

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54250; File No. SR-CBOE-2005-93)

July 31, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change and Amendment No. 1 Thereto to Establish a Quote Risk Monitor Mechanism and to Define Continuous Quoting

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> notice is hereby given that on November 3, 2005, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On May 16, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons. In addition, the Commission is granting accelerated approval of the proposed rule change, as amended.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

CBOE proposes to adopt CBOE Rule 1.1(ccc) to define the nature of CBOE Market-Makers’ continuous electronic quoting obligations under the Exchange rules. CBOE also proposes to adopt CBOE Rule 8.18 to codify a description of the Quote Risk Monitor (“QRM”) Mechanism, which is a certain functionality the Exchange offers CBOE Market-Makers who have continuous electronic quoting obligations under Exchange rules for the Hybrid Trading

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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> Amendment No. 1, which replaced and superseded the original filing in its entirety, modified the proposed rule change to: (1) clarify the nature of a CBOE Market-Maker’s obligation to quote “continuously” in order to incorporate a “99% standard” applicable to electronic quotes; and (2) provide that Hybrid Market-Makers are not required to use the QRM Mechanism.

System and Hybrid 2.0 Platform (“Hybrid”) to help them manage their quotations. The text of the proposed rule change, as amended, is below. Proposed new language is underlined; proposed deletions are in [brackets].

Rule 1.1. Definitions

When used in these Rules, unless the context otherwise requires:

(a)-(bbb) No change.

Continuous Electronic Quotes

(ccc) With respect to a Market-Maker who is obligated to provide continuous electronic quotes on the Hybrid Trading System or Hybrid 2.0 Platform (“Hybrid Market Maker”), the Hybrid Market-Maker shall be deemed to have provided “continuous electronic quotes” if the Hybrid Market-Maker provides electronic two-sided quotes for 99% of the time that the Hybrid Market-Maker is required to provide electronic quotes in an appointed option class on a given trading day. If a technical failure or limitation of a system of the Exchange prevents the Hybrid Market-Maker from maintaining, or prevents the Hybrid Market-Maker from communicating to the Exchange, timely and accurate electronic quotes in a class, the duration of such failure shall not be considered in determining whether the Hybrid Market-Maker has satisfied the 99% quoting standard with respect to that option class. The Exchange may consider other exceptions to this continuous electronic quote obligation based on demonstrated legal or regulatory requirements or other mitigating circumstances.

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Rule 8.7 – Obligations of Market-Makers

(a) – (c) No change.

(d) Market Making Obligations in Applicable Hybrid Classes

The following obligations in this paragraph (d) are only applicable to Market-Makers trading classes on the CBOE Hybrid System and only in those Hybrid classes. As such, this paragraph has no applicability to non-Hybrid classes. This paragraph is not applicable to Remote Market-Makers, who instead will be subject to the obligations imposed by Rule 8.7(e). Unless otherwise provided in this Rule, Market-Makers trading classes on the Hybrid System remain subject to all obligations imposed by CBOE Rule 8.7. To the extent another obligation contained elsewhere in Rule 8.7 is inconsistent with an obligation contained in paragraph (d) of Rule 8.7 with respect to a class trading on Hybrid, this paragraph (d) shall govern trading in the Hybrid class.

These requirements are applicable on a per class basis depending upon the percentage of volume a Market-Maker transacts electronically versus in open outcry. With respect to making this determination, the Exchange will monitor Market-Makers' trading activity every calendar quarter to determine whether they exceed the thresholds established in [this] paragraph (d)(i). If a Market-Maker exceeds the threshold established below, the obligations contained in (d)(ii) will be effective the next calendar quarter.

For a period of ninety (90) days commencing immediately after a class begins trading on the Hybrid system, the provisions of paragraph (d)(i) shall govern trading in that class.

(i) Market-Maker Trades [Less Than] 20% or Less Contract Volume Electronically:

If a Market-Maker on the CBOE Hybrid System never transacts more than 20% (i.e., he trades 20% or less) of his contract volume electronically in an appointed Hybrid class during any calendar quarter, the following provisions shall apply to that Market-Maker with respect to that class:

(A) Quote Widths: With respect to electronic quoting, the Market-Maker will not be required to comply with the quote width requirements of CBOE Rule 8.7(b)(iv) in that class. The effectiveness of this subparagraph (i)(A) shall be in effect in each Hybrid for a period of one year commencing with the date the class begins trading on the Hybrid System.

