

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-50920; File No. SR-CBOE-2004-81)**

**December 22, 2004**

**Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change by the Chicago Board Options Exchange, Incorporated Relating to Amending Rule 30.20 to Conform to the Requirements of Regulation SHO**

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Exchange Act”),<sup>1</sup> notice is hereby given that on December 8, 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 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

CBOE proposes to amend CBOE Rule 30.20 to conform to the requirements of Regulation SHO.<sup>2</sup> The text of the proposed rule change is available at the Office of the Secretary, CBOE and at the Commission.<sup>3</sup>

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 received on the proposed rule change. The text of these statements may be examined at the places

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

<sup>2</sup> See Securities Exchange Act Release No. 50103 (July 28, 2004), 69 FR 48008 (August 6, 2004)(“Adopting Release”).

<sup>3</sup> Exhibit A is available at <http://www.sec.gov/rules/sro.shtml>.

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

The Commission on July 23, 2004 adopted Regulation SHO (“Reg SHO”) to address short sales of securities and to create uniform rules relating to the short selling of securities.<sup>4</sup> The purpose of this rule filing is to amend existing Exchange rules relating to short sales to bring them into conformity with the requirements of Reg SHO.

The Exchange proposes to amend Rule 30.20, as described below.

**Rule 30.20(a):** The Exchange amends this paragraph to require that all orders to sell a security be marked either long, short, or short exempt.

**Rule 30.20(b):** The Exchange amends this paragraph to incorporate a reference to Exchange Act Rule 242.202T.<sup>5</sup>

**Rule 30.20(c):** The Exchange eliminates the entire text of paragraph (c) in favor of language referencing the Commission’s “Locate and Delivery Requirements for Short Sales.” As amended, new paragraph (c) provides that no member or member organization shall accept, represent or execute for his or its own account or the account of any other person an order to

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<sup>4</sup> Id.

<sup>5</sup> Rule 202T provides a procedure for the Commission to suspend, on a pilot basis, the trading restrictions of the Commission's short sale price test, as well as any short sale price test of any exchange or national securities association, for short sales in such securities as the Commission designates by order as necessary or appropriate in the public interest and consistent with the protection of investors, after giving due consideration to the security's liquidity, volatility, market depth and trading market. Rule 202T makes explicit that no SRO "shall have a rule that is not in conformity with or conflicts with" the suspension of a price test for the securities selected for the pilot.

sell a security subject to the rules in this Chapter unless such member or member organization complies with Exchange Act Rule 242.203.

**Rule 30.20.02:** The Exchange amends this Interpretation to provide that the terms long, short, and short exempt will have the same meaning as in Exchange Act Rule 242.200.

**Rule 30.20.03:** The Exchange proposes to delete existing Interpretation .03, which is specific to a product (SuperShares) that the Exchange never traded.

**Rule 30.20.04:** The Exchange proposes to revise current Interpretation .04 to include new text referencing the Exchange Act Rules governing the requirements for long sales (Exchange Act Rule 242.203(a)) and short sales (Exchange Act Rule 242.203(b)). The Exchange also proposes to clarify that the requirements members currently must satisfy in order to make an affirmative determination for short sales shall continue to be required for documenting compliance with Exchange Act Rule 242.203(b)(1). In this respect, the requirements remain the same.

**Rule 30.20.05:** The Exchange proposes to delete this Interpretation, which is specific to an expired product (S&P 500 Index Bear market Warrants), and replace it with language from Exchange Act Rule 242.203(b)(3) relating to threshold securities.

**Rule 30.20.06:** The Exchange proposes to adopt this new Interpretation to remind members that even if a security is excepted from any short sale price test under any Pilot program (or any order issued pursuant to Exchange Act Rule 242.202T), members or member organizations must still comply with the marking and locate requirements in Exchange Act Rules 242.200 and 203.

