

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-51938; File No. SR-CBOE-2005-40)**

**June 29, 2005**

**Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated;  
Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating  
to the Hybrid Opening System**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 16, 2005, 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 the CBOE. The CBOE submitted Amendment No. 1 on June 24, 2005.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange proposes to amend its rules relating to the Hybrid Opening System (“HOSS”) procedures. The text of the proposed rule change is set forth below. Additions are in italics. Deletions are brackets.

**CHAPTER VI**

**Doing Business on the Exchange Floor**

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Amendment No. 1 revised the rule text to reflect language recently approved in another filing.

**Rule 6.2B. Hybrid Opening System ("HOSS")**

Rule 6.2B. (a) No change.

(b) After the Opening Notice is sent, the System will calculate and provide the Expected Opening Price ("EOP") and expected opening size ("EOS") given the current resting orders during the EOP Period ("EOP Period"). The appropriate FPC will establish the duration of the EOP Period on a class basis at between five and sixty seconds. The EOP, which will be calculated and disseminated to market participants every few seconds, is the price at which the greatest number of orders in the Book are expected to trade. After the Opening Notice is sent, quotes and orders may be submitted without restriction. An EOP may only be calculated if: (i) there are market orders in the Book, or the Book is crossed (highest bid is higher than the lowest offer) or locked (highest bid equals lowest offer), and (ii) at least one [the DPM's] quote [(or if there is no DPM appointed to the class, at least one quote from either a Market-Maker or LMM with an appointment in the class)] is present and complies with the legal width quote requirements of Rule 8.7(b)(iv).

(c) - (d) No Change.

(e) The System will not open a series if one of the following conditions is met:

- (i) [In classes in which a DPM has been appointed, there] There is no quote present in the series that complies with the legal width quote requirements of Rule 8.7(b)(iv) [from the DPM for the series. In classes in which no DPM has been appointed, there is no quote from at least one market-maker or LMM with an appointment in the class];
- (ii) The opening price is not within an acceptable range (as determined by the appropriate FPC and announced to the membership via Regulatory Circular)

compared to the [highest] lowest quote offer and the [lowest] highest quote bid [(e.g., the upper boundary of the acceptable range may be 125% of the highest quote offer and the lower boundary may be 75% of the lowest quote bid)]; or

(iii) No Change.

(f) – (i) 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. The 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**

The Exchange is proposing to amend its rules relating to HOSS procedures. HOSS is the Exchange's automated system for initiating trading at the beginning of each trading day. For each class of options contracts approved for trading, the appointed designated primary market maker ("DPM") conducts an opening rotation, which must be held promptly following the opening of the underlying security in the primary market. For purposes of HOSS, an underlying security shall be deemed to have opened on the primary market if such market has (i) reported a transaction in the underlying security, or

(ii) disseminated opening quotations for the underlying security and not given an indication of a delayed opening, whichever occurs first.

Currently, CBOE rules do not allow a Hybrid option series to be opened unless the DPM for that option class has submitted a quote that complies with the legal quote width requirements of CBOE Rule 8.7(b)(v),<sup>4</sup> regardless of whether other market participants have timely submitted legal opening quotes.<sup>5</sup> In an effort to better ensure that all options series are promptly opened on CBOE, the Exchange is proposing to allow HOSS to open an option series as long as any market participant,<sup>6</sup> not just the DPM, has submitted an opening quote that complies with the legal width quote requirements. It should be noted that, under the proposal, even though HOSS can open a series without a DPM's quote, DPMs, as well as electronic DPMs ("e-DPMs"), remain obligated under CBOE rules to timely submit opening quotes.<sup>7</sup>

Finally, this rule change proposes to clarify one of the conditions necessary for opening a series. Current CBOE Rule 6.2B(e)(ii) provides that, in order for the Hybrid System to open a series, the opening price must be within an acceptable range (as determined from time to time by the appropriate Exchange floor procedure committee)

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<sup>4</sup> See CBOE Rules 6.2B(b) and (e).

<sup>5</sup> Other factors must also be satisfied. The opening price for the series must be within an acceptable range and the opening trade cannot create a market order imbalance. See CBOE Rule 6.2B(e)(ii) and (iii).

<sup>6</sup> This includes a quote from a DPM, e-DPM, market maker, or a remote market maker. See CBOE Rule 6.45A.

<sup>7</sup> See Securities Exchange Act Release No. 51670 (May 9, 2005), 70 FR 28338 (May 18, 2005) (order approving SR-CBOE-2005-027, which requires e-DPMs to submit opening quotes in 100% of the series in all of their respective allocated option classes).

compared with the highest quote offer and the lowest quote bid. The Exchange proposes to change the method for determining the acceptable range to use the highest bid and the lowest offer, which could provide for an even tighter opening price range. In addition, the example provided in the same rule would be eliminated.

## 2. Statutory Basis

By allowing more participants' quotes to be included in the opening process, the Exchange is increasing the likelihood that any particular option series will open, and, as such, the Exchange believes this proposed rule change, as amended, is consistent with Section 6(b) of the Act,<sup>8</sup> in general, and further the objectives of Section 6(b)(5) in particular,<sup>9</sup> in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.

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

This proposed rule change, as amended, does not 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

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<sup>8</sup> 15 U.S.C. 78f(b)(5).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

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 CBOE 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-40 on the subject line.

##### **Paper comments:**

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission/Station Place, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-40. 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. 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-2005-40 and should be submitted by [insert date 21 days after the date of publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Margaret H. McFarland  
Deputy Secretary

Action as set forth or recommended herein  
APPROVED pursuant to authority delegated by  
the Commission under Public Law 87-592.

For: Division of Market Regulation

By: \_\_\_\_\_

Date: \_\_\_\_\_

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<sup>10</sup> 17 CFR 200.30-3(a)(12).