

IV. Conclusion

It is therefore ordered, pursuant to section 19(b)(2) of the Act,¹⁶ that Amendment No. 1 is approved on an accelerated basis, and that the proposed rule change (File No. SR-BSE-2003-07) be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹⁷

Margaret H. McFarland,

Deputy Secretary.

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SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-48858; File No. SR-CBOE-2003-07]

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

December 1, 2003.

I. Introduction

On February 24, 2003, the Chicago Board Options Exchange, Inc. ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission" or "SEC"), 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 allow ratio orders to be executed through the CBOE. The CBOE filed Amendment No. 1 to the proposal on October 8, 2003.³

The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on October 28, 2003.⁴ The Commission received no comments regarding the proposal. This order approves the proposed rule change, as amended.

II. Description of the Proposal

The CBOE proposes to amend CBOE Rule 6.53, "Certain Types of Orders Defined," to allow ratio orders with certain permissible ratio limits, as

defined below, to be executed through the CBOE. In addition, the CBOE proposes to revise paragraph (e) of CBOE Rule 6.45, "Priority of Bids and Offers—Allocation of Trades," to include these types of permissible ratio orders in CBOE Rule 6.45(e), thereby providing such ratio orders with the exception to the priority rules that CBOE Rule 6.45(e) provides currently for spread, straddle, and combination orders.⁵ The CBOE believes that because ratio orders are slight variations on the types of complex orders currently permitted on the CBOE, it is appropriate to treat ratio orders like spread, straddle, and combination orders for purposes of CBOE Rule 6.45(e).

CBOE Rule 6.53 lists and defines several types of orders that are executed through the CBOE including, among others, three types of complex orders: spread orders, combination orders, and straddle orders. The CBOE proposes to add certain ratio orders within permissible established limits to the list of orders included in CBOE Rule 6.53. CBOE Rule 6.53(n) would define a ratio order as 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 CBOE Rule 6.53(n), a permissible ratio would be 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.

III. Discussion

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 exchange⁶ and, in particular, with the requirements of section 6(b)(5) of the

Act,⁷ which requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and to protect investors and the public interest.

The proposal will allow certain ratio orders to be executed through the CBOE. As described above, 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 differs by a permissible ratio.⁸ The Commission believes that ratio orders within certain permissible ratios may provide market participants with greater flexibility and precision in effectuating trading and hedging strategies. In addition, the Commission believes that including such ratio orders in the exception to the priority rules provided in CBOE Rule 6.45(e) will facilitate the execution of ratio orders. In this regard, the Commission believes that the procedures governing the execution of complex orders, such as ratio orders, serve to reduce the risk of incomplete or inadequate executions while increasing efficiency and competitive pricing by requiring price improvement before the order can receive priority over other orders.⁹ The Commission also notes that the rules of other options exchanges treat certain ratio orders like other complex orders for purposes of their priority rules.¹⁰

The CBOE's rule also provides specific examples of permissible ratio orders. Specifically, the rule provides that a permissible ratio is any ratio that is equal to or greater than one-to-three and less than or equal to three-to-one. For example, as indicated in the rule, a one-to-two ratio, a two-to-three ratio, or a two-to-one ratio is permissible, whereas a one-to-four ratio or a four-to-one ratio is not. This should help to provide guidance to CBOE members of the permissible ratios allowed under CBOE rules for such ratio orders.

The Commission believes that permitting ratio orders to have ratios equal to or greater than one-to-three or

¹⁶ 15 U.S.C. 78s(b)(2).

¹⁷ 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).

⁴ See Securities Exchange Act Release No. 48672 (October 21, 2003), 68 FR 61499.

⁵ CBOE Rule 6.45(e), "Complex Order Priority Exception," currently states that: "A member holding a spread, straddle, or combination 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."

⁶ In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

⁷ 15 U.S.C. 78f(b)(5).

⁸ Under the 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).

⁹ See, e.g., CBOE Rule 6.45(e). See also Securities Exchange Act Release No. 44955 (October 18, 2001), 66 FR 53819 (October 24, 2001) (order approving File No. SR-ISE-2001-18).

¹⁰ See, e.g., ISE rule 722(b)(2), "Complex Order Priority," and PHILX Rule 1033(g), "Ratio Spread Type Priority."