

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77553; File No. SR-CBOE-2016-009)

April 7, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change Relating to LMMs and DPMs

I. Introduction

On February 8, 2016, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”)¹ and Rule 19b-4 thereunder,² a proposed rule change to amend its rules relating to Lead Market-Makers (“LLMs), Designated Primary Market-Makers (“DPMs”) and Supplemental Market-Makers (“SMMs”). The proposed rule change was published for comment in the Federal Register on February 26, 2016.³ The Commission received no comments on the proposal. This order approves the proposed rule change.

II. Description of the Proposed Rule Change⁴

The Exchange proposes to (i) reorganize, simplify and make consistent certain text relating to LMM and DPM obligations generally, (ii) amend its Rules related to LMMs, (iii) delete outdated references in its Rules to SMMs and other obsolete language and (iv) make other clarifying changes.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ See Securities Exchange Act Release No. 77200 (February 22, 2016), 81 FR 9910 (“Notice”).

⁴ A more detailed description of the proposed rule change appears in the Notice. See Notice, supra note 3.

Specifically, the Exchange proposes to make modifications to Rules 8.15 (pertaining to LMMs in Hybrid 3.0 classes), 8.15A (pertaining to LMMs in Hybrid classes) and 8.85 (pertaining to DPMs) to modify the descriptions of certain obligations of LMMs and DPMs (e.g., obligations related to quote accuracy, bid/ask differentials, minimum size and trading rotations, competitive markets and promotion of the Exchange, and material operational or financial change notifications) to be more consistent with each other.⁵ The Exchange notes that LMMs and DPMs have substantially similar functions and obligations (including the same continuous quoting obligations, along with the same participation entitlement percentages), and therefore, having consistent language with respect to these obligations will simplify its rules and reflect the similar roles served by LMMs and DPMs.⁶

Of significance, CBOE proposes to change the opening quoting obligations of LMMs and DPMs. CBOE Rules 8.15A(b)(iv) and 8.85(a)(xi) require LMMs and DPMs, respectively, to ensure that a trading rotation is initiated promptly following the opening of the underlying security in 100% of the series of each allocated class by entering opening quotes as necessary. The Exchange proposes to modify the opening quote requirement to require that opening quotes must be entered within one minute in any series that is not open due to the lack of a quote. The proposed rule change also modifies the Rules' language to provide that the timing of the opening quoting obligation begins after the initiation of an opening rotation on the Exchange rather than after the opening of the underlying security.⁷

⁵ See Notice, supra note 3, at 9913.

⁶ See id. Currently, the primary difference between LMMs and DPMs relates to their appointment terms. An LMM receives an appointment for a limited term (e.g., one month), while a DPM serves in that role until it resigns or the Exchange removes it from that role pursuant to Rule 8.90.

⁷ See Notice, supra note 3, at 9913.

CBOE also proposes to impose a continuous quoting obligation on LMMs in Hybrid 3.0 classes.⁸ LLMs in Hybrid classes currently must provide continuous electronic quotes in the lesser of 99% of the non-adjusted option series or 100% of the non-adjusted option series minus one call-put pair, with the term “call-put pair” referring to one call and one put that cover the same underlying instrument and have the same expiration date and exercise price.⁹ According to CBOE, its rules currently do not prescribe for LMMs a continuous electronic quoting requirement for Hybrid 3.0 classes, though CBOE has historically assumed a requirement of at least 90% of the series of each appointed class for 99% of the time.¹⁰ CBOE now proposes to codify for LMMs a continuous quoting requirement for Hybrid 3.0 classes to be identical to the existing requirement for LMMs assigned to Hybrid classes.¹¹

The Exchange also proposes modifications to Rules 8.15, 8.15A, 8.83 and 8.85 as they relate to the Off-Floor DPM and Off-/On-Floor LMM programs. For instance, CBOE proposes to amend Rule 8.83(g) to conform Hybrid 3.0 classes to Hybrid classes by providing that in a Hybrid 3.0 class in which an Off-Floor DPM has been appointed, the Exchange also would be

⁸ See Notice, supra note 3, at 9915.

⁹ See CBOE Rule 8.15A(b)(i).

¹⁰ See Notice, supra note 3, at 9915.

¹¹ See id. As proposed, this obligation would not apply to intra-day add-on series on the day during which such series are added for trading, and would apply to an LMM’s appointed classes collectively. CBOE would determine compliance with an LMM’s continuous electronic quoting obligation on a monthly basis (however, determining compliance with this obligation on a monthly basis would not relieve an LMM from meeting this obligation on a daily basis, nor would it prohibit the Exchange from taking disciplinary action against an LMM for failing to meet these obligations each trading day). Further, the proposed Rule would provide that when the underlying security for a class is in a limit up-limit down state, LMMs in Hybrid 3.0 classes would have no quoting obligations in the class. The Exchange represents that these obligations are identical to the obligations currently imposed on LMMs in Hybrid classes, as well as DPMs in Hybrid 3.0 classes. See Notice, supra note 3, at 9915.

permitted to appoint an On-Floor LMM, which would be eligible to receive a participation entitlement under current Rule 8.15B with respect to orders represented in open outcry.¹²

CBOE also proposes that the Exchange have the discretion to appoint an On-Floor LMM in any class in which an Off-Floor LMM has been appointed, and that any such On-Floor LMM would be eligible to receive a participation entitlement under current Rule 8.15B with respect to orders represented in open outcry.¹³ The Exchange also proposes to treat Off-Floor LMMs in a manner similar to the current treatment of Off-Floor DPMs with respect to their quoting requirement and appointments.