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 Exchange Act. Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>6</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

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 Exchange Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants or Others

The Exchange neither solicited nor received comments on the proposal.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing rule change has become effective pursuant to Section 19(b)(3) of the Exchange Act<sup>7</sup> and subparagraph (f)(6) of Exchange Act Rule 19b-4.<sup>8</sup> CBOE has designated the proposed rule change as one that: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate. CBOE requests that the Commission waive the 30-day pre-operative delay requirement contained in Rule 19b-4(f)(6)(iii). CBOE

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<sup>6</sup> 15 U.S.C. 78(f)(b)(5).

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>8</sup> 17 CFR 240.19b-4(f)(6).

believes that good cause exists to grant such waiver because of the importance of short sale regulation to the protection of investors and compliance with Reg SHO.<sup>9</sup>

The Commission believes that waiving the 30-day pre-operative delay is consistent with the protection of investors and the public interest. The Commission believes that accelerating the operative date does not raise any new regulatory issues, significantly affect the protection of investors or the public interest, or impose any significant burden on competition. For these reasons, the Commission designates the proposed rule change effective and operative immediately.

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Exchange Act.

#### **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 Exchange Act. Comments may be submitted by any of the following methods:

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<sup>9</sup> The compliance date for Reg SHO is January 3, 2005. See Adopting Release, supra note 2. The operative date of the proposed filing is January 3, 2005. See CBOE Regulatory Circular RG04-127, December 21, 2004, available at <http://www.cboe.org/Legal/>.

**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-2004-81 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-2004-81. 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 available publicly. All submissions should refer to File Number SR-CBOE-2004-81 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>10</sup>

Margaret H. McFarland  
Deputy Secretary

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

**Chicago Board Options Exchange, Inc.**

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The Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") proposes to amend Rule 30.20 to conform to the requirements of Regulation SHO. Set forth are proposed changes to the rule text, with additions represented by underscoring and deletions represented by bracketing.

**Rule 30.20 “Long” and “Short” Sales**

(a) No member or member organization shall accept, represent or execute for his or its own account or the account of any other person an order to sell a security subject to the rules in this Chapter unless such order is marked "long," [or] "short[.]," or “short exempt” in accordance with Exchange Act Rule 242.200(g).

(b) No member or member organization shall for his or its own account or the account of any other person effect on the Exchange any short sale of a security that is subject to the rules in this Chapter unless such sale is (1) at a price higher than the price at which the last sale thereof, regular way, was effected on the Exchange, or (2) at such latest price and such price is above the last different price at which a sale in the unit of trading of such security, regular way, was effected on the Exchange; provided, however, that transactions exempted from paragraphs (a) or (b) of Exchange Act Rule 10a-1 by paragraph (e) thereof, or by action of the Securities and Exchange Commission pursuant to paragraph (f) thereof, any order



pursuant to Exchange Act Rule 242.202T or otherwise, are also exempted from the requirements of this paragraph (b).

(c) No member or member organization shall accept, represent or execute for his or its own account or the account of any other person an order to sell a security subject to the rules in this Chapter unless such member or member organization complies with Exchange Act Rule 242.203.

[For the purpose of effecting delivery within the time period required under regular way settlement procedures, any sale of a security for a customer which is designated as a "long" sale may be effected only if:

(1) The customer is "long," in good deliverable form, the security to be sold on the books of the selling member organization, or

(2) The selling member organization notes on the order ticket that –

(i) It has received from the customer assurance that the security to be sold is placed or deposited, in good deliverable form, in such a manner as to be obtainable only by the customer by physical means other than the giving of instructions, and that the customer may be bought in with respect to the security within a time period which is reasonable in view of the circumstances, or

(ii) Such security is on deposit, in good deliverable form, with a member of a registered securities exchange, a member of the National Association of Securities Dealers, any broker-dealer registered with the Securities and Exchange Commission or any organization subject to state or federal banking regulations and that

instructions have been or are being forwarded to such depository to deliver such security against payment, or

(3) The customer presents to the selling member organization, with proper instructions, a security convertible into or exchangeable for, or an option, warrant or right which entitles him to purchase, together with the necessary funds, prior to settlement date, the security to be sold.]

