

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51030; File No. SR-CBOE-2004-91)

January 12, 2005

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendment No. 1 Thereto by the Chicago Board Options Exchange, Incorporated To Extend a Pilot Program and Eliminate the Rule Prohibiting Electronically Generated and Communicated Orders

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 December 29, 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 and II below, which Items have been prepared by the Exchange. On January 7, 2005, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Exchange filed the proposal, as amended, as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act⁴ and Rule 19b-4(f)(6) thereunder.⁵ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Form 19b-4 dated January 7, 2005 (“Amendment No. 1”). Amendment No. 1 made minor revisions to Item 7 of the proposed rule change as originally filed.

⁴ 15 U.S.C. 78s(b)(3)(A)(iii).

⁵ 17 CFR 240.19b-4(f)(6).

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

The Exchange proposes to extend the pilot program in CBOE Rule 6.13 relating to market maker access to the Exchange's automatic execution system and to eliminate CBOE Rule 6.8A prohibiting the electronic generation and communication of orders.

Below is the text of the proposed rule change. Proposed additions are italicized; proposed deletions are [bracketed].

Rules of the Chicago Board Options Exchange

* * * * *

Rule 6.8A. [Electronically Generated and Communicated Orders] Reserved

[(a) Members may not enter, nor permit the entry of, orders into the Exchange's Order Routing System if those orders are created and communicated electronically without manual input (i.e., order entry must involve manual input such as entering the terms of an order into an order-entry screen or manually selecting a displayed order against which an off-setting order should be sent), and if such orders are eligible for execution on RAES at the time they are sent. Nothing in this paragraph, however, prohibits members from electronically communicating to the Exchange orders manually entered by customers into front-end communication systems (e.g., Internet gateways, online networks, etc.). An order is eligible for execution on RAES if

- (1) its size is equal to or less than the maximum RAES order size for the particular series;
- (2) for public customer orders, the order is marketable or is tradable pursuant to the RAES auto step-up feature at the time it is sent; or for broker-dealer orders, the order is otherwise submitted in accordance with Interpretation .01 of Rule 6.8; and

(3) if the order has either no contingency or has a contingency that is accepted for execution by the RAES system.

A marketable order is a market order or a limit order where the specified price to sell is below or at the current bid, or if to buy is above or at the current offer. An order is tradable pursuant to the RAES auto step-up feature if the appropriate Floor Procedure Committee has designated the class as an automatic step-up class and if the National Best Bid or Offer for the particular series is reflected by the current best bid or offer in another market by no more than the step-up amount as defined in Interpretation .02 of Rule 6.8.

(b) The Exchange's Order Routing System ("ORS") is the Exchange's electronic order routing and delivery system which routes orders to the Exchange's automatic and electronic execution systems and to other Exchange systems, such as handheld terminals and trade match systems. The ORS also delivers electronic fill reports and order status reports.]

Rule 6.13. CBOE Hybrid System's Automatic Execution Feature

(a) No change

(b) Automatic Execution

(i) * * * * *

(A) - (B) No change

(C) Access:

(i) – (ii) No Change

(iii) 15-Second Limitation: With respect to orders eligible for submission pursuant to paragraph (b)(i)(C)(ii), members shall neither enter nor permit the entry of multiple orders on the same

side of the market in an option class within any 15-second period for an account or accounts of the same beneficial owner. The appropriate FPC may shorten the duration of this 15-second period by providing notice to the membership via a Regulatory Circular that is issued at least one day prior to implementation. The effectiveness of this rule shall terminate on [January 12, 2005] October 12, 2005.

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(ii) - (iv) No change

(c) * * * * *

(i) No change

(ii) * * * * *

(A) No change

(B) [Electronic generation and communication of orders in violation of Rule 6.8A by non-trading crowd participants.]

[(C)] Effecting transactions that constitute manipulation as provided in Rule 4.7 and Exchange Act Rule 10b-5.