CBOE also proposes to make changes to eliminate obsolete references, including those related to individual LMMs, SMMs, an expired pilot program, the former Linkage Plan, and strike price interval, bid/ask differential and quote continuity requirements. Further, CBOE proposes to make non-substantive or technical modifications to Rules 1.1(fff) and (ggg), 3.2, 6.1A, 6.2A, 6.45A, 6.45B, 6.74, 8.7, 8.13, 8.14, 8.15, 8.15A, 8.83, 8.85, 17.50, 22.14, 24.9, and 29.17, including amendments to correct typographical errors, update headings, update cross-references to Rules 8.15, 8.15A and 8.15B, make the rule text more plain English, and make the rule text more consistently organized, numbered and worded.

III. Discussion

The Commission believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements

¹² The provisions in current Rule 8.15A related to the on-floor LMM program would apply to Hybrid 3.0 classes pursuant to proposed Rule 8.15.

¹³ See proposed Rule 8.15, Interpretation and Policy .01(c). This proposed change is consistent with the program for Off-Floor DPMs/On-Floor LMMs and would extend the applicability of the provision to Hybrid and Hybrid 3.0 classes that have Off-Floor LMMs (rather than Off-Floor DPMs):

of Section 6(b) of the Act.¹⁴ Specifically, the Commission believes the proposed rule change is consistent with the Section 6(b)(5)¹⁵ requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. In addition, the Commission believes the proposed rule change is consistent with the Section 6(b)(5)¹⁶ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Commission believes that the proposed rule changes to amend Rules 8.15, 8.15A and 8.85 to revise descriptions of obligations of LMMs in Hybrid 3.0 classes, LMMs in Hybrid classes, and DPMs, respectively, as well as to combine the LMM obligations into a single rule for all classes, should benefit investors by providing more uniformity to the Rules related to market participants with substantially similar functions that are subject to analogous obligations. In addition, the Commission believes that CBOE's proposal to impose a continuous quoting obligation on LMMs in Hybrid 3.0 classes that mirrors the existing continuous quoting obligation in Hybrid classes should help facilitate transactions in securities in a manner that protects investors and the public interest.

The CBOE's proposal also slightly modifies the opening quoting obligations of LMMs and DPMs to include a specific time by which opening quotes must be entered. The

¹⁴ 15 U.S.C. 78f(b).

¹⁵ 15 U.S.C. 78f(b)(5).

¹⁶ Id.

Commission believes that the Exchange's proposal to require an opening quotation within one minute rather than promptly should provide DPMs and LMMs with clearer guidance regarding the opening quote obligation, which should facilitate compliance by LMMs and DPMs with this obligation. The Commission notes the Exchange's representation that nearly all series open for trading within this timeframe on a daily basis.¹⁷ Therefore, the Commission believes this time frame should not be unduly burdensome to LMMs and DPMs while still helping to ensure a timely opening.

Further, the Commission believes the proposed revisions to the descriptions of the Off-Floor DPM and Off-/On-Floor LMM programs should clarify these programs, including with respect to appointments. Among other things, CBOE's proposal extends to Hybrid 3.0 classes certain provisions currently applicable to Hybrid classes, including on-floor appointments, and clarifies the effect on an on-floor appointment when an off-floor appointment is reallocated. These changes further harmonize Hybrid 3.0 with Hybrid and codify into the CBOE rules important detail regarding on and off-floor appointments.

Finally, the Commission believes that the CBOE's proposal to eliminate obsolete provisions, including those related to individual LMMs, SMMs, an expired pilot program, the former Linkage Plan, as well as references to the non-applicability of strike price intervals, bid/ask differentials, and quote continuity requirements for LEAPs, should protect investors by eliminating potential confusion that may result from incorrect references in CBOE's rules. With respect to strike price intervals, bid/ask differentials, and quote continuity requirements for LEAPs, the CBOE represents that other existing rules address those requirements¹⁸ and, therefore, the proposed rule change should have no effect on the regulatory requirements

¹⁷ See Notice, supra note 3, at 9913.

¹⁸ See Notice, supra note 3, at 9917.

applicable to CBOE market makers. The Commission notes that the non-substantive, technical changes proposed should help to reduce duplication, simplify and provide clarity in the Exchange's rules, which should benefit all CBOE market participants.

IV. Conclusion

IT IS THEREFORE ORDERED pursuant to Section 19(b)(2) of the Act¹⁹ that the proposed rule change (SR-CBOE-2016-009), be and hereby is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Robert W. Errett
Deputy Secretary

¹⁹ 15.U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).