



The Chicago Board
Options
Exchange

Walter E. Auch
Chairman and
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OFFICE OF THE COMMISSIONER

August 10, 1983

Chairman John S.R. Shad
Commissioner John Evans
Commissioner Bevis Longstreth
Commissioner Barbara Thomas
Commissioner James Treadway

Dear Chairman and Commissioners:

On August 11, 1983, The Commission will consider whether to approve proposed rule changes by the American Stock Exchange to trade options on industry stock indexes. I understand that the Commission will also consider general issues relating to industry stock indexes.

In connection with this meeting, the Commission staff recently inquired whether CBOE would voluntarily agree to a listing restriction which would limit each options exchange to two industry index option contracts for an unspecified period of time. Absent agreement by all the options exchanges to such a listing restriction, we are advised that the staff will ask the Commission to consider whether it is in the public interest to impose such a restriction by order. Our Executive Committee refused to agree to any listing restriction, and that position has been communicated to the staff.

I am taking the liberty to write to you at this late date because the Commission release concerning the proposed rule change did not solicit comment on a listing restriction, and the Exchange is very strongly opposed to it.

In 1980, in order to end the options "moratorium," CBOE reluctantly entered into a contractual agreement with the other three options exchanges to allocate new stock options among the exchanges. Essentially, any options exchange may call for an allocation at any time, and in the allocation each exchange obtains one-quarter of the new options. My concern is simple: CBOE is the largest options exchange - its market share exceeds 25% - and each time there is an allocation CBOE loses market share.

Thus, you can understand my concern about a Commission order imposing a listing restriction which would divide up the options market in the same fashion as is currently done for stock options. CBOE would be able to list only two industry-based indexes to compete with a potential of eight listed by the four competing options exchanges (including NYSE). In general, CBOE has the greatest number of actively traded options on stocks of highly capitalized issuers, and the effect of this restriction will be to leave CBOE's equity options markets vulnerable to the

depredations of its competitors through the construction of narrow-based indexes heavily weighted with CBOE's prime stocks. Thus under the umbrella of this anti-competitive listing restriction, CBOE's rivals will be free to attack CBOE's prime option stocks, secure in the knowledge that CBOE is not free to launch a meaningful response.

By letter dated May 31, 1983, CBOE raised a number of regulatory and policy questions respecting industry-based indexes and urged that approval of such contracts be deferred until the issues raised by our letter could be adequately aired and addressed. If the Commission determines that these policy questions do not merit further consideration and permits the trading of options on such indexes, then such trading should occur in an environment that has a minimum of competitive restrictions. The ideal of free and open competition would dictate that each exchange be permitted to list options on industry indexes without numerical limitation. At a minimum, in order to be competitively neutral, any limitation on the number of such listings should correlate to the current market share of each exchange.

Sincerely,



Walter E. Auch
Chairman and Chief Executive Officer

cc: Douglas Scarff