(d) – (e) 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, the Exchange 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. The Exchange 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

The Commission in 2004 approved on a pilot basis CBOE Rule 6.13(b)(i)(C)(iii) relating to the frequency with which certain market participants could submit orders for execution through the Exchange’s Hybrid Trading System.⁶ Rule 6.13(b)(i)(C)(iii) provides in relevant part:

“(iii) 15-Second Limitation: With respect to orders eligible for submission pursuant to paragraph (b)(i)(C)(ii), members shall neither enter nor permit the entry of multiple orders on the same side of the market in an option class within any 15-second period for an account or accounts of the same beneficial owner. The appropriate FPC may shorten the duration of this 15-second period by providing notice to the membership via a Regulatory Circular that is issued at least one day prior to implementation. The effectiveness of this rule shall terminate on January 12, 2005.” * * * * *

Upon approval of CBOE Rule 6.13(b)(i)(C)(iii), the Exchange began allowing orders from options market makers to be eligible for automatic execution, subject to the 15-second limitation described above. As the pilot period is scheduled to expire on January 12, 2005, the Exchange proposes to extend the pilot program for a nine-month period. The Exchange believes that the pilot program has been successful in attracting market maker volume to the Exchange. In this regard, the Exchange represents that during November 2004, the number of average daily transactions involving options market maker orders submitted through the Exchange’s Order Routing System (“ORS”) increased more than 300% compared to pre-pilot period transactions, and the average

⁶ See Securities Exchange Act Release No. 50005 (July 12, 2004), 69 FR 43032 (July 19, 2004) (SR-CBOE-2004-33).

daily volume involving options market makers orders submitted through the Exchange's ORS almost doubled when compared to pre-pilot period volume. The Exchange notes that given the early success of the pilot program, the Exchange proposes to extend the pilot program's duration nine months, until October 12, 2005.

The Exchange also proposes to delete CBOE Rule 6.8A, Electronically Generated and Communicated Orders, and all other existing references to CBOE Rule 6.8A. When the Exchange adopted CBOE Rule 6.13(b)(i)(C)(iii), CBOE market makers and Designated Primary Market Makers (DPMs) did not have the protections available to them that they have today to prevent the rapid influx of orders. For this reason, CBOE Rule 6.8A when adopted was necessary to prevent excessive exposure. Today, market makers have the ability to manage their exposure more quickly and efficiently, thereby obviating the need for the CBOE Rule 6.8A.⁷

2. Statutory Basis

The Exchange believes that the extension of the pilot program will allow the Exchange to continue to provide auto-ex access to all options market makers, and that elimination of the electronic generation of orders prohibition will enhance access to the Exchange. Accordingly, the Exchange believes the proposed rule change is consistent with the Act⁸ 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 Act⁹.

⁷ In this regard, the Exchange notes that the Philadelphia Stock Exchange eliminated its electronic generation rule in 2003. See Securities Exchange Act Release No. 48648 (October 16, 2003), 68 FR 60762 (October 23, 2003) (SR-Phlx-2003-37).

⁸ 15 U.S.C. 78a et seq.

⁹ 15 U.S.C. 78f(b).

Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁰ 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.

B. Self-Regulatory Organization's Statement on 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 the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposal.

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

Because the foregoing rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹¹ and Rule 19b-4(f)(6) thereunder.¹² At any time within

¹⁰ 15 U.S.C. 78f(b)(5).

¹¹ 15 U.S.C. 78s(b)(3)(A).

¹² 17 CFR 240.19b-4(f)(6).

60 days of the filing of such proposed rule change, the Commission may summarily abrogate such 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.¹³

The Exchange has requested that the Commission waive the 30-day operative delay under Rule 19b-4(f)(6)(iii).¹⁴ The Commission believes that the waiver of the 30-day operative delay is consistent with the protection of investors and the public interest. Acceleration of the 30-day operative period delay would allow the pilot program to continue uninterrupted and would remove immediately the restriction on the entry into the Exchange's ORS of electronically generated and communicated orders.¹⁵ For this reason, the Commission designates this proposal to be operative upon filing with the Commission.

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:

¹³ 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 Commission considers that period to commence on January 7, 2005, the date the Exchange filed Amendment No. 1 to the proposed rule change. See 15 U.S.C. 78s(b)(3)(C).

¹⁴ 17 CFR 240.19b-4(f)(6)(iii).

¹⁵ For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

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-2004-91 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-2004-91. 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 the 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-2004-91 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.¹⁶

J. Lynn Taylor
Assistant Secretary

¹⁶ 17 CFR 200.30-3(a)(12).