

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-51205; File No. SR-CBOE-2004-72)

February 15, 2005

Self-Regulatory Organizations; Order Approving Proposed Rule Change and Amendment No. 1 by the Chicago Board Options Exchange, Incorporated Relating to the SizeQuote Mechanism Pilot Program

On November 10, 2004, the Chicago Board Options Exchange, Incorporated (“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 6.74, “Crossing Orders,” to adopt, on a one-year pilot basis, a “SizeQuote Mechanism” for the execution of large-sized orders in open outcry. On December 22, 2004, the CBOE filed Amendment No. 1 to the proposal. The proposed rule change, as amended, was published for comment in the Federal Register on January 12, 2005.³ The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended.

The proposed SizeQuote Mechanism is a procedure by which floor brokers may execute and facilitate large-sized orders of at least 250 contracts in open outcry.⁴ Under the proposed

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 50967 (January 5, 2005), 70 FR 2197 (“January Release”).

⁴ The appropriate CBOE Market Performance Committee will determine the options classes in which SizeQuote operates and may vary the minimum size of the orders eligible for SizeQuote, provided, however, that the minimum qualifying order size may not be less than 250 contracts.

procedures, a floor broker must be willing to facilitate the entire size of the order for which he or she requests quotes through the SizeQuote Mechanism (the “SizeQuote Order”).⁵

As described more fully in the January Release,⁶ a floor broker seeking to use the SizeQuote trading procedure must specifically request a “SizeQuote” from in-crowd market participants (“ICMPs”), who may respond with indications of the price and size at which they would be willing to trade with the SizeQuote Order.⁷ ICMPs that provide SizeQuote responses at the highest bid or lowest offer (the “best price”) have priority to trade with the SizeQuote Order at that best price and at a price equal to one trading increment better than the best price (the “improved best price”).⁸ Allocation of the SizeQuote Order among ICMPs will be pro rata, up to the size of each ICMP’s SizeQuote response. If the ICMPs providing the best price or the improved best price do not execute the entire SizeQuote Order, the floor broker representing the SizeQuote Order must trade the remaining contracts at the best price or the improved best price, as applicable. A floor broker may execute the entire SizeQuote Order at a price two trading increments better than the best price provided by the ICMPs in their responses to the SizeQuote request.

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 exchange,

⁵ A floor broker may not execute a SizeQuote Order at a price inferior to the national best bid or offer (“NBBO”). See proposed CBOE Rule 6.74(f)(i)(E).

⁶ See note 4, *supra*.

⁷ CBOE Rule 6.45A, “Priority and Allocation of Trades for CBOE Hybrid System,” defines an “in-crowd market participant” to include an in-crowd Market-Maker, an in-crowd DPM, or a floor broker representing orders in the trading crowd.

⁸ However, a public customer order in the electronic book has priority to trade with a SizeQuote Order over any ICMP providing a SizeQuote response at the same price as the order in the electronic book. See proposed CBOE Rule 6.74(f)(i)(C).

and, in particular, with the requirements of Section 6(b)(5) of the Act,⁹ which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, 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.

The CBOE believes that the SizeQuote Mechanism will create enhanced incentives for ICMPs to quote competitively by giving ICMPs that respond to a SizeQuote request at the best price priority to trade with the SizeQuote Order at that best price and at the improved best price (i.e., one trading increment better), as described above.¹⁰ Moreover, ICMPs will have only one opportunity to respond to a SizeQuote request, and ICMPs that do not respond at the best price will lose the opportunity to trade with the SizeQuote Order. The Commission believes that these procedures may encourage ICMPs to quote more competitively. The Commission notes, in addition, that if ICMPs providing SizeQuote responses do not execute the entire SizeQuote Order, the floor broker representing the SizeQuote Order must trade any remaining contracts at the best price, or at the improved best price, as applicable. At the same time, because the floor broker would be permitted to execute the entire SizeQuote Order at two increments better than the ICMPs' best price, the Commission believes it is essential for the Exchange to monitor the impact of the proposed rule change on the competitive process. Thus, the Commission is approving the proposed rule change on a one-year pilot basis. The CBOE has represented that it

⁹ 15 U.S.C. 78f(b)(5). In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

¹⁰ A public customer order in the electronic book has priority to trade with a SizeQuote Order over any ICMP providing a SizeQuote response at the same price as the order in the electronic book. See CBOE Rule 6.74(f)(i)(C).

will provide the Commission, at the end of the pilot period, a report summarizing the effectiveness of the SizeQuote Mechanism. The Commission intends to carefully review this report before approving any extension of the program.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹¹ that the proposed rule change (SR-CBOE-2004-72), as amended, is approved on a pilot basis until February 15, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹²

Margaret H. McFarland
Deputy Secretary

¹¹ 15 U.S.C. 78s(b)(2).

¹² 17 CFR 200.30-3(a)(12).