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Ms. Florence Harmon
Acting Secretary
U.S. Securities & Exchange Commission
100 F Street, NE
Washington, DC 20549-1090

Re: SR-CBOE-2008-105: CBOE Response to optionsXpress Holdings, Inc. Comment Letter

Dear Ms. Harmon:

Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) submits this letter in response to a comment letter received by the SEC from optionsXpress Holdings, Inc. (“optionsXpress”) (“optionsXpress Letter”) regarding the above-referenced CBOE rule filing.¹ The optionsXpress Letter makes two main arguments as to why the SEC should abrogate the Exchange’s rule filing. First, it claims that the Options Regulatory Fee (“ORF”) is applied inequitably solely to customer-range transactions and makes several arguments in support of this claim. Second, it claims the ORF proposal is operationally challenging. The Exchange responds to each of these claims separately.

I. Response to Comments Regarding Inequitable Application of the ORF solely to Customer Range Transactions

A. Response to comment that there is no justifiable nexus between solely customer range transactions on the CBOE and the “regulatory costs” that the ORF seeks to recoup.

optionsXpress asserts that the ORF does not satisfy the equitable allocation standards of Section 6(b)(4) of the Securities Exchange Act of 1934 (“Exchange Act”). optionsXpress argues that the ORF discriminates in its application by favoring member option transactions in the firm range. The Exchange believes that the ORF is equitably allocated among CBOE members. As discussed in the Exchange’s rule filing, the ORF is proposed to replace registered representative (“RR”) fees. Because RR fees relate to a member’s customer business, the Exchange believes it is appropriate to charge the ORF only to transactions that clear in the customer range at the Options Clearing Corporation (“OCC”). Furthermore, with the evolution of the industry, the Exchange believes the ORF is a much fairer way to allocate regulatory fees than the RR fee structure. Under the RR fee structure, some firms, such as optionsXpress, pay little or no RR

¹ Letter from Hillary Victor, Associate General Counsel, optionsXpress Holdings, Inc., to Florence Harmon, Acting Secretary, SEC, dated November 13, 2008.

fees. Under the ORF structure, regulatory fees would be more evenly allocated among customer order sending firms.

The Exchange does not believe the ORF discriminates in its application by favoring member option transactions. As discussed in the Exchange's rule filing, the ORF would not be charged for member options transactions because the Exchange believes members are already paying their fair share of the costs of regulation. Members incur the costs of owning memberships and through their memberships are charged transaction fees, dues and other fees that are not applicable to non-members. optionsXpress fails to mention that retail customers are not charged any transaction fees to trade most equity options on the Exchange. The Exchange believes it is appropriate not to charge the ORF for member options transactions because the dues and fees paid by members go into the general funds of the Exchange, a significant portion of which is used to help pay the costs of regulation.

The optionsXpress letter states that the Exchange should be required to provide a cost analysis in support of the ORF proposal. The Exchange notes that in connection with its rule filing it has confidentially provided to the SEC detailed information regarding the cost of the Exchange's regulatory programs, current regulatory fee revenue and the revenue expected to be generated by the ORF. In addition, the Exchange made a statement in its rule filing that its total regulatory fee revenue (not including regulatory fine revenue) covers only about 65% of its regulatory costs.

B. Response to comment that the proposal lacks support to show that the fees are reasonable.

optionsXpress asserts that the ORF is not reasonable because "retail customers" would absorb the cost and it would place a higher burden on "online and discount firms" in comparison to other CBOE members. The ORF is not targeted solely to retail customers and online and discount firms. The ORF would be charged to members for all options transactions that are cleared by OCC in the customer range. The Exchange notes that transactions that clear in the customer range include not only transactions of retail customers but also transactions of institutional customers and transactions for the proprietary accounts of broker-dealers that are not OCC members. Moreover, all types of firms, not just online or discount firms, execute and clear customer transactions. Therefore, the Exchange believes the ORF is reasonable and not disproportionately allocated to retail customers and online and discount firms.

