SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-55246; File No. SR-CBOE-2006-62)

February 6, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change as Modified by Amendment No. 1 Thereto Relating to its Index Obvious Error Rule

I. Introduction

On July 7, 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")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend CBOE Rule 24.16, which is the Exchange's rule applicable to the nullification and adjustment of transactions in index options, options on exchange-traded funds ("ETFs"), and options on HOLDing Company Depository ReceiptS ("HOLDRS"). On October 30, 2006, the CBOE submitted Amendment No. 1 to the proposed rule change. The proposed rule change, as amended, was published for comment in the Federal Register on December 20, 2006.[3] The Commission received no comment letters on the proposal. This order approves the proposed rule change as modified by Amendment No. 1.

II. Description of the Proposed Rule Change

The Exchange is proposing to amend Rule 24.16 in order to: (i) re-define what constitutes an "obvious price error;" (ii) provide for a Market-Maker to Market-Maker adjustment of obvious price errors (currently such erroneous transactions are subject to

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 Securities Exchange Act Release No. 54926 (December 13, 2006), 71 FR 76393.

nullification); (iii) eliminate the nullification and adjustments provisions for erroneous quantity errors; and (iv) make various non-substantive changes to the text of Rule 24.16.

Specifically, an "obvious price error" would be deemed to have occurred for series trading with normal bid-ask differentials as established in CBOE Rule 8.7(b)(iv) when the execution price of a transaction is above or below the "fair market value"[4] of the option by at least: $0.125 for options trading under $2; $0.20 for options trading at or above $2 and up to $5; $0.25 for options trading above $5 and up to $10; $0.40 for options trading above $10 and up to $20; and $0.50 for options trading above $20. For series trading with bid-ask differentials that are a multiple of the widths established in Rule 8.7(b)(iv), the prescribed error amount would have the same multiple applied to the amounts prescribed above.

Second, the proposal revises the obvious price error provision as it relates to the handling of transactions involving only CBOE Market-Makers. Under the current rule, such erroneous price transactions are nullified. Under the proposal, CBOE-Market-Maker-to-CBOE-Market-Maker transactions would be subject to adjustment. In applying the proposed CBOE Market-Maker adjustment provision to index options and options on ETFs or HOLDRs, the adjustment price would be equal to the fair market value of the option minus the minimum error amount in the case of an erroneous sell transaction or the fair market value plus the minimum error amount in the case of an erroneous buy transaction. If the adjusted price is not in a multiple of the

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4 Fair market value is defined in Rule 24.16 as the midpoint of the national best bid and national best offer for the series (across all exchanges trading the option). In multiply listed issues, if there are no quotes for comparison purposes, fair market value shall be determined by Trading Officials. For singly-listed issues and for transactions occurring as part of the Rapid Opening System ("ROS trades") or Hybrid Opening System ("HOSS"), the Exchange clarified in the proposed rule change that the fair market value shall be the midpoint of the first quote after the transaction(s) in question that does not reflect the erroneous transaction(s).

applicable minimum trading increment, the adjusted price would be rounded down (up) to the next price that is a multiple of the applicable minimum trading increment with respect to an erroneous sell (buy) transaction.

Third, the proposal would eliminate obvious quantity errors as a type of transaction that is subject to obvious error review. The elimination of this provision is consistent with the Exchange's current rule for equity options, which does not have an obvious error review for quantity errors.[5]

Lastly, the proposal would make various non-substantive changes to CBOE Rule 24.16, such as making cross-reference updates to correspond to the above-described revisions, changing the title of the rule to reflect its application to options on ETFs and HOLDRS (currently the title only references index options), clarifying that fair market value is to be determined by Exchange Trading Officials in accordance with the provisions of the definition of fair market value, and making other technical changes.

. 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[6] and, in particular, the requirements of Section 6(b) of the Act[7] and the rules and regulations thereunder. Specifically, the Commission finds that the proposal is consistent with

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5 See CBOE Rule 6.25(a).

6 In approving this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

7 15 U.S.C. 78f(b).

Section 6(b)(5) of the Act,[8] in that the proposal promotes just and equitable principles of trade, prevents fraudulent and manipulative acts, removes impediments to and perfects the mechanism of a free and open market and a national market system, and, in general, protects investors and the public interest.

The Commission considers that in most circumstances trades that are executed between parties should be honored. On rare occasions, the price of the executed trade indicates an "obvious error" may exist, suggesting that it is unrealistic to expect that the parties to the trade had come to a meeting of the minds regarding the terms of the transaction. In the Commission's view, the determination of whether an "obvious error" has occurred should be based on specific and objective criteria and subject to specific and objective procedures. The revised scale for identifying the minimum error amount for an obvious price error and the elimination of obvious quantity errors set out a clear and objective methodology for determining when an obvious error has occurred. The proposed amendments with respect to obvious error transactions involving only CBOE Market Makers also establish specific and objective criteria governing the adjustment of such trades. In addition, the technical conforming and clarifying changes made by the proposed rule change, including the clarification with respect to the role of Trading Officials, should help facilitate understanding and application of CBOE Rule 24.16. Therefore, the Commission believes that the proposed rule change is consistent with the Act.

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8 15 U.S.C. 78f(b)(5).

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[9] that the proposed rule change (SR-CBOE-2006-62), as modified by Amendment No. 1, be, and it hereby is, approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[10]

Florence E. Harmon
Deputy Secretary

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9 15 U.S.C. 78s(b)(2).

10 17 CFR 200.30-3(a)(12).