

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52256; File No. SR-CBOE-2005-56)

August 15, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval to Proposed Rule Change and Amendments No. 1 and 2 Thereto to Amend CBOE Rule 8.7 to Extend for an Additional Six Months its Pilot Program Pertaining to Market-Maker Quote Sizes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on July 15, 2005, the Chicago Board Options Exchange, Incorporated (“CBOE” or “Exchange”) filed with the Securities and Exchange Commission (“SEC” or “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. On July 29, 2005, CBOE submitted Amendment No. 1 to the proposed rule change.³ On August 10, 2005, CBOE submitted Amendment No. 2 to the proposed rule change.⁴ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons and to approve the proposal on an accelerated basis.

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

CBOE proposes to amend CBOE Rule 8.7 to extend for an additional six months its pilot program pertaining to market-maker quote sizes. The text of the proposed rule

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 1, CBOE replaced the original rule filing in its entirety.

⁴ In Amendment No. 2, CBOE revised the text of the proposed rule change to be consistent with its current rule in order to accurately reflect the proposed rule change.

change is available on CBOE's Web site at <http://www.CBOE.com>, at CBOE's Office of the Secretary and at the Commission's Public Reference Room.

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 received on the proposed rule change. The text of these statements may be examined at the places specified in Item III 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

On August 17, 2004, the Commission approved, on a one-year pilot basis, an exception to CBOE Rule 8.7, pertaining to the general quoting obligations of Market-Makers in option classes traded on CBOE's Hybrid Trading System ("Pilot Program").⁵ The Pilot Program allows Market-Makers to submit an undecrement electronic quotation of a size as low as 1-contract ("1-up") when the underlying primary market for the option disseminates a 1-up market (i.e., a market that reflects a quotation for 100 shares of the underlying security). The ability to quote 1-up is expressly conditioned on the process being automated; in other words, a Market-Maker may not manually adjust his quotes to reflect a 1-up size quote.

CBOE believes that the Pilot Program has been effective in serving the original purpose of the rule filing. Specifically, the purpose of the Pilot Program was to address

⁵ See Securities Exchange Act Release No. 50205 (August 17, 2004), 69 FR 51869 (August 23, 2004) (approving SR-CBOE-2003-39).

the fact that Market-Makers may be subject to heightened and possibly inappropriate levels of risk due to their obligation to maintain electronic two-sided quotes for at least 10-contracts, whereas there is no restriction on the stock specialist's ability to disseminate a 1-up market. Additionally, when the underlying market disseminates a 1-up quote, it substantially restricts the amount of liquidity available in that security to 100 shares on that particular side of the market, which limits a Market-Maker's ability to hedge his/her positions and increases his/her financial