

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-45800; File No. SR-CBOE-2001-65]

Self-Regulatory Organizations; Order Approving Proposed Rule Change by the Chicago Board Options Exchange, Inc. To Permit a Single Response From Market Makers to a Request To Execute a Large Order

April 22, 2002.

I. Introduction

On December 17, 2001, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") submitted to the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")¹ and Rule 19b-4 thereunder,² a proposed rule change to permit a single response from market makers to a request to execute a large order.³ The CBOE filed an amendment to the proposed rule change on March 6, 2002.⁴ The **Federal Register** published the proposed rule change and Amendment No. 1 for comment on March 18, 2002.⁵ The Commission received no comments on the proposed rule change. This order approves the proposed rule change, as amended by Amendment No. 1.

II. Description of Proposal

The CBOE proposes to amend CBOE Rule 8.7 to allow CBOE market makers to respond to a member's request for a quick and certain market. Proposed Interpretation .11 to CBOE Rule 8.7 would permit market makers jointly to discuss a request from a member for a single response to an order that is

greater in size than the RAES order eligibility size for that option class, in order to provide a single bid or offer, based upon the aggregate of individual bids or offers by members in the trading crowd. Such coordination would be permitted only in situations where the member representing the order requests a single bid or offer. When a single bid or offer made in response to a request results in the order being executed, the order will be apportioned among the market makers who participated in making the single bid or offer according to the number of contracts each market participant committed to trading, and each market maker shall be obligated to fulfill his portion of the single bid or offer at the single price.⁶

III. Discussion

After careful consideration the Commission has determined to approve the proposed rule change. For the reasons discussed below, the Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange,⁷ and, in particular, with section 6(b)(8) of the Act,⁸ which requires that the rules of an exchange not impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

The proposed rule change would permit CBOE market makers in the trading crowd to make a collective response to a request to fill a large order, provided that a collective response is requested. The Commission believes that this exception recognizes the desire of the marketplace to provide a single price to a request to fill a large order that a single member would not be able to fill. The Commission believes that any anticompetitive effect of this exception is limited by requiring that there be a member's specific request for a single price and that the order be sufficiently large.⁹ In addition, the Commission notes that notwithstanding this exception, a single crowd participant may voice a bid or offer

independently from, and differently from, the LMM and other members of a trading crowd.

Although the Exchange states in the proposal its belief that the proposed rule change enhances competition, the Commission does not agree. The Commission believes, however, that the proposal is not inconsistent with the Act because it does not impose an inappropriate burden on competition. Moreover, the Commission strongly disagrees with the CBOE's statement in its proposal that members representing large orders who do not request a single price may not be satisfying their duty of best execution because of the risk that the market may move substantially as the member attempts to execute the whole order in pieces. The Commission also notes that in Amendment No. 1, the Exchange deleted a footnote from the original filing that stated that a member would be viewed as having requested a single bid or offer if the member expressed to a trading crowd that generally he or she expected a single bid or offer for any order of greater than the RAES order eligibility size, unless he or she requested otherwise in a specific circumstance. In light of this change, and for the reasons set forth above, the Commission finds that the proposed rule change is consistent with the Act.

Finally, the Commission finds that the proposed rule change is designed to effectively limit the circumstances in which collective action is permissible.

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁰ that the proposed rule change (SR-CBOE-2001-65), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹¹

Margaret H. McFarland,

Deputy Secretary.

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The Exchange filed this proposed rule change pursuant to the provisions of Section IV.B.j. of the Commission's September 11, 2000 Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Act, which required the Exchange, among other things, to adopt new, or amend existing, rules to include any practice or procedure whereby market makers trading any particular option class determine by agreement the spreads or option prices at which they will trade any option class.

⁴ See letter from Patrick Sexton, Assistant General Counsel, CBOE, to Deborah Flynn, Assistant Director, Division of Market Regulation, dated March 4, 2002 ("Amendment No. 1). Amendment No. 1 deletes a footnote from the original filing that stated that a member would be viewed as having requested a single bid or offer if the member expressed to a trading crowd that generally he or she expected a single bid or offer for any order of greater than the Exchange's Retail Automatic Execution System ("RAES") order eligibility size, unless he or she requested otherwise in a specific circumstance.

⁵ Securities Exchange Act Release No. 45542 (March 12, 2002), 67 FR 12068.

⁶ The Exchange has submitted another proposed rule change (SR-CBOE-2002-08) relating to allocation of trades, including trades pursuant to proposed Interpretation and Policy .11 to CBOE Rule 8.7.

⁷ In approving this proposed rule change, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁸ 15 U.S.C. 78f(b)(8).

⁹ The Commission expects the Exchange to monitor the collective actions that are undertaken pursuant to the rule change approved herein for any undesirable or inappropriate anticompetitive effects. The Commission's examination staff will monitor the Exchange's efforts in this regard.

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 17 CFR 200.30-3(a)(12).