triggered and automatically convert the order to a market order or limit order, as applicable. CBOE states that the purpose of this filing is to provide that the stop and stop-limit order DPM restrictions in CBOE Rule 8.85(a)(viii) should not apply to orders in classes that are on the Hybrid system that are routed to CBOE electronically, and not visible to or handled by the DPM.

CBOE, in general, believes that the restrictions in CBOE Rule 8.85(a)(viii) are overly cumbersome and unnecessary. CBOE believes that the proposed Hybrid stop and stop-limit order handling enhancement will obviate the need for the restrictions in Hybrid classes. The stop and stop-limit orders will reside on the Hybrid system invisibly so that no DPM would know that it is triggering a stop or stop-limit order when with a trade or quote. Since, according to the CBOE, the handling of the stop and stop-limit orders will be entirely automated, the DPM will no longer handle the stop order at any point or have any influence to purposefully affect triggering the stop or the ultimate execution price of the order.

2. Statutory Basis

CBOE believes that the proposed rule change is consistent with Section 6(b) of the Act,⁴ in general, and furthers the objectives of Section 6(b)(5) of the Act,⁵ in particular, in that it is designed to promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanisms of a free and open market and a national market system, and to protect investors and the public interest.

⁴ 15 U.S.C. 78(b).

⁵ 15 U.S.C. 78(b)(5).

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

CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the 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 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. Please include File Number SR-CBOE-2004-50 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-2004-50. 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 Room. 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-2004-50 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.⁶

Margaret H. McFarland
Deputy Secretary

⁶ 17 CFR 200.30-3(a)(12).