**Interpretations and Policies:**

.01 Pursuant to the equalization exemption of paragraph (e)(5) of Exchange Act Rule 10a-1, a Market-Maker is permitted to sell short for his own account on the Exchange any security for which he has an appointment at a price equal to the last regular way sale reported by the consolidated last sale reporting system.

The Exchange may disseminate an offer by a Market-Maker to sell at a price equal to the last regular way sale reported by the consolidated last sale reporting system, and a short sale may be effected by the Market-Maker responsible for such offering without further regard to prices reported by such system.

The Exchange may, by rule, prohibit Market-Makers from availing themselves of this exemption if it is determined that such action is necessary or appropriate in the public interest or for the protection of investors.

**.02** The terms “long,” “short,” “short exempt,” and “short sale” shall have the same meaning as in Exchange Act Rule [3b-3] 242.200.

**.03** Reserved [The Securities and Exchange Commission ( "SEC") has exempted short sales of SuperShares from the "tick test" requirements of paragraph (a) of Rule 10a-1 under the Exchange Act. That exemption, which is subject to revocation or modification by the SEC, does not apply to any transaction made for the purpose of creating actual, or apparent, active trading in or raising or otherwise affecting the price of SuperShares or any related security. So long as this exemption remains in force, short sales of SuperShares will be exempt from the "tick" requirements of paragraph (b) of this Rule.]

**.04** [Member organizations effecting short sales, either for their own account (as, for instance, an arbitrage transaction) or for the accounts of customers, must be in a position to complete the transaction. Therefore, no member or person associated with a member shall accept a "short" sale order for any customer or for its own account in any security unless the member or person associated with the member makes an affirmative determination: (1) in the case of customer short sales, that the member will receive delivery of the security from the customer or that the member can borrow the securities on behalf of the customer for delivery by settlement date, or (2) in the case of proprietary short sales, that the member can borrow the securities or otherwise provide for delivery of the securities by settlement date.]

Under Exchange Act Rule 242.203(a)(1), no member that knows or has reasonable grounds to believe that the sale of a security subject to the rules in this Chapter was or will be effected

pursuant to an order marked "long" shall lend or arrange for the loan of any security for delivery to the purchaser's broker after the sale, or fail to deliver a security on the date delivery is due. Exchange Act Rule 242.203(a)(2) contains exceptions from this requirement, including an exception in subsection (a)(2)(ii) for the situation in which the member knows, or has been reasonably informed by the seller, that the seller owns the security, and that the seller would deliver the security to the member or dealer prior to the scheduled settlement of the transaction, but the seller failed to do so. To demonstrate reasonableness under Exchange Act Rule 242.203(a)(2)(ii), the member or person associated with a member must keep documentation which includes the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member by the settlement date if the customer assures delivery.

[This limitation on short selling applies to all member organizations whether effecting transactions on the Exchange, another national securities exchange, or in the over-the-counter market.] Under Exchange Act Rule 242.203(b)(1), no member may accept a short sale order in an equity security from another person, or effect a short sale in an equity security for its own account, unless the member: (i) has borrowed the security or entered into a bona-fide arrangement to borrow the security and has documented compliance; or (ii) has reasonable grounds to believe that the security can be borrowed so that it can be delivered on the date delivery is due and has documented compliance. [This limitation shall not apply to a market-maker] Exchange Act Rule 242.203(b)(2) contains exceptions from this requirement, including an exception from its provisions in subsection (b)(2)(iii) for short sales by market-makers so long as such short sales are in connection with [furtherance of his] bona fide market making [transactions in securities in which he is registered as a market-maker.]

activities. [in the security for which the exception is claimed.] In the event that a short sale occurs pursuant to this Interpretation .04, the burden is on the market-maker to show that such sale was in furtherance of his bona fide market making activities.

[Arbitrageurs who are unable to borrow securities for delivery must sell short when issued contracts when such contracts are trading, or refrain from trading when borrowings can not be effected.

