

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52888; File No. SR-CBOE-2005-83)

December 5, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to the SizeQuote Mechanism

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on October 11, 2005, the Chicago Board Options Exchange, Incorporated (“CBOE” or the “Exchange”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

CBOE proposes to modify its pilot SizeQuote Mechanism for the execution of large-sized orders in open outcry to make clear that Floor Brokers (“FBs”) may facilitate such orders with firm facilitation orders and/or solicited orders. The Exchange is also proposing to correct the text of the pilot rule in order to capitalize the phrase “SizeQuote Order” for consistency throughout the text. This change is merely a non-substantive, typographical correction. No other changes to the pilot are being requested at this time. The text of the proposed rule change is below. Proposed additions are underlined; proposed deletions are in brackets.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Chicago Board Options Exchange, Incorporated

Rules

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Rule 6.74 “Crossing” Orders

RULE 6.74. (a) – (e) No change.

(f) Open Outcry “SizeQuote” Mechanism

(i) SizeQuotes Generally: The SizeQuote Mechanism is a process by which a floor broker (“FB”) may execute and facilitate large-sized orders in open outcry. Floor brokers must be willing to facilitate the entire size of the order for which they request SizeQuotes (the “SizeQuote Order”) or to execute it against one or more solicited orders, or against a combination of solicited and facilitation orders. The appropriate Market Performance Committee shall determine the classes in which the SizeQuote Mechanism shall apply. The SizeQuote Mechanism will operate as a pilot program which expires February 15, 2006.

(A) Eligible Order Size: The appropriate MPC shall establish the eligible order size however such size shall not be less than 250 contracts.

(B) In-crowd Market Participants: The term "in-crowd market participants" (“ICMPs”) shall be as defined in CBOE Rule 6.45A.

(C) Public Customer Priority: Public customer orders in the electronic book have priority to trade with a SizeQuote [o]Order over any ICMP providing a SizeQuote response at the same price as the order in the electronic book.

(D) DPM Participation Rights: The DPM participation entitlement shall not apply to SizeQuote transactions.

(E) FBs may not execute a SizeQuote [o]Order at a price inferior to the national best bid or offer (“NBBO”). Unless a SizeQuote request is properly canceled in accordance with paragraph (iv), a FB is obligated to execute the entire SizeQuote [o]Order at a price that is not inferior to the NBBO in situations where there are no SizeQuote responses received or where such responses are inferior to the NBBO.

(ii) SizeQuote Procedure: Upon request by a FB for a SizeQuote, ICMPs may respond with indications of the price and size at which they would be willing to trade with a SizeQuote [o]Order. After the conclusion of time during which interested ICMPs have been given the opportunity to provide their indications, the FB must execute the SizeQuote [o]Order with ICMPs and/or with a firm facilitation order and/or solicited order(s) in accordance with the following procedures:

(A) Executing the Order at ICMP's Best Price: ICMPs that provided SizeQuote responses at the highest bid or lowest offer (“best price”) have priority to trade with the SizeQuote Order at that best price. Allocation of the order among ICMPs shall be prorata, up to the size of each ICMP's SizeQuote response. The FB must trade at the best price any contracts remaining in the original SizeQuote Order that were not executed by ICMPs providing SizeQuote responses.

(B) Executing the Order at a Price that Improves upon ICMP's Price by One Minimum Increment: ICMPs that provided SizeQuote responses at the best price (“eligible ICMPs”) have priority to trade with the SizeQuote Order at a price equal to one trading increment better than the best price (“improved best price”). Allocation of the order among eligible ICMPs at the improved best price shall be prorata, up to the size of each eligible ICMP's SizeQuote response. The FB must trade at the improved best price

any contracts remaining in the original SizeQuote Order that were not executed by eligible ICMPs.

(C) Trading at a Price that Improves upon ICMP's Price by More than One Minimum Increment: A FB may execute the entire SizeQuote [o]Order at a price two trading increments better than the best price communicated by the ICMPs in their responses to the SizeQuote request.