C. Response to comment that there is no justifiable nexus between solely customer range transactions on other exchanges and the regulatory activities of CBOE.²

optionsXpress argues that the ORF proposal promotes "taxation" of retail customers trading options on exchanges having no nexus to the CBOE. As discussed in its rule filing, the

² As a side note, in this section the optionsXpress Letter indicates that the ORF proposal is driven by the Intermarket Surveillance Group ("ISG"). The ORF is a CBOE proposal and is not driven by ISG

Exchange has broad regulatory responsibilities with respect to its members' activities, irrespective of where their transactions take place. Many of the Exchange's surveillance programs for customer trading activity requires the Exchange to look at activity across all options markets, such as surveillances for position limit violations, manipulation and insider trading. In contrast, the Exchange's surveillance programs for market-maker trading activity require the Exchange to review only activity taking place on the Exchange, such as market-maker quoting obligations. Accordingly, there is a strong nexus between the ORF and the Exchange's regulatory activities with respect to its members' customer trading activity.³

D. Response to comment that the proposal encourages routing to a market maker to avoid facing a competitive disadvantage.

The optionsXpress Letter states that "Inherent in the Proposal is the loophole enabling a retail firm to route would-be customer range orders through an affiliated market-maker on an omnibus basis to avoid the ORF." The Exchange does not understand this comment. It would be a violation of CBOE rules (and may be a violation of other exchange rules) for a firm to misrepresent a customer order as a market-maker order. Exchange rules require each member to record the appropriate account origin code on all orders at the time of entry in order to allow the Exchange to properly prioritize and route orders and assess transaction fees pursuant to the rules of the Exchange and report resulting transactions to the OCC. The Exchange has surveillances in place to verify that members mark orders with the correct account origin code, including surveillances to review for origin code changes after trade execution. The Exchange is not aware of any member misrepresenting customer orders as market-maker orders.

E. Response to comment that the proposal disadvantages retail customers.

optionsXpress argues that the ORF places an undue financial impediment on retail customers and could likely drive marginal investors from trading options. As discussed above, the ORF is not solely a fee on retail investors. Retail investors would not be treated differently from institutional investors. The Exchange does not believe the ORF would drive marginal investors from trading options. The amount of the ORF is small, much less than a customer would pay in commissions (e.g., the ORF would be \$.45 for a 100-lot trade). Obviously, the Exchange would not propose a fee that would drive investors away from the options market. The Exchange believes the amount of the ORF should not be a financial impediment to any investor found to be suitable for options trading.

³ Another comment received by the Exchange in this regard is for an explanation as to why the ORF rate is not lower for transactions executed at other exchanges. While there may be a difference in some respects between the amount of resources spent by the Exchange for surveillance of orders executed on other exchanges and surveillance of orders executed on the Exchange, the Exchange believes any difference is small enough to not justify a complicated bifurcation of the ORF fee calculation for activity on other exchanges. In addition, the Exchange incurs significant additional costs in maintaining the appropriate data to perform cross market surveillance that is not required for the few surveillances that do not require the Exchange to look at activity on other exchanges.

II. Response to Comments that the Proposal is Operationally Challenging.

The optionsXpress letter states that the ORF proposal does not answer how the Exchange proposes to charge the ORF for trading a one-lot or any odd-lot. The Exchange intends to advise members in a Regulatory Circular that the ORF for a one-lot or a two-lot must be rounded up to the nearest cent. As a result, the ORF for one-lot and two lot transactions would be one cent. The Exchange also intends to advise members in a Regulatory Circular that the ORF for an odd-lot must be rounded to the nearest cent using pure rounding (i.e., any digit 5 and above is rounded up).

The optionsXpress letter also suggests that if the ORF were to be imposed, a *de minimis* exemption would be appropriate for those trades that would result in a fee below a certain threshold (e.g., below one cent). optionsXpress argues that the resources a firm must devote to charge the ORF for a one-lot would far exceed any regulatory cost benefit of such a small transaction. The Exchange believes a *de minimis* exemption is not appropriate because the Exchange is required to surveill small-lot transactions like any other transaction. The cost to the Exchange to surveill a small-lot transaction in many cases is the same as the cost to review a much larger transaction.

Conclusion

As addressed above, the Exchange believes the ORF is reasonable and equitably allocated among its members. Accordingly, the Exchange believes that the proposed rule change is consistent with Section 6(b)(4) of the Securities Exchange Act of 1934 and urges the Commission not to abrogate the proposed rule change. Please do not hesitate to contact me at (312) 786-7925 if you have any questions.

Sincerely,



Patrick Fay

cc: Richard Holley III (SEC)
Johnna Dumler (SEC)
David Michehl (SEC)
Edward Joyce
Lawrence Bresnahan
Joanne Moffic-Silver
Timothy Thompson