

**SECURITIES AND EXCHANGE COMMISSION**  
**(Release No. 34-54182; File No. SR-CBOE-2006-51)**

**July 20, 2006**

**Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated;  
Order Approving a Proposed Rule Change Regarding Market Maker Appointments**

**I. Introduction**

On May 19, 2006, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to make the Market-Maker appointment process similar to the process applicable to Remote Market-Maker (“RMM”) appointments. The proposed rule change was published for comment in the Federal Register on June 20, 2006.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

**II. Description of the Proposal**

The proposal would allow a Market-Maker to create a Virtual Trading Crowd (“VTC”) appointment, which would confer the right to quote electronically in an appropriate number of Hybrid 2.0 Classes (as defined in CBOE Rule 1.1(aaa)) selected from “tiers” that have been structured according to trading volume statistics. Each class within a specific tier would be assigned an “appointment cost” depending upon its tier

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> See Securities Exchange Act Release No. 53975 (June 12, 2006), 71 FR 35471.

location, which would be identical to the tiers and appointment costs set forth in CBOE Rule 8.4(d) that have been structured for purposes of RMM appointments.

With respect to Hybrid Classes (as defined in CBOE Rule 1.1(aaa)), CBOE proposes to allow a Market-Maker to quote electronically in Hybrid Classes that are located at one trading station. CBOE proposes to assign an appointment cost of .01 to each Hybrid Class.

With regard to trading in open outcry, CBOE proposes to amend CBOE Rule 8.3 to provide that a Market-Maker has an appointment to trade in open outcry in all Hybrid and Hybrid 2.0 Classes traded on the Exchange. A Market-Maker would be required to be physically present in the trading crowd where an option class is located in order to trade in open outcry in that option class. A Market-Maker would be permitted to submit electronic quotations into any of his/her appointed Hybrid or Hybrid 2.0 Classes while the Market-Maker is trading in open outcry.

For non-Hybrid and non-Hybrid 2.0 Classes (collectively “Non-Hybrid Classes”), CBOE proposes to allow a Market-Maker to select as his appointment one or more Non-Hybrid Classes traded on the Exchange, which would confer the right to trade in open outcry in Non-Hybrid Classes.

As is the case for RMMs, each membership owned or leased by a Market-Maker would have an appointment credit of 1.0. A Market-Maker would be permitted to select for each Exchange membership it owns or leases any combination of Hybrid 2.0 Classes, Hybrid Classes which are located at one trading station, and Non-Hybrid Classes, whose aggregate “appointment cost” does not exceed 1.0. The Exchange would rebalance the “tiers” (excluding the “AA” and “A+” tiers) set forth in paragraph (c)(i) of CBOE Rule

8.3 once each calendar quarter, which may result in additions or deletions to their composition. When a class changes tiers, it would be assigned the appointment cost of that tier. Upon rebalancing, each Market-Maker with a VTC appointment would be required to own or lease the appropriate number of Exchange memberships reflecting the revised appointment costs of the Hybrid and Hybrid 2.0 Classes constituting its appointment.

In new paragraph (c)(vi) of CBOE Rule 8.3, CBOE proposes to continue and modify slightly an existing Pilot Program in effect until March 24, 2007, which allows a Market-Maker to quote remotely. The existing Pilot Program provides that a Market-Maker may submit electronic quotations in his/her appointed Hybrid and Hybrid 2.0 Classes from outside of his/her appointed trading station.<sup>4</sup> Because CBOE is proposing to allow Market-Makers to create a VTC consisting of Hybrid 2.0 Classes, CBOE proposes to modify the Pilot Program such that it provides Market-Makers with the ability to quote remotely away from CBOE's trading floor in their appointed Hybrid and Hybrid 2.0 option classes. While on the trading floor, there would be no requirement that a Market-Maker must be present in a particular trading station in order to stream electronic quotations into his/her appointed classes.