(iii) Definition of Trading Increments: Permissible trading increments are \$0.05 for options quoted below \$3.00 and \$0.10 for all others. In classes in which bid-ask relief is granted pursuant to CBOE Rule 8.7(b)(iv), the permissible trading increments shall also increase by the corresponding amount. For example, if a series trading above \$3.00 has double-width bid-ask relief, the permissible trading increment for purposes of this rule shall be \$0.20.

(iv) It will be a violation of a FB's duty of best execution to its customer if it were to cancel a SizeQuote [o]Order to avoid execution of the order at a better price. The availability of the SizeQuote Mechanism does not alter a FB's best execution duty to get the best price for its customer. A SizeQuote request can be canceled prior to the receipt by the FB of responses to the SizeQuote request. Once the FB receives a response to the SizeQuote request, if he or she were to cancel the order and then subsequently attempt to execute the order at an inferior price to the previous SizeQuote response, there would be a presumption that the FB did so to avoid execution of its customer order in whole or in part by others at the better price.

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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 CBOE included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed

rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

CBOE Rule 6.74(f), which relates to the open outcry "SizeQuote" Mechanism, was approved on a pilot basis in February 2005 and will expire in February 2006.³ This pilot rule provides a process by which a FB, using his or her exercise of due diligence to execute orders at the best price(s), may execute and facilitate large-sized orders in open outcry. For purposes of the pilot rule, the minimum qualifying order size is 250 contracts⁴ and FBs must stand ready to facilitate the entire size of the order for which they request SizeQuotes (referred to as the "SizeQuote Order"). The SizeQuote procedure currently works in the following manner:

- A FB holding an order for at least 250 contracts must specifically request a SizeQuote from in-crowd market participants ("ICMPs").⁵ Upon such a request by a FB, ICMPs may respond with indications of the price and size at which they would be willing to trade with a SizeQuote Order. ICMPs may respond with any size and price they desire (subject to the rules governing the current market maker

³ See Securities Exchange Act Release No. 51205 (February 15, 2005), 70 FR 8647 (February 22, 2005) (approving SR-CBOE-2004-72 on a pilot basis through February 15, 2006).

⁴ The appropriate Exchange committee determines the classes in which SizeQuote operates and may vary the minimum qualifying order size, provided that such number may not be less than 250 contracts.

⁵ Pursuant to CBOE Rule 6.45A, "Priority and Allocation of Trades on the CBOE Hybrid System," in-crowd market participant includes an in-crowd Market-Maker, an in-crowd DPM, and a floor broker representing orders in the trading crowd.

obligation requirements) and as such are not obligated to respond with a size of at least 250 contracts.⁶ The rule provides that FBs may not execute a SizeQuote Order at a price inferior to the national best bid or offer (“NBBO”). Paragraph (f)(i)(E) clarifies that unless a SizeQuote request is properly canceled in accordance with paragraph (iv), a FB is obligated to execute the entire SizeQuote Order at a price that is not inferior to the NBBO in situations where there are no SizeQuote responses received or where such responses are inferior to the NBBO.

- After the conclusion of the time during which interested ICMPs have been given the opportunity to provide their indications, the FB will execute the SizeQuote Order he or she is holding with ICMPs or with a facilitation order, or both, in accordance with procedures specified in the rule, which vary depending upon whether the SizeQuote Order is being executed at the ICMP’s best price,⁷ at a price that improves upon the ICMP’s price by one minimum increment,⁸ or at a

⁶ CBOE Rule 8.7(d), “Market Making Obligations in Applicable Hybrid Classes,” requires Market-Makers to respond to any request by a FB for a market with a legal-width (as defined in CBOE Rule 8.7(b)(iv)), 10-contract minimum size quote in classes trading on the CBOE Hybrid System.

⁷ ICMPs that provided SizeQuote responses at the highest bid or lowest offer (“best price”) have priority to trade with the SizeQuote Order at that best price. For example, assume a FB requests a SizeQuote and ICMPs respond with a market quote of \$1.00 – 1.20 for 1,000 contracts. This quote constitutes the “best price” and those ICMPs that responded have priority at those prices. If the FB chooses to trade at either of those prices, the SizeQuote order will be allocated pro-rata to those ICMPs that responded with a quote at the best price, up to the size of their respective quotes. If in the above example the SizeQuote order is for more than 1,000 contracts, the FB must trade the balance with a facilitation order at the best price. ICMPs that did not respond to the SizeQuote response would not be eligible to participate in the allocation of this trade.