(B) Continuous Electronic Quoting Obligation: The Market-Maker will not be obligated to quote electronically in any designated percentage of series within that class. If a Market-Maker quotes electronically, its undecremented quote must be for at least ten contracts ("10-up"), unless the underlying primary market disseminates a 100-share quote, in which case the Market-Maker's undecremented quote may be for as low as 1-contract ("1-up"). The ability to quote 1-up when the underlying primary quotes 100 shares is expressly conditioned on the process being automated (i.e., a Market-Maker may not manually adjust his quotes to reflect 1-up sizes). Quotes must automatically return to at least 10-up when the underlying primary market no longer disseminates a 100-share quote. Market-Makers that have not automated this process may not avail themselves of the relief provided herein. The ability to quote 1-up shall operate on a pilot basis and shall terminate February 17, 2006.

(C) Continuous Open Outcry Quoting Obligation: In response to any request for quote by a [floor broker or DPM representing an order as agent]member or PAR Official, Market-Makers must provide a two-sided market complying with the quote width requirements contained in Rule 8.7(b)(iv) for a minimum of ten contracts for non-broker-dealer orders and one contract for broker-dealer orders.

(D) In-Person Quoting Requirement: Any volume transacted electronically will not count towards the Market-Maker's in-person requirement contained in Rule 8.7.03(B).

(ii) Market-Maker Trades More Than 20% Contract Volume Electronically:

If a Market-Maker on the CBOE Hybrid System transacts more than 20% of his contract volume electronically in an appointed Hybrid class during any calendar quarter, commencing the next calendar quarter he will be subject to the following quoting obligations in that class for as long as he remains in that class:

(A) Quote Widths: The Market-Maker must comply with the quote width requirements contained in Rule 8.7(b)(iv).

(B) Continuous Electronic Quoting Obligation: A Market-Maker will be required to maintain continuous electronic [two-sided ]quotes (as defined in Rule 1.1(ccc)) [for at least ten contracts (undecremented size)] in 60% of the series of his/her appointed class[es]. The initial size of a Market-Maker's quote must be for at least ten contracts (undecremented size). If the underlying primary market disseminates a 100-share quote, a Market-Maker's undecremented quote may be for as low as 1-contract ("1-up"), however, this ability is expressly conditioned on the process being automated (i.e., a Market-Maker may not manually adjust his quotes to reflect 1-up sizes). Quotes must automatically return to at least 10-up when the underlying primary market no longer disseminates a 100-share quote. Market-Makers that have not automated this process may not avail themselves of the relief provided herein. The ability to quote 1-up shall operate on a pilot basis and shall terminate February 17, 2006.

(C) Continuous Open Outcry Quoting Obligation: In response to any request for quote by a [floor broker or DPM representing an order as agent] member or PAR Official, in-crowd Market-Makers must provide a two-sided market complying with the current quote width requirements contained in Rule 8.7(b)(iv) for a minimum of ten contracts for non-broker-dealer orders and one contract for broker-dealer orders.

(iii) The obligations and duties of Market-Makers set forth in paragraphs (d)(i) and (d)(ii) apply to a Market-Maker on a per class basis and only when the Market-Maker is quoting in a particular class on a given trading day (e.g., if on a given trading day a Market-Maker is quoting in 1 of his/her 10 appointed classes, the Market-Maker has quote width, continuous electronic quoting and, to the extent the Market-Maker is present in the trading crowd, continuous open outcry quoting obligations in that class; the continuous electronic quoting obligation in subparagraph (d)(ii)(B) applies to 60% of the series of that class while the Market-Maker is quoting). The obligations and duties are not applicable to an appointed class if a Market-Maker is not quoting in that appointed class.

(iv) A Market-Maker that is in the trading crowd but that is not quoting electronically or in open outcry in an appointed class must provide an open outcry two-sided market complying with the current quote width requirements contained in Rule 8.7(b)(iv) for a minimum of ten contracts for non-broker-dealer orders and one contract for broker-dealer orders in response to a request for quote by a member or PAR Official directed at that Market-Maker or when, in response to a general request for a quote by a member of PAR Official, a market is not then being vocalized by a reasonable number of Market-Makers. A Market-Maker may also be called upon by an Exchange official designated by the Board of Directors to submit a single quote or maintain continuous quotes in one or more series of a class to which the Market-Maker is

appointed whenever, in the judgment of such official, it is necessary to do so in the interest of maintaining a fair and orderly market.

