

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-50583; File No. SR-CBOE-2004-64)

October 22, 2004

Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change by the Chicago Board Options Exchange, Inc. Relating to the Allocation of N-Second Group Trades Pursuant to Rule 6.45A(c)

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 October 14, 2004, the Chicago Board Options Exchange, Inc. (“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 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 CBOE proposes to eliminate the Designated Primary Market-Maker (“DPM”) participation entitlement for trades occurring pursuant to CBOE Rule 6.45A(c). Below is the text of the proposed rule change. Proposed new language is in *italics*; proposed deletions are in brackets.

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**Rule 6.45A Priority and Allocation of Trades for CBOE Hybrid System**

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(a) – (b) No change.

(c) Interaction of Market Participant’s Quotes and/or Orders with Orders in Electronic Book

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

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

(i) – (ii) No change.

(iii) DPM Participation Entitlement: [If a DPM is eligible for an allocation pursuant to the operation of this paragraph (c) by virtue of being a member of the “N-second group” as described in paragraph (c)(ii), the DPM shall be entitled to receive an allocation equal to the amount it would be entitled to pursuant to the DPM participation right established pursuant to Rule 8.87 (and Regulatory Circulars issued thereunder). The DPM’s entitlement percentage is expressed as a percentage of the remaining quantity after all public customer orders in the electronic book have been executed.] There is no DPM participation entitlement applicable to orders allocated pursuant to paragraph (c).

[(iv) Temporary Order Access Terminals: The Exchange will provide Temporary Order Access Terminals (“T-OATs”) in each trading crowd in which Hybrid is operational. Each T-OAT, which will be reserved for the exclusive use of floor brokers, will allow the entry by floor brokers of agency orders that will be eligible to participate in the “N-second group.” Each T-OAT will be conveniently located and will be easily accessible. The Exchange will provide in each crowd at least one T-OAT, and where necessary, as many T-OATs as are necessary to accommodate demand in that trading pit. The Exchange will continue to provide T-OATs until either November 28, 2003 or until the Hybrid system is capable of accepting orders from floor broker workstations that will be eligible to participate in the “N-second group,” whichever occurs first.]

(d) – (e) No change.

**... Interpretations and Policies:**

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, the Exchange included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV 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

CBOE Rule 6.45A(c) governs the allocation of orders resting in the Exchange's electronic book ("book" or "Ebook") among market participants. Generally, if only one market participant interacts with the order in the book, he/she will be entitled to full priority. If, however, more than one market participant attempts to interact with the same order in the book, a "quote trigger" process initiates. Under the quote trigger process, the first market participant to interact with the book order starts a counting period lasting N-seconds whereby each market participant that submits an order within that "N-second period" becomes part of the "N-second group" and is entitled to share in the allocation of that order via the formula contained in the rule. The Exchange does not propose to change the operation of the quote trigger process other than to eliminate the DPM participation right for "N-second group" trades.

Currently, if a DPM is a member of the "N-second group," he/she receives the standard participation entitlement.<sup>3</sup> The Exchange proposes to eliminate the participation entitlement to

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<sup>3</sup> CBOE Rule 8.87 governs the operation of the DPM participation entitlement. The Exchange proposes no changes to the participation entitlement process or percentages.

DPMs involved in the quote trigger process. Instead, DPMs will be treated as any other market participant and will take in accordance with the formula contained in the rule. The Exchange believes eliminating the DPM participation entitlement will incent other market participants to quote competitively by giving them a greater percentage of resting orders in the book.

Generally, the DPM participation entitlement is at least 30% (up to the size of the DPM's quote). In crowds where there are several members in the "N-second group," this 30% may represent a relatively substantial portion of the book order. By treating the DPM as any other market participant, all market participants will be on equal footing. Accordingly, there should be a larger percentage of booked orders available for allocation to other non-DPM crowd members.

While the Exchange is in the process of amending CBOE Rule 6.45A(c), it takes this opportunity to eliminate paragraph (c)(iv) from the Rule. Under this paragraph, the Exchange was obligated to provide Temporary Order Access Terminals in all Hybrid trading crowds until no later than November 28, 2003. As this date has come and gone, the Exchange proposes to eliminate this expired provision from the rule.

## 2. Statutory Basis

The Exchange believes this amendment to the quote trigger process will provide market participants with an enhanced incentive to quote competitively, which should enhance competition and provide investors with deeper and more liquid markets. For these reasons, the Exchange believes the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>4</sup> Specifically, the Exchange believes the proposed rule

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

change is consistent with the Section 6(b)(5)<sup>5</sup> requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

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

The CBOE does not believe that the proposed rule change will impose any burden on competition 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 neither received nor solicited written comments on the proposal.

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 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 is consistent with the Act. Comments may be submitted by any of the following methods:

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

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-2004-64 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-2004-64. 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 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 publicly available. All submissions

should refer to File Number SR-CBOE-2004-64 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>6</sup>

Margaret H. McFarland  
Deputy Secretary

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<sup>6</sup> 17 CFR 200.30-3(a)(12).