CBOE also proposes to continue two existing Pilot Programs set forth in CBOE Rules 8.4(c)(i) and 8.93(vii), which are in effect until September 14, 2006, and which provide that an RMM or e-DPM in an option class can have one Market-Maker affiliated with the RMM or e-DPM trading in the option class. CBOE Rule 8.3(c) would continue

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<sup>4</sup> Prior to the Pilot Program, a Market-Maker could stream electronic quotes into an option class only when he/she was physically present in his/her appointed trading station.

to require that the affiliated Market-Maker can submit electronic quotations in any class in which the affiliated e-DPM or RMM has an appointment only if the Market-Maker is present in the trading station where the class is located. CBOE also notes in paragraph (c)(vii) to CBOE Rule 8.3 that a Market-Maker and an affiliated e-DPM or affiliated RMM can operate as multiple aggregation units under the criteria set forth in CBOE Rule 8.4(c)(ii), pursuant to a Pilot Program that expires on March 14, 2007.

In new paragraph (c)(viii) to CBOE Rule 8.3, CBOE notes that pursuant to a Pilot Program that expires on March 14, 2007, two affiliated Market-Makers can hold an appointment in the same class provided both Market-Makers operate as multiple aggregation units under the criteria set forth in CBOE Rule 8.4(c)(ii). This provision is consistent with current CBOE Rule 8.3(c)(iii).

As provided in new Interpretation .01 to CBOE Rule 8.3, in the event the total appointment cost for all of the Hybrid 2.0 Classes, Hybrid Classes, and/or Non-Hybrid Classes, constituting a Market-Maker's appointment on the approval date of this rule change exceed 1.0, CBOE proposes to grant the Market-Maker six months from the date of the approval of this rule change to comply with the provisions of CBOE Rule 8.3(c)(v) that provide a Market-Maker's appointed classes cannot have a total appointment cost in excess of 1.0. During these six months, any Market-Maker whose total appointment cost exceeds 1.0 would be ineligible to request an appointment in any other option class until the Market-Maker's total appointment cost has been reduced to less than 1.0. The preceding limited exemption to CBOE Rule 8.3(c)(v) would be available only to those Market-Makers whose total appointment cost for all of the Hybrid 2.0 Classes, Hybrid

Classes, and/or Non-Hybrid Classes constituting a Market-Maker's appointment would have exceeded 1.0 on April 24, 2006, if the rule had been in effect on that date.

### **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 exchange and, in particular, the requirements of Section 6 of the Act<sup>5</sup> and the rules and regulations thereunder.<sup>6</sup> The Commission specifically finds that the proposed rule change is consistent with Section 6(b)(5) of the Act<sup>7</sup> in that it is designed to promote just and equitable principles of trade, to remove impediments and to perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest. The Commission believes that the proposal to move to VTC appointments should allow Market-Makers additional flexibility in choosing their appointed classes.

The Commission also believes that the proposed amendments to the pilot program that would allow Market-Makers to quote remotely away from CBOE's trading floor in their appointed Hybrid and Hybrid 2.0 option classes, instead of from outside of his/her appointed trading station, are a reasonable extension of the pilot. The Commission notes that RMMs and e-DPMs in an option class would continue to be permitted, on a pilot basis, to have an affiliated Market-Maker in that class. CBOE Rule 8.3(c) would continue to require that the affiliated Market-Maker can submit electronic quotations in

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<sup>5</sup> 15 U.S.C. 78f.

<sup>6</sup> In approving this proposed rule change, the Commission notes that it has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

any class in which the affiliated e-DPM or RMM has an appointment only if the Market-Maker is present in the trading station where the class is located. The Commission believes that requiring that the Market-Maker affiliated with the e-DPM or RMM be present in the trading station where the class is located is reasonable, given the allocation algorithm adopted by the Exchange.

The Commission also notes that Market-Makers and affiliated RMMs or e-DPMs would continue to be permitted, on a pilot basis, to operate as multiple aggregation units under the criteria set forth in CBOE Rule 8.4(c)(ii). In addition, the Commission notes that two affiliated Market-Makers would continue to be permitted to hold an appointment in the same class provided both Market-Makers operate as multiple aggregation units under the criteria set forth in CBOE Rule 8.4(c)(ii). However, an affiliated Market-Maker and DPM would not be permitted to hold an appointment in the same class.

#### **IV. Conclusion**

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>8</sup> that the proposed rule change (SR-CBOE-2006-51) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>9</sup>

Nancy M. Morris  
Secretary

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<sup>8</sup> 15 U.S.C. 78s(b)(2).

<sup>9</sup> 17 CFR 200.30-3(a)(12).