(e) Obligations of Remote Market-Makers (RMMs): The following obligations apply only to RMMs:

(i) An RMM[s] must provide legal-width, continuous [two-sided, legal-width quotations]electronic quotes (as defined in Rule 1.1(ccc)) in 60% of the series of [their]its appointed class[es]. The initial size of an RMM's quote must be for at least ten contracts (undecrement size). [The Exchange may consider exceptions to this quoting requirement based on demonstrated legal or regulatory requirements or other mitigating circumstances (e.g., excused leaves of absence, personal emergencies, or equipment problems).] If the underlying primary market disseminates a 100-share quote, an RMM's undecrement quote may be for as low as 1-contract ("1-up"), however, this ability is expressly conditioned on the process being automated (i.e., an RMM may not manually adjust its quotes to reflect 1-up sizes). Quotes must automatically return to at least 10-up when the underlying primary market no longer disseminates a 100-share quote. RMMs that have not automated this process may not avail themselves of the relief provided herein. The ability to quote 1-up shall operate on a pilot basis and shall terminate February 17, 2006.

The obligations and duties of an RMM set forth in this paragraph (e)(i) apply to an RMM on a per class basis and only when the RMM is logged on to the CBOE Hybrid system and quoting electronically in a particular class on a given trading day (e.g., if on a given trading day an RMM is logged in and quoting electronically in 1 of its 10 appointed classes, the RMM has quote width and continuous electronic quoting obligations in that class; the continuous electronic quoting obligation applies to 60% of the series of that class while the RMM is logged on to the

CBOE Hybrid system and quoting electronically in that class). The obligations and duties are not applicable to an appointed class if an RMM is not logged in and quoting electronically in that appointed class.

(ii) An RMM may be called upon by an Exchange official designated by the Board of Directors to submit a single electronic quote or maintain continuous electronic quotes in one or more series of a class to which the RMM is appointed whenever, in the judgment of such official, it is necessary to do so in the interest of maintaining a fair and orderly market.

(iii) – (vi) No change.

. . . Interpretations and Policies:

.01 - .13 No change.

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#### Rule 8.13. Preferred Market-Maker Program

(a) No change.

(b) Eligibility. Any Exchange Market-Maker type (e.g. Remote Market-Maker, Lead Market-Maker, and Designated Primary Market-Maker) may be designated as a Preferred Market-Maker, however, a recipient of a Preferred Market-Maker order will only receive a participation entitlement for such order if the following provisions are met:

(i) – (ii) No change.

(iii) The Preferred Market-Maker must comply with the quoting obligations applicable to its Market-Maker type under Exchange rules and must provide continuous [two-sided quotations]electronic quotes (as defined in Rule 1.1(ccc)) in at least 90% of the series of each class for which it receives Preferred Market-Maker orders.

(c) No change.

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**Rule 8.15A. Lead Market-Makers in Hybrid Classes**

(a) No change.

(b) LMM Obligations: LMMs are required to:

(i) provide continuous [market quotations]electronic quotes (as defined in Rule 1.1(ccc)) that comply with the bid/ask differentials permitted by Rule 8.7(b) in 90% of the option series within their assigned classes;

(ii) – (vi) No change.

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**Rule 8.18. Quote Risk Monitor Mechanism**

Each Market-Maker who is obligated to provide and maintain continuous electronic quotes (as defined in Rule 1.1(ccc)) in an option class traded on the Hybrid Trading System or the Hybrid 2.0 Platform (“Hybrid Market-Maker”) may establish parameters by which the Exchange will activate the Quote Risk Monitor (“QRM”) Mechanism. Hybrid Market-Makers that use the QRM Mechanism shall specify, for each such option class in which the Hybrid Market-Maker is engaged in trading, a maximum number of contracts for such option class (the “Contract Limit”) and a rolling time period in seconds within which such Contract Limit is to be measured (the “Measurement Interval”). When the Exchange determines that the Hybrid Market-Maker has traded more than the Contract Limit for such option class during any rolling Measurement Interval, the QRM Mechanism shall cancel all electronic quotes that are being disseminated with respect to that Hybrid Market-Maker in that option class until the Hybrid Market-Maker refreshes those electronic quotes.

