



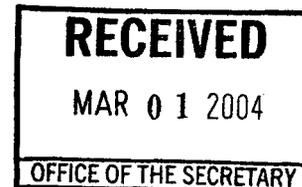
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February 27, 2004

Mr. Jonathan G. Katz
Secretary
Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549



Re: File No. SR-CBOE-2003-33; Release No. 34-48815

Dear Mr. Katz:

The Chicago Board Options Exchange, Incorporated (CBOE) appreciates the opportunity to respond to the comments of the International Securities Exchange (ISE) on our rule filing SR-2003-33, Release No. 34-48815.

Section 6(b)(4) of the Securities Exchange Act of 1934 (the "Act") requires that the rules of CBOE and other national security exchanges provide for "the *equitable* allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities." (Emphasis supplied). It is crucial to note the Act's use of the term "equitable," which does not necessarily mean "equal," but rather "fair."¹ In other words, nothing in Section 6(b)(4) requires that "members and issuers and other persons using [CBOE's] facilities" pay the *same* fees, but only that the differences among the fees of various persons using CBOE facilities be fair. This is confirmed by Section 6(b)(5) of the Act, which does not prohibit *any* discrimination in the rules of the exchanges, but only *unfair* discrimination.²

CBOE respectfully submits that it has already articulated a fair and reasonable rationale for the \$0.02 per contract fee differential proposed in SR-CBOE-2003-33 between member and non-member market-makers: namely, that CBOE can fairly charge higher transaction fees to non-member market-makers than to members, because the members already "pay a variety of additional fees through their membership in the Exchange to help offset the Exchange's expenses." SR-CBOE-2003-33 (Amendment #1) at 2.

¹ *E.g.*, Webster's New World Dictionary of the American Language, Second College Edition (1984) at 473.

² For this same reason, the ISE comment is incorrect to the extent it suggests that CBOE cannot file a rule change limited to the transaction fees paid by member versus nonmember market-makers. It is in fact routine for CBOE and other SROs to maintain fee schedules with different fees for different types of members and non-members, and to change various individual parts of these schedules as needed at different times.

Although not specified in the amended filing, the current CBOE fee schedule, posted at www.CBOE.com, demonstrates that CBOE market-makers pay a variety of fees supporting the trading opportunities they receive on the Exchange, including but not limited to, Membership dues of \$250 per month³, a Technology Fee of \$200 per month⁴, an initial application fees of at least \$1,000⁵, in addition to the customary transaction, trade match and floor brokerage fees,⁶ as well as numerous more specific fees relating to booths, telephones, and other logistics of trading on the CBOE floor.

CBOE, like other SROs, needs the ability to spread its operating costs fairly among the parties using its markets, not only to satisfy the Exchange Act, but also to ensure that it functions effectively as a member organization. This is what ISE overlooks in dismissing CBOE member complaints about the current parity between member and non-member market-maker fees. Such concerns in fact require CBOE to strike a balance in setting member and non-member fees. CBOE recognizes that the differential between the fees of member and non-member market-makers should not be so large as to discourage the latter from sending orders to CBOE altogether. However, CBOE (and other SROs) also need to make sure that the differential between member and non-member fees is not so *small* as to incent current CBOE market-makers to abandon their CBOE memberships and simply send in their orders to CBOE as non-members, in order to avoid the dues and other fees noted above, as well as numerous market-making and regulatory requirements, that apply only to CBOE members.

Because non-member market-makers can currently enter orders that enable them to take advantage of CBOE's markets without incurring any share of the above-mentioned fees, the CBOE submits that the \$.02 per contract differential it proposes under the current circumstances strikes a fair and reasonable balance among the competing concerns noted above, and therefore is entirely consistent with the statutory requirement that exchange fees be equitably allocated among users of the exchange.⁷

The ISE suggests that approval of SR-CBOE-2003-33 may prompt other exchanges to file similar proposals. CBOE respectfully suggests that this is not to be feared. Particularly in the current, highly competitive market among the various option exchanges, competition for order flow will discipline exchanges to keep all their

³ See February 2, 2004 CBOE Fee Schedule at Section 9.

⁴ *Id.* at Section 10.

⁵ *Id.* at Section 11.

⁶ *Id.* at Section 1, 2, and 3.

⁷ See Release No. 34-37273, 61 FR 29438 (June 10, 1996) (in approving SR-NYSE-95-47, which authorized NYSE to exclude orders of competing nonmember market makers from a "no charge" provision for smaller system orders, the Commission noted that "whether a proposed fee can be deemed an equitable allocation of a reasonable fee depends on the facts and circumstances under which the proposal is being made." 61 FR at 29442.)

transaction fee proposals within reasonable limits that the 'market will bear,' even without the Commission having to exercise its oversight authority under Section 6(b)(4) of the Act. Because it is in CBOE's own interest to set a fee differential that represents a reasonable balance between the two opposing objectives noted above (and likewise would be in the self interest of any other exchange that may follow CBOE's lead in this respect), we believe the Commission may find that the fee differential proposed by CBOE (or other exchanges) is presumptively reasonable.⁸

CBOE also rejects the contention that a \$.02 per contract differential in transaction fees will negate inter-market price discovery, both because CBOE has expressly exempted linkage orders from the fee change, and because of the small size of the proposed differential. CBOE maintains that effects upon price discovery, to the extent they can be expected at all, will be a function of the degree of any proposed price differential. CBOE believes it has proposed a reasonably small differential of \$.02 per contract that will help it achieve its objective of more equitably assessing its costs among various users of its markets without negating inter-market price discovery.⁹

We hope this addresses the Commission's concerns. As always, if you have further concerns, feel free to call me at (312) 786-7462 or Chris Hill at (312) 786-7031.

Very truly yours,



Joanne Moffic-Silver
General Counsel

CC: Annette Nazareth
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⁸ *Id.*

⁹ *Cf.* Release No. 34-45252, 67 FR 2002, (January 15, 2002), (approving SR-AMEX-2001-26, which increased the regulatory fee \$.01 per contract for certain orders entered for the account of a non-member competing market maker.)