⁸ ICMPs that provided SizeQuote responses at the best price (“eligible ICMPs”) have priority to trade with the SizeQuote Order at a price equal to one minimum increment better than the best price (“improved best price”). Minimum increments are governed by CBOE Rule 6.42, “Minimum Increments for Bids and Offers.” The term “minimum increment” is synonymous with “trading increment.” Accordingly, using the example

price that improves upon the ICMP's best price by more than one minimum increment.⁹

- The Rule also provides that it will be a violation of a FB's duty of best execution to its customer if it were to cancel a SizeQuote Order to avoid execution of the order at a better price. The availability of the SizeQuote Mechanism does not alter a FB's best execution duty to get the best price for its customer. A SizeQuote request can be canceled prior to the receipt by the FB of responses to the SizeQuote request. Once the FB receives a response to the SizeQuote request, if he or she were to cancel the order and then subsequently attempt to execute the order at an inferior price to the previous SizeQuote response, there would be a presumption that the FB did so to avoid execution of its customer order in whole or in part by others at the better price.

CBOE is now proposing to modify the pilot program to enable a FB to execute a SizeQuote Order with either a firm facilitation order, one or more solicited orders, or a combination of the FB's facilitation order and such solicited order(s). CBOE believes that making this change to the pilot rule is consistent with existing Exchange rules that enable members to facilitate large customer orders by crossing them with orders for firm accounts or

above, eligible ICMPs, if they desire, have priority at prices of \$1.05 and \$1.15 of up to 1,000 contracts. If the FB chooses to trade at either of those prices, the SizeQuote order will be allocated pro-rata at the improved best price to those eligible ICMPs that responded with a quote at the best price, up to the size of their respective quotes. If the SizeQuote order is for more than 1,000 contracts, the FB must trade the balance with a facilitation order at the improved best price. ICMPs that did not respond to the SizeQuote response would not be eligible to participate in the allocation of this trade.

⁹ A FB may execute the entire SizeQuote Order with a facilitation order at a price two minimum increments better than the best price communicated by the ICMPs in their responses to the SizeQuote request. Using the example in note 7 above, a FB could trade the SizeQuote order with a facilitation order at \$1.10. ICMPs would not be able to participate in the trade at that price.

orders solicited from other sources.¹⁰ The procedures for executing a SizeQuote Order will remain unchanged under Rule 6.74(f), as amended, and solicited orders will be treated as facilitated orders in all respects for purposes of the operation of the SizeQuote Mechanism algorithm.

The Exchange believes it is reasonable to modify the pilot program in order to clarify that it includes solicited orders. The revisions, in pertinent part, benefit FB customers by expanding the number of potential “facilitations” (and thus enable customers to receive executions on orders that may not have been otherwise executable) and benefit members by allowing them to facilitate customer orders in crossing transactions without exposing their own capital to market risk, while at the same time maintaining the existing in-crowd market participation opportunities through the auction market.

Finally, the Exchange is also proposing to correct the text of the pilot rule in order to capitalize the phrase “SizeQuote Order” for consistency throughout the text. This change is merely a non-substantive, typographical correction.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,¹¹ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹² in particular, in that it is designed to promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect

¹⁰ See Securities Exchange Act Release No. 22273 (July 29, 1985), 50 FR 31449 (August 2, 1985) (SR-CBOE-85-23) (order approving a proposed change to CBOE Rules 6.74 and 6.53 to expand the provisions governing facilitations to allow for the crossing of a public customer order with a “facilitation” order solicited from another source).

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

investors and the public interest.

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

CBOE does not believe that the proposed rule change will 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 solicited or received with respect to the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

(A) by order approve such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2005-83 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-9303.

All submissions should refer to File Number SR-CBOE-2005-83. 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 Section. Copies of such filing also will be available for inspection and copying at the principal office of the 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 available publicly. All submissions should refer to File Number SR-CBOE-2005-83 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.¹³

Jonathan G. Katz
Secretary

¹³ 17 CFR 200.30-3(a)(12).