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## Rule 8.85. DPM Obligations

(a) Dealer Transactions. Each DPM shall fulfill all of the obligations of a Market-Maker under the Rules, and shall satisfy each of the following requirements in respect of each of the securities allocated to the DPM. To the extent that there is any inconsistency between the specific obligations of a DPM set forth in subparagraphs (a)(i) through (a)(xi) of this Rule and the general obligations of a Market-Maker under the Rules, subparagraphs (a)(i) through (a)(xi) of this Rule shall govern. Each DPM shall:

(i) provide continuous [market quotations]electronic quotes (as defined in Rule 1.1(ccc)) for each class and series allocated to it and assure that its disseminated market quotations are accurate;

(ii) – (xii) No change.

(b) – (e) No change.

. . . Interpretations and Policies:

.01 - .03 No change.

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## Rule 8.93. e-DPM Obligations

Each e-DPM shall fulfill all of the obligations of a Market-Maker and of a DPM under the Rules (except those contained in Rules 8.85(a)(i),(iv),(v) and (vii)-(x), 8.85(b), 8.85(c)(i) and (v), and 8.85(e)), and shall satisfy each of the following requirements:

(i) provide continuous [two-sided quotations]electronic quotes (as defined in Rule 1.1(ccc)) in at least 90% of the series of each allocated class, or alternatively, respond to 98% of Requests for Quotes (RFQs) if RFQ functionality is enabled as determined by the Exchange;

(ii) – (xi) No change.

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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 Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it had received on the proposed rule change. The text of these statements may be examined at the places specified in Item III below. 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

1. Purpose

**Proposed CBOE Rule 1.1(ccc)**

The purpose of the proposed change to CBOE Rule 1.1 is to define the nature of a CBOE Market-Maker's obligation to provide "continuous" electronic quotes in an option class traded on Hybrid. This continuous electronic quoting obligation is contained in various CBOE rules – including CBOE Rules 8.7(d)(ii)(B), 8.7(e), 8.13(b)(iii), 8.14(b)(2), 8.15A(b)(i), 8.85(a)(i), and 8.93(i) – and these rules in turn prescribe the percentage of the series of an option class with respect to which specified types of Market-Makers ("Hybrid Market-Makers") have an obligation to provide continuous electronic quotes.

Proposed CBOE Rule 1.1(ccc) will provide that a Hybrid Market-Maker satisfies the continuous electronic quoting obligation by providing electronic quotes for 99% of the time that the Hybrid Market-Maker is obligated to provide electronic quotes in an appointed option class on a given trading day. Proposed CBOE Rule 1.1(ccc) recognizes that there is always an interval

between successive electronic quotes and that “continuous” electronic quoting cannot literally preclude all gaps in electronic quoting. In addition, gaps in electronic quoting are expected in certain circumstances. For instance, a Hybrid Market-Maker requires time to repost electronic quotes either after the quantity associated with an electronic quote has been exhausted by trades done at the quoted price or after electronic quotes have been canceled pursuant to the Quote Risk Monitor covered by proposed CBOE Rule 8.18.

In applying the proposed definition, the Exchange notes that the duration of a Hybrid Market-Maker’s continuous electronic quoting obligation, and the percentage of series to which that obligation applies, varies depending on the particular type of Market-Maker. For instance, the Exchange rules impose a continuous electronic quoting obligation for the time the Exchange is open for trading in 100% of the series in each of a Designated Primary Market-Maker’s (“DPM”) appointed classes, in 90% of the series in each of an Electronic DPM’s (“e-DPM”) appointed classes, and in 90% of the series in each of a Lead Market-Maker’s (“LMM”) appointed classes. The Exchange thus believes that these types of Market-Makers should be deemed to have provided continuous electronic quotes with respect to the applicable percentage of series in an option class if the respective DPM, e-DPM, or LMM has provided electronic quotes for 99% of the time that the Exchange is open for trading in that option class on a given trading day. The Exchange rules also impose a continuous electronic quoting obligation in 60% of the series in the respective Market-Maker’s or Remote Market-Maker’s (“RMM”) appointed class which applies only during the time the Market-Maker is quoting in the class or the RMM is logged onto Hybrid and quoting in that class. The Exchange thus believes that these two types of Market-Makers should be deemed to have provided continuous electronic quotes with respect to the applicable percentage of series in an option class if the respective Market-Maker or RMM

has provided electronic quotes for 99% of the time that he is quoting in the class (in the case of a Market-Maker) or logged into Hybrid and quoting in that option class (in the case of an RMM) on a given trading day. Consequently, in calculating compliance with CBOE Rule 1.1(ccc), any time interval during which the Market-Maker or RMM has ceased quoting in that option class (e.g., while taking breaks, during lunch or upon ceasing trading for the day) would not be considered.