To satisfy the requirement for an "affirmative determination" required by this Interpretation .04 for customer and proprietary short sales,] To ensure compliance under Exchange Act Rule 242.203(b)(1), the member or person associated with a member must [keep a written record] provide documentation which includes: (1) if a customer assures delivery, the present location of the securities in question, whether they are in good deliverable form and the customer's ability to deliver them to the member [within three (3) business days] by the settlement date; or (2) if the member or the person associated with a member locates the stock, the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing by settlement date and the number of shares needed to cover the short sale.

The manner by which a member or person associated with a member annotates compliance with the ["affirmative determination"] record-keeping requirements in this Interpretation (e.g., marking an order ticket, recording inquiries in a log, etc.) shall be determined by each member. Members may rely on ["blanket" or standing assurances] an "easy to borrow" list that securities will be available for borrowing on settlement date to satisfy their [affirmative

determination] requirements in Exchange Act Rule 242.203(b)(1)(ii) under this Interpretation, provided: (1) the information used to generate the ["blanket" or standing assurance] "easy to borrow" list is not more than 24-hours old; and (2) the member delivers the security on settlement date. Should a member relying on [a blanket or standing assurance] an "easy to borrow" list fail to deliver the security on settlement date, the Exchange shall deem such conduct inconsistent with the terms of this Interpretation, absent mitigating circumstances adequately documented by the member.

**.05** [The Securities and Exchange Commission ("SEC") has exempted short sales of S&P 500 Index Bear Market Warrants ("Warrant") from the "tick test" requirements of paragraph (a) of Rule 10a-1 under the Exchange Act. That exemption, which is subject to revocation or modification by the SEC, does not apply to any transaction made for the purpose of creating actual, or apparent, active trading in or raising or otherwise affecting the price of the Warrants or any related security. So long as this exemption remains in force, short sales of the Warrants will be exempt from the "tick test" requirements of paragraph (b) of this Rule.]

Exchange Act Rule 242.203(b)(3) restricts the ability of a member, including a market-maker, to accept or effect short sales for its account or the account of a customer in certain "threshold securities." "Threshold securities" generally are defined as equity securities registered or subject to reporting requirements under the Exchange Act: (1) for which there is an aggregate fail to deliver position for five consecutive settlement days at a registered clearing agency of 10,000 shares or more, and that is equal to at least 0.5% of the issue's total

shares outstanding; and (2) are included on a list disseminated to its members by a self-regulatory organization.

Exchange Act Rule 242.203(b)(3) prohibits a member, including a market-maker covered by the bona fide market making exemption in Exchange Act Rule 242.203(b)(2)(iii), from accepting or effecting short sales in a threshold security that has a fail to deliver position with at a registered clearing agency for thirteen consecutive settlement days. However, a member of a registered clearing agency that has the ability to trace a short sale in a threshold security for which there is a failure to deliver to a particular account, and to age that failure to deliver, may limit the application of this restriction to the account with the failure to deliver. This prohibition would not apply if: (1) the member borrows the security or enters into a bona-fide arrangement to borrow the security; or (2) the requirements in the rule with respect to closing out these fail to deliver positions are met. The rule also has a limited exemption in subsection (b)(3)(ii) for registered options market-makers.

Members are expected to monitor which threshold securities have a fail to deliver position with the member's clearing firm for thirteen consecutive settlement days. Registered clearing agency members must close out a fail to deliver position that remains for thirteen consecutive settlement days by purchasing securities of like kind and quantity. If a market-maker is able to borrow or enter into a bona-fide arrangement to borrow these securities, the market-maker must keep a written record which includes the identity of the individual and firm contacted who offered assurance that the shares would be delivered or that were available for borrowing and the number of shares needed to cover the short sale.

.06 Even if a security is excepted from any short sale price test under any Pilot program (or any order issued pursuant to Exchange Act Rule 242.202T), members or member organizations must still comply with the marking and locate requirements in Exchange Act Rules 242.200 and 203.