

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.⁹

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Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

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Self-Regulatory Organizations; Notice of Filing of Proposed Rule Change and Amendment No. 1 by the Chicago Board Options Exchange, Inc., Relating to the Trading of Ratio Orders

October 21, 2003.

Pursuant to section 19(b)(1) of the Securities Exchange Act of 1934 ("Act"),¹ and Rule 19b-4 thereunder,² notice is hereby given that on February 24, 2003, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the CBOE. The CBOE filed Amendment No. 1 to the proposal on October 8, 2003.³ 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

The CBOE proposes to amend CBOE Rules 6.45, "Priority of Bids and Offers," and 6.53, "Certain Types of Orders Defined," to allow ratio orders to be executed through the CBOE. The text of the proposed rule change appears below. Additions are italicized; deletions are bracketed.

Priority of Bids and Offers

Rule 6.45 Except as provided by Rules, including but not limited to Rule 6.2A, 6.8, 6.9, Rule 6.47, Rule 8.87, and CBOE Regulatory Circulars approved by the SEC concerning Participation Rights,

the following rules of priority shall be observed with respect to bids and offers:

(a)-(d) No Change.

(e) Complex Order Priority Exception: A member holding a spread, straddle, [or] combination, or ratio order (or a stock option order as defined in Rule 1.1(ii)(b)) and bidding (offering) on a net debit or credit basis (in a multiple of the minimum increment) may execute the order with another member without giving priority to equivalent bids (offers) in the trading crowd or in the book provided at least one leg of the order betters the corresponding bid (offer) in the book. Stock-option orders, as defined in Rule 1.1(ii)(a), have priority over bids (offers) of the trading crowd but not over bids (offers) of public customers in the limit order book.

* * * Interpretation and Policies:
.01-.02 No change.

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Certain Types of Orders Defined

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Rule 6.53(a)-(m) No change.

(n) *Ratio Order. A Ratio Order is a spread, straddle, or combination order in which the stated number of option contracts to buy (sell) is not equal to the stated number of option contracts to sell (buy), provided that the number of contracts differ by a permissible ratio. For purposes of this section, a permissible ratio is any ratio that is equal to or greater than one-to-three (.333) and less than or equal to three-to-one (3.0). For example, a one-to-two (.5) ratio, a two-to-three (.667) ratio, or a two-to-one (2.0) ratio is permissible, whereas a one-to-four (.25) ratio or a four-to-one (4.0) ratio is not.*

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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 CBOE 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 IV below. The CBOE 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

CBOE Rule 6.53 lists and defines the several types of orders that are executed

through the CBOE.⁴ Of the several types of orders defined in CBOE Rule 6.53, three are complex orders: spread orders, combination orders, and straddle orders.⁵ The CBOE proposes to add another type of complex order, ratio orders, to the list of orders included in CBOE Rule 6.53. A ratio order is either a spread, straddle, or combination order in which the stated number of option contracts to buy (sell) is not equal to the stated number of option contracts to sell (buy), provided that the number of contracts differs by a permissible ratio. Under the CBOE's proposal, a permissible ratio is any ratio that is equal to or greater than one to three (.333) or less than or equal to three to one (3.0). For example, a one to two (.5) ratio, a two to three (.667) ratio, or a two to one (2.0) ratio is permissible, whereas a one to four (.25) ratio or a four to one (4.0) ratio is not.

The CBOE believes that ratio orders are merely slight variations on the types of complex orders currently permitted on the CBOE. For this reason, the CBOE believes that it is appropriate to treat ratio orders in a manner similar to the existing complex orders that currently trade on the CBOE. Accordingly, the CBOE proposes to afford ratio orders within the permissible ratio the exception to the priority rules under CBOE Rule 6.45(e).

Specifically, CBOE Rule 6.45(e) provides for exceptions to the Exchange's priority rules when a member is holding a spread order, straddle order, or a combination order. Under CBOE Rule 6.45(e), a member holding a spread, straddle, or combination order and bidding (offering) on a net debit or credit basis (in a multiple of the minimum increment) may execute the order with another member without giving priority to equivalent bids (offers) in the trading crowd or in the book, provided that at least one leg of the order betters the corresponding bid (offer) in the book. Under the CBOE's proposal, ratio orders that are equal to or greater than one to three (.333) or less than or equal to three to one (3.0) will be given the same exception under CBOE Rule 6.45(e) as spread, straddle, and combination orders.

Because the proposal seeks consistent priority treatment for similar types of orders traded on the CBOE, the CBOE believes that the proposal furthers the objectives of section 6(b)(5) of the Act⁶

⁴ These orders include, for example, market orders, contingency orders, and straddle orders.

⁵ These types of orders are defined in paragraphs (d), (e), and (f), respectively, of CBOE Rule 6.53.

⁶ 15 U.S.C. 78f(b)(5).

⁹ 17 CFR 200.30-3(a)(12).

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See letter from James M. Flynn, Attorney II, Legal Division, CBOE, to Yvonne Fraticelli, Division of Market Regulation, Commission, dated October 6, 2003 ("Amendment No. 1"). Amendment No. 1 revises the proposal to provide that the permissible ratio for a ratio order is any ratio that is equal to or greater than one to three (.333) and less than or equal to three to one (3.0).