The Exchange believes that the 99% standard sets an appropriately high threshold for continuous electronic quoting, while also recognizing the circumstances under which a Hybrid Market-Maker may require a brief time interval in order to post new electronic quotes. This 99% standard is similar to one contained in a rule submitted by the Pacific Exchange, Inc. ("PCX") and approved by the Commission.<sup>4</sup>

The Exchange does not believe that a Hybrid Market-Maker has failed to quote continuously if Exchange technical problems prevent electronic quotes from being provided. Accordingly, if a technical failure or limitation in an Exchange system prevents a Hybrid Market-Maker from maintaining, or communicating to the Exchange, timely and accurate electronic quotes, proposed CBOE Rule 1.1(ccc) would exclude the duration of that technical failure or limitation in determining whether the Hybrid Market-Maker has satisfied the 99% continuous electronic quote obligation with respect to that option class.

Proposed CBOE Rule 1.1(ccc) will also provide that the Exchange may consider other exceptions to the continuous electronic quote obligation based on demonstrated legal or

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<sup>4</sup> See Securities Exchange Act Release No. 51740 (May 25, 2005), 70 FR 32686 (June 3, 2005) (SR-PCX-2005-64) (notice of filing and order granting accelerated approval to SR-PCX-2005-64).

regulatory requirements or other mitigating circumstances.<sup>5</sup> This provision is the same as an existing provision with respect to continuous electronic quoting obligations of RMMs contained in CBOE Rule 8.7(e). The Exchange believes it is appropriate to apply the same considerations to all Hybrid Market-Makers with continuous electronic quoting obligations and including this provision within the text of proposed CBOE Rule 1.1(ccc) accordingly reflects that principle. The Exchange is also proposing to amend various rules to include cross-references to the definition of “continuous electronic quotes” contained in proposed CBOE Rule 1.1(ccc). The Exchange will conduct regulatory surveillance for compliance with the 99% continuous electronic quote requirement set forth in CBOE Rule 1.1(ccc).

The Exchange is proposing various clarifying changes to CBOE Rule 8.7 respecting Market-Maker and RMM quoting obligations in order to clarify the intent and application of the rule that the continuous electronic quoting obligations apply on a per class basis and only during the time the respective Market-Maker is quoting or respective RMM is logged onto Hybrid and quoting, and to clarify certain open outcry quoting obligations. First, the changes make clear that obligations and duties of Market-Makers, as set forth in paragraph (d) of CBOE Rule 8.7, apply to a Market-Maker on a per class basis and only when the Market-Maker is quoting in a particular class on a given trading day (e.g., if on a given trading day a Market-Maker is quoting in 1 of his 10 appointed classes, the Market-Maker has quote width, continuous electronic

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<sup>5</sup> Mitigating circumstances that may be considered by the Exchange may include, but is not limited to, instances where a technical failure or limitation in a Hybrid Market-Maker’s system prevents the Hybrid Market-Maker from maintaining, or communicating to the Exchange, timely and accurate electronic quotes. However, a pattern or practice of technical failures or limitations, or the excessive frequency of technical failures or limitations, may also be considered by the Exchange in determining whether to except the period of time from the continuous electronic quoting requirements.

