

to the Commission addressing each of these issues in depth ("ROS Study").

With respect to issues 1 and 2, the Exchange represents that it has observed that in general, market-makers have set the contract and delta thresholds on ROS at a level which ensures that an options class that has orders to trade will not auto-open, in order to avoid openings based on erroneous prints in the underlying security or delayed updates to bid/ask information on underlying securities. Nonetheless, the Exchange represents that it has still been able to open classes within seconds of the opening of the underlying class because ROS can open classes very quickly even if they are not set to auto-open. CBOE represents that based on Exchange staff observations of ROS openings during the pilot period, AutoQuote adjustments by market-makers after the "lock" is initiated are rare.

With respect to issue 3, the Exchange believes that market-maker adjustments to AutoQuote have had no adverse effect on the quality of customer executions. In fact, CBOE represents that AutoQuote adjustments are made to ensure the accurate pricing of options based on the opening price of the underlying security. Market-makers are required to price contracts in a manner consistent with their obligations under CBOE Rule 8.7(b)(iv). The Exchange has published regulatory circulars to remind market makers of their obligation to set AutoQuote in accordance with Exchange rules.⁸ CBOE believes that scrutiny by customers and firms is another factor that ensures that market-makers adjust AutoQuote values consistent with their obligation.

The Exchange represents that it has submitted along with the ROS Study a written description of the methods employed by the Exchange to surveil market-maker activities on ROS. The Exchange believes that other than the situation where ROS has opened based on an incorrect underlying value, there have been no customer complaints regarding ROS opening prices.

With respect to issue 4, the Exchange believes that ROS has served to protect the quality of executions received by non-bookable orders that participate in the opening. The Exchange has developed a procedure for including non-bookable orders (firm, broker-dealer and customer contingency orders) into the opening process. CBOE represents that this procedure has been incorporated into CBOE Rule 6.2A and has been detailed in two regulatory

circulars.⁹ The Exchange believes ROS has enhanced the quality of customer executions and has served to provide non-bookable orders represented before the open with the executions that they deserve on the opening. CBOE represents that as is demonstrated by the statistics in the ROS Study, during the review period noted, the vast majority of orders that traded during the "opening period" (defined as the ROS opening plus the first minute after the ROS opening) received the ROS opening price or better.¹⁰

The Exchange represents that it is committed to ensuring that non-bookable orders that participate on the opening continue to receive quality executions. The Exchange represents that the implementation of the requirement under Phase V of the Consolidated Options Audit Trail ("COATS") Plan that all non-electronic orders must be captured electronically for audit trail purposes will facilitate the Exchange's efforts in monitoring on an ongoing basis the executions received by non-bookable orders that participate in the opening.¹¹ CBOE anticipates that after the implementation of COATS Phase V, a non-bookable order sent to the Exchange prior to the opening will be captured electronically and incorporated into the Exchange's audit trail. CBOE believes this will facilitate its regulatory staff's ability to investigate with more speed and efficiency any complaint regarding the execution received by a non-bookable order on the opening, in that the Exchange will now have an electronic record of the time of receipt of the order, in addition to the order information and the execution price of the order.¹²

With respect to issue 5, the Exchange represents that it has observed that firms consistently wait until after the ROS opening has been completed to represent non-bookable orders. CBOE believes that by waiting until after ROS opens, the firms have a better sense of where they may trade the order after opening quotes have been disseminated. CBOE represents that the statistics in

the ROS Study demonstrate that few, if any, non-bookable orders are being represented before ROS openings. The Commission stated in the Pilot Program Approval Order that prior to considering permanent approval of ROS, it expected the Exchange to develop a workable plan for electronic incorporation of non-bookable orders on ROS. The Exchange believes, for the reasons set forth above, that permanent approval of ROS should not be contingent upon the development of a plan to electronically incorporate non-bookable orders on ROS. CBOE believes that such a systems change would have very little impact on ROS trading due to the fact that non-bookable orders are virtually non-existent before the open. The Exchange represents that it continues to consider modification of EBook to include other order types, but it is uncertain at this time when such a project might be completed.

Based on the successful operation of ROS over the past three years, the Exchange proposes that the Commission approve ROS on a permanent basis.

2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act,¹³ in general, and furthers the objectives of Section 6(b)(5),¹⁴ in particular, in that it is designed to promote just and equitable principles of trade and to protect investors and the public interest, because ROS has improved market efficiency for all market participants by successfully facilitating expedited openings of options classes on the Exchange during the pilot period.

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 purposes of the Act.

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

No written comments were solicited or received with respect to 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)

⁸ See CBOE Regulatory Circulars RG99-91 (April 14, 1999) and RG02-34 (May 28, 2002).

⁹ See CBOE Rule 6.2A(ii), and Regulatory Circulars RG99-35 (February 10, 1999) and RG00-40 (March 13, 2000).

¹⁰ See Amendment No. 1, *supra* note 3.

¹¹ The COATS Plan is a plan that the options exchanges are required to submit to the Commission in order to comply with Section IV.B.e. of the *Order Instituting Public Administrative Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions*. See In the Matter of Certain Activities of Options Exchanges, Securities Exchange Act Release No. 43268, September 11, 2000; Administrative Proceeding File No. 3-10282.

¹² See Amendment No. 1, *supra* note 3.

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).