

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51063; File No. SR-CBOE-2004-35)

January 21, 2005

Self-Regulatory Organizations; Order Approving a Proposed Rule Change and Notice of Filing and Order Granting Accelerated Approval to Amendment No. 2 Thereto by the Chicago Board Options Exchange, Inc. to Require the Immediate Display of Customer Limit Orders

I. Introduction

On June 17, 2004, the Chicago Board Options Exchange, Inc. (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend CBOE Rule 8.85 to require the immediate display of customer limit orders. The proposed rule change was published for comment in the Federal Register on July 2, 2004.³ No comments were received regarding the proposal. CBOE filed Amendments No. 1 and 2 with the Commission on August 31, 2004,⁴ and January 6, 2005,⁵ respectively. This order approves the proposed rule change, grants accelerated approval to Amendment No. 2, and solicits comment on Amendment No 2.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 49916 (June 25, 2004), 69 FR 40422 (“Notice of the Proposal”).

⁴ See letter from Steve Youhn, Assistant Secretary, CBOE, to Nancy Sanow, Assistant Director, Commission, Division of Market Regulation, dated August 30, 2004 (“Amendment No. 1”). In Amendment No. 1, CBOE corrected a typographical error in the proposed rule text. Because Amendment No. 1 is a technical amendment, it is not subject to notice and comment.

⁵ See Amendment No. 2, dated January 6, 2005, submitted by Steve Youhn, Assistant Secretary, CBOE (“Amendment No. 2”). In Amendment No. 2, CBOE proposes a minor modification to the exemptions to the Display Obligation.

II. Description of Proposed Rule

CBOE proposes to amend CBOE Rule 8.85(b)(i) to codify an immediate display requirement with respect to eligible customer limit orders⁶ (“Display Obligation”). Under the proposal, each DPM would be required to display the price and full size of eligible customer limit orders when such orders represent buying or selling interest that is at a better price than the best disseminated CBOE quote. A DPM also must increase the size of its quote to reflect a limit order priced equal to the CBOE disseminated quote. In proposed CBOE Rule 8.85(b)(i), CBOE proposes to define “immediately” to mean, under normal market conditions, as soon as practicable but no later than 30 seconds after receipt by the DPM.⁷

CBOE proposes to exempt, or partially exempt, certain orders from the Display Obligation. Specifically, CBOE proposes to exempt orders executed upon receipt as well as any order where the customer who placed it requests that the order not be displayed, if upon receipt of the order the DPM announces via public outcry the information about the order that would be displayed if the order were subject to display. CBOE further proposes an exemption from the Display Obligation for orders for which, immediately upon receipt, a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another

⁶ CBOE proposes to define the term “customer limit order” as “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.” Proposed CBOE Rule 8.85(b)(i).

⁷ In its filing, 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.

options exchange that is a participant in the intermarket options linkage plan.⁸ Exempt order types would also include contingency orders (i.e., market-if-touched, market-on-close, stop (stop-loss), and stop-limit orders), one-cancels-the-other orders, all or none orders, fill or kill orders, immediate or cancel orders, complex orders (i.e., spread, combination, straddle and stock-option orders), orders received during a trading rotation (although once the trading rotation ends such orders would then be subject to the Display Obligation), and orders of more than 100 contracts, unless the customer placing such order requests that it be displayed.⁹

III. Commission Findings and Order Granting Approval

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange¹⁰ and, in particular, the requirements of Section 6(b)(5) of the Act,¹¹ which requires, among other things, that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in facilitating transactions in securities, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

Specifically, the Commission believes that the display of customer options limit orders that improve the price or size of the best disseminated CBOE quote should promote transparency

⁸ See Securities Exchange Act Release No. 43086 (July 28, 2000), 65 FR 48023 (August 4, 2000) (order approving the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage).

⁹ For a complete discussion of these exempt order types, see Notice of the Proposal, supra note 3.

¹⁰ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹¹ 15 U.S.C. 78f(b)(5).

and enhance the quality of executions of customer limit orders on CBOE. The proposed amendments to CBOE Rule 8.85 introduce requirements for customer limit order display that are comparable to the requirements of the Commission's Display Rule, Rule 11Ac1-4 under the Act,¹² which is applicable to customer limit orders received in the equity market. In addition, the Commission believes that the Exchange's proposal to exempt all-or-none, fill-or-kill, immediate-or-cancel, and large sized orders from the Display Obligation is reasonable since these order types are either identical or substantially similar to order types exempt from the Commission's Display Rule.

The Commission also believes that it is consistent with the Act for CBOE to exempt from the Display Obligation under its rules market-if-touched, stop-limit, and stop or stop-loss orders. These orders are contingent orders that are subject to a particular triggering event and, thus, are not available for execution until the triggering event occurs. A market-if-touched or stop-loss order becomes a market order when triggered and thus is not subject to the Display Obligation because such an order would then be immediately executable. A stop-limit order becomes a limit order when the triggering event occurs. This limit order would be subject to the Display Obligation.

Market-on-close orders may not be represented, displayed or booked until as near as possible to the close of trading, and, therefore, the Commission believes it is reasonable to exempt such orders from the Display Obligation. Spread, combination, straddle, stock-option, and one-cancels-the-other orders are complex orders with more than one component and, thus, the Commission believes, are not suitable for display.

¹² 17 CFR 240.11Ac1-4.

During a trading rotation, CBOE systems attempt to set an opening price for the series. Until that opening price is established, there is no disseminated market. Therefore, it is reasonable to exempt orders received during a trading rotation from the Display Obligation. The Commission notes, however, that once the trading rotation ends, any orders not executed would then be subject to the Display Obligation.

Finally, the Exchange proposes to exempt from the Display Obligation customer orders for which a related order for the principal account of a DPM reflecting the terms of the customer order is routed to another options exchange. The Commission believes it is reasonable to exempt such orders since they are subject to execution upon receipt at the other options exchange. Moreover, the Exchange represents that if an order routed to another options exchange is cancelled in whole or in part by the other exchange, then the order would be subject to the Display Obligation immediately upon receipt of the cancellation notice by the Exchange.

The Commission finds good cause for approving Amendment No. 2 to the proposed rule change prior to the thirtieth day after their publication in the Federal Register, pursuant to Section 19(b)(2) of the Act.¹³ Amendment No. 2 made a minor modification to the exemption for customer orders for which a related order reflecting the terms of the customer order is immediately delivered to another exchange for execution. Acceleration of Amendment No. 2 will permit the Exchange to implement the proposal in an expeditious manner. The Commission, therefore, believes that good cause exists, consistent with Section 6(b)(5)¹⁴ and Section 19(b)¹⁵ of the Act, to accelerate approval of Amendment No. 2.

¹³ 15 U.S.C. 78s(b)(2).

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ 15 U.S.C. 78s(b).

IV. Solicitation of Comments Concerning Amendment No. 2

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 2, including whether it 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-2004-35 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 Room. 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].

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁶ that the proposed rule change (File No. SR-CBOE-2004-35) be approved, and that Amendment No. 2 thereto be approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland
Deputy Secretary

¹⁶ Id.

¹⁷ 17 CFR 200.30-3(a)(12).