quoting and, to the extent the Market-Maker is present in the trading crowd, continuous open outcry quoting obligations in that 1 class; the continuous electronic quoting obligation applies in 60% of the series of that class while the Market-Maker is quoting in that class). The obligations and duties are not applicable to an appointed class if a Market-Maker is not quoting in an appointed class. The clarifications also make clear that, under certain circumstances, a Market-Maker present in the trading crowd may still be obligated to provide a quote in an appointed class that he is not currently quoting in electronically or in open outcry. Specifically, a Market-Maker in the trading crowd must provide an open outcry two-sided market complying with the Exchange rules on quote width and size in response to a request for quote directed at that Market-Maker or when, in response to a general request for a quote, a market is not then being vocalized in that series by a reasonable number of Market-Makers. These obligations are derived from CBOE Rule 8.7(b), which describes various conditions that trigger a Market-Maker's duty to verbalize a market in a particular option series. In addition, a Market-Maker may also be called upon by an Exchange official designated by the Board of Directors to submit a single quote or maintain continuous quotes in one or more series of a class to which the Market-Maker is appointed whenever, in the judgment of such official, it is necessary to do so in the interest of maintaining a fair and orderly market. This Exchange official provision is parallel to language that is already provided in paragraph (e) for RMMs.

Second, the changes make clear the obligations and duties of RMMs, as set forth in paragraph (e) of CBOE Rule 8.7, apply to an RMM on a per class basis and only when the RMM is logged on to the CBOE Hybrid system and quoting in a particular class on a given trading day (e.g., if on a given trading day an RMM is logged in and quoting in 1 of its 10 appointed classes, the RMM has quote width and continuous electronic quoting obligations in that 1 class; the

continuous electronic quoting obligation applies in 60% of the series of that class while the RMM is logged in and quoting in that class). The obligations and duties are not applicable to an appointed class if an RMM is not logged in and quoting in that appointed class. Clarifying language proposed to be added to paragraph (e) make clear these obligations and duties of RMMs.

Finally, the Exchange is proposing to amend the text in paragraphs (d)(i)(C) and (d)(ii)(C) of CBOE Rule 8.7, which pertains to the continuous open outcry quoting obligation of Market-Makers. The revised text will provide that the open outcry quoting obligation is triggered in response to a request for quote by a member or Exchange PAR Official. As currently written, the obligation is only triggered in response to a request for quote from a floor broker or a DPM representing an order as agent, the later of which is an outdated reference because DPMs no longer perform an agency function.<sup>6</sup>

### **Proposed CBOE Rule 8.18**

Through this rule change, the Exchange is also seeking to codify in its rules a service CBOE offers Hybrid Market-Makers to help them manage their quotations. As discussed above, CBOE Rules require Hybrid Market-Makers to maintain continuous electronic quotes. To comply with this requirement, each Hybrid Market-Maker can employ its own proprietary quotation and risk management systems to determine the prices and sizes at which it quotes. In addition, Hybrid also has the QRM Mechanism, which is designed to help Hybrid Market-Makers manage their quotations in related option series.

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<sup>6</sup> See Securities Exchange Act Release No. 52798 (November 18, 2005), 70 FR 71344 (November 28, 2005) (order approving amendments relating to the removal of agency responsibilities from DPMs and the establishment of PAR Officials).

A Hybrid Market-Maker's risk in an options class is not limited to the risk in a single series of that class. Rather, a Hybrid Market-Maker typically is active in quoting in multiple option classes, and each such option class can comprise dozens of individual option series. Under the Hybrid systems, trades are automatically effected against the Hybrid Market-Maker's then current quote. As a result, a Hybrid Market-Maker faces exposure in all series of a class, requiring that the Hybrid Market-Maker off-set or otherwise hedge its overall position in a class. The QRM functionality described in Proposed CBOE Rule 8.18 helps Hybrid Market-Makers limit this overall exposure and risk. Specifically, the functionality permits a Hybrid Market-Maker to establish parameters in the Hybrid to cancel its electronic quotes in all series of an option class until the Hybrid Market-Maker refreshes those electronic quotes.

Under proposed CBOE Rule 8.18, each Hybrid Market-Maker that elect to use the functionality would be required to specify two parameters that the QRM Mechanism would use to determine when that Hybrid Market-Maker's quotes should be cancelled. In particular, each Hybrid Market-Maker is required to specify a maximum number of contracts for each option class (the "Contract Limit") and a rolling time period in seconds during which such Contract Limit is to be measured (the "Measurement Interval").

When the QRM Mechanism determines that the Hybrid Market-Maker has traded more than the Contract Limit for any option class during any rolling Measurement Interval, the QRM Mechanism automatically cancels all of the Hybrid Market-Maker's quotes in any series of that option class. By limiting its exposure across series, a Hybrid Market-Maker is better able to quote aggressively in an option, knowing that the QRM Mechanism will automatically cancel all its quotations in a class when its exposure limit is hit.

