

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-47200; File No. SR-CBOE-2002-63]

Self-Regulatory Organizations; Notice of Filing and Immediate Effectiveness of Proposed Rule Change and Amendments Nos. 1 and 2 Thereto by the Chicago Board Options Exchange, Inc. Proposing To Allow Limited Side-by-Side Trading and Integrated Market Making for Certain Securities and Their Related Options

January 15, 2003.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act" or "Exchange Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 16, 2002, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Exchange filed Amendment No. 1 to the proposed rule change on December 27, 2002.³ The Exchange filed Amendment No. 2 to the proposed rule change on January 2, 2003.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to amend Exchange rules and the related Interpretations and Policies to allow for limited "Side-by-Side Trading"⁵ and "Integrated Market

Making"⁶ for certain securities and their related options. The text of the proposed rule change follows. Additions are in *italics*. Deleted text is in [brackets].

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Chapter XXX

Part A—Trading in Stocks, Warrants, and Other Securities

General Floor Prohibitions

Rule 30.18. No member of the Exchange, while on the floor, shall:

(a) Dealing When Option Granted or Held. *Except as otherwise provided in Section (d) below*, [I] initiate the purchase or sale on the Exchange of any security subject to the Rules in this Chapter, for his own account or for any account in which he, his member organization or any person associated with such member or member organization is directly or indirectly interested, including by means of the issuance or acceptance of a commitment or obligation to trade, where (i) such member holds, or has sold or granted, an option or warrant on that security, or (ii) such member has knowledge that his member organization or any person associated with such member or member organization holds, or has sold or granted, any such option or warrant; or

(b) No change.

(c) No change.

(d) *Notwithstanding the foregoing:*

(i) *The DPM or an associated person of the DPM for an IPR, IPS, or TIR that meets the criteria set forth in Interpretation and Policy .03 of this Rule may act as a DPM, market-maker, and/or floor broker in the related options without implementing procedures to restrict the flow of information between them and without any physical separation between the trading in the underlying IPR, IPS, or TIR and the trading in the related options.*

(ii) *Reserved.*

* * * Interpretations and Policies

.01 No change.

.02 No change.

.03 *The criteria to qualify particular IPRs, IPSs and TIRs for side-by-side trading and integrated market making pursuant to Exchange Rule 30.18(d)(i) are as follows:*

a. *Component securities that in the aggregate account for at least 90% of the weight of the portfolio must have a minimum market value of at least \$75 million.*

b. *The component securities representing 90% of the weight of the portfolio each have a minimum monthly trading volume during each of the last six months of at least 250,000 shares.*

c. *The most heavily weighted component security cannot exceed 25% of the weight of the portfolio and the five most heavily weighted component securities cannot exceed 65% of the weight of the portfolio.*

d. *The underlying portfolio must include a minimum of 13 securities.*

e. *All securities in the portfolio must be listed on a national securities exchange or the NASDAQ Stock Market.*

Chapter 30

30.18A. *An option DPM that is also approved as a DPM in the underlying security in a side-by-side trading environment pursuant to Exchange Rule 30.18(d)(i) is required to disclose on request to all participants in the option or security trading crowds information about aggregate buying and selling interest at different price points represented by limit orders then being represented or otherwise held by the DPM.*

* * * Interpretations and Policies

.01. *"Side-by-side trading" refers to the trading of options and their underlying securities in the same physical vicinity, though not necessarily by the same DPM or firm.*

.02. *Notwithstanding the fact that a DPM's option transactions may be in conformity with Rule 30.18 and its Interpretations and Policies, such DPM shall nonetheless be deemed to be in violation of Rule 30.18 if the DPM has engaged in such option transactions for manipulative purposes.*

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 specified in Item III below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ On December 27, 2002, the Exchange filed a Form 19b-4, which replaced the original filing in its entirety ("Amendment No. 1"). In Amendment No. 1, the Exchange withdrew the portion of the proposed rule change to permit limited integrated market making of securities admitted to dealings on an UTP basis and their related options if information barriers are established, approved and maintained. In addition, the Exchange amended the proposal to designate the proposed rule change as filed under section 19(b)(3), rather than section 19(b)(2), of the Act.

⁴ See letter from Christopher Hill, Attorney, CBOE, to Nancy Sanow, Assistant Director, Division of Market Regulation ("Division"), Commission, dated December 30, 2002 ("Amendment No. 2"). In Amendment No. 2, the Exchange provided reasons for requesting that the Commission waive the 5 day pre-filing requirement and the 30 day delay of the operative date as required under section 19(b)(3) of the Act, and Rule 19b-4(f)(6) thereunder.

⁵ The Exchange defines "Side-by-Side Trading" as the trading of options and their underlying stocks in the same vicinity, though not necessarily by the same DPM or firm.

⁶ The Exchange defines "Integrated Market Making" as the trading of options and their underlying stocks by the same DPM.