

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50055; File No. SR-CBOE-2004-12)

July 21, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated to Require Members to Use and Maintain a Back-up Autoquote System in Hybrid Classes

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 February 23, 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, II, and III below, which Items have been prepared by the Exchange. 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

CBOE proposes to require members to use and maintain a back-up quoting system in Hybrid classes and to incorporate violations of this requirement in the Exchange’s Minor Rule Violation Plan (“Plan”). The text of the proposed rule change is available at the principal office of the Exchange and at the Commission’s Public Reference Room.

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

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

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

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 Exchange seeks to adopt new CBOE Rule 8.85(a)(xii) which require a Designated Primary Market-Maker ("DPM"), utilizing a proprietary autoquote system in a class trading on CBOE's Hybrid platform, to have available for immediate use an alternative autoquote system that is independent of the DPM's primary autoquote system. This requirement would apply at all times during market hours. The Exchange believes that the back-up system would need to be independent in order to ensure that any event that may cause a failure to the primary autoquote system does not corrupt the back-up system. The Exchange also proposes to modify subparagraph (g)(10) of CBOE Rule 17.50 - Imposition of Fines for Minor Rule Violations - to incorporate in its Plan violations of proposed CBOE Rule 8.85(a)(xii). The Exchange believes that this proposed rule change is substantially similar to a requirement currently in place for non-Hybrid classes<sup>3</sup> (except, in that case, CBOE requires use of CBOE's autoquote system as a back-up; that system is not available in the Hybrid environment, so CBOE proposes to require a second proprietary back-up instead).

The Exchange believes that the failure of a proprietary autoquote system could result in CBOE's inability to open for an entire group of listed option classes for a brief or sometimes lengthy time period. Thus, CBOE has strongly encouraged, and now seeks to require, that members have a back-up system ready in Hybrid classes should the primary autoquote system

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<sup>3</sup> See Securities Exchange Act Release No. 46808 (November 12, 2002), 67 FR 69776 (November 19, 2002) (SR-CBOE-2002-30).

fail. CBOE believes that failure to comply with the proposed requirement should be subject to sanction under the Exchange's Plan on a trading-station-by-trading-station basis.

The Exchange believes that determining a violation would be objective in nature and very suitable for inclusion in the Plan. However, because a DPM could be in violation for one minute or four hours, the Exchange believes that violations can vary greatly in terms of the impact on CBOE's marketplace. Therefore, the Exchange believes it is appropriate to allow for summary fines under the Plan that could range from \$100 to \$2,500 for first-time violations and from \$100 to \$5,000 (the minimum and maximum allowable under the Plan) for a limited number of subsequent violations. For egregious violations, including those that severely impact the trading of option classes on the Exchange for an extended period of time, the Modified Trading System Appointments Committee (the committee charged with DPM supervision) would have the discretion to refer the matter to the CBOE Business Conduct Committee instead of handling such violations under the Plan. Further, in no event would more than three violations by the same DPM in any 12 month period be handled under the Plan. CBOE floor officials would be responsible for issuing summary fines under the proposed rule. Lastly, because different trading stations operated by the same DPM organization can operate and maintain autoquote systems differently, the Exchange believes it is appropriate for the summary fines to be handled on a trading-station-by-trading-station basis.

## 2. Statutory Basis

The Exchange believes that, because the proposed rule change would refine and enhance the Exchange's Plan to make it more efficient and effective, the proposed rule change is consistent with Section 6(b) of the Act,<sup>4</sup> in general, and furthers the objectives of Sections

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<sup>4</sup> 15 U.S.C. 78f(b).

6(b)(5)<sup>5</sup> and 6(b)(7)<sup>6</sup> in particular, in that it is designed to promote just and equitable principles of trade, to protect investors and the public interest, and enhances the effectiveness and fairness of the Exchange's disciplinary procedures.

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

The Exchange does not believe that the proposed rule change would 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

The Exchange has neither solicited nor received written comments on 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 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 Exchange 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

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

<sup>6</sup> 15 U.S.C. 78f(b)(7).

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:

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-2004-12 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-2004-12. 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, 450 Fifth Street, NW, Washington, DC 20549. 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-2004-12 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.<sup>7</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).