The Exchange notes that the proposed rule would not relieve a Hybrid Market-Maker of its obligations to provide continuous electronic quotes under the Exchange rules nor to provide “firm” quotes pursuant to the requirements of CBOE Rule 8.51.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,<sup>7</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>8</sup> in particular, in that it is 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, in general, to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change would impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

No written comments were either solicited or received with respect to the proposed rule change.

III. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change, as amended, is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

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

<sup>8</sup> 15 U.S.C. 78f(b)(5).

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2005-93 on the subject line.

Paper comments:

- Send paper comments in triplicate to Nancy M. Morris, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2005-93. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying in the Commission's Public Reference Room. Copies of such filing also will be available for inspection and copying at the principal office of CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make publicly available. All submissions should refer to File Number SR-CBOE-2005-93 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

After careful review, the Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder, applicable to a national securities exchange.<sup>9</sup> In particular, the Commission believes that the proposed rule change is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires among other things, that the rules of the Exchange are 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, in general, to protect investors and the public interest.

The Commission believes that the proposed QRM Mechanism should provide Hybrid Market-Makers assistance in effectively managing its quotations. In conjunction with the implementation of the QRM Mechanism, CBOE proposes to define the nature of Hybrid Market-Makers' continuous electronic quoting obligations under its rules. The Commission believes that it is consistent with the Act to allow CBOE to define "continuous electronic quotes" as providing electronic two-sided quotes for 99% of the time that the Hybrid Market-Maker is required to provide electronic quotes in an appointed option class on a given trading day. The Commission notes that when the QRM Mechanism is triggered for an option class it will automatically cancel all of the Hybrid Market-Maker's quotes in any series of that option class. The Commission believes that the proposed definition of "continuous electronic quotes" should provide a Hybrid Market-Maker a brief amount of time to update its quotes after the QRM Mechanism has canceled its quotes in an option class.

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<sup>9</sup> In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

In addition, CBOE proposes certain clarifying changes to CBOE Rule 8.7 regarding Market-Maker and RMM quoting obligations. Specifically, CBOE proposes to clarify the intent and application of the rule that the continuous electronic quoting obligations apply on a per class basis and only during the time the respective Market-Maker is quoting or respective RMM is logged onto Hybrid and quoting, and to clarify certain open outcry quoting obligations. The Commission believes that these clarifying changes are appropriate and consistent with the Act.

The Commission notes that the proposal does not alter the obligations of Hybrid Market-Makers, except for the fact that it will specifically define what it means to provide continuous electronic quotes. The Commission also notes that CBOE has represented that it will conduct routine surveillance for Hybrid Market-Maker compliance with the 99% standard for continuous electronic quotes set forth in CBOE Rule 1.1(ccc).

CBOE has requested that the Commission find good cause for approving the proposed rule change prior to the thirtieth day after publication of notice thereof in the Federal Register. The Commission notes that similar proposals to provide protection from risk for market makers have been approved for other options exchanges.<sup>11</sup> The Commission believes that granting accelerated approval of the proposal should allow Hybrid Market-Makers to have similar protections from the risk associated with an excessive number of near simultaneous executions in a single options class. Accordingly, the Commission finds good cause, pursuant to Section

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<sup>11</sup> See Securities Exchange Act Release Nos. 51049 (January 18, 2005), 70 FR 3756 (January 26, 2005) (SR-BSE-2004-52); 51050 (January 18, 2005), 70 FR 3758 (January 26, 2005) (SR-ISE-2004-31); 51740 (May 25, 2005), 70 FR 32686 (June 3, 2005) (SR-PCX-2005-64); 53148 (January 19, 2006), 71 FR 4386 (January 26, 2006) (SR-Amex-2005-131); and 53166 (January 23, 2006), 71 FR 4625 (January 27, 2006) (SR-Phlx-2006-05).

19(b)(2) of the Act,<sup>12</sup> for approving the proposed rule change, as amended, prior to the thirtieth day after the date of publication of notice thereof in the Federal Register.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-CBOE-2005-93) and Amendment No. 1 thereto be, and hereby are, approved on an accelerated basis.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

Nancy M. Morris  
Secretary

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<sup>12</sup> 15 U.S.C. 78s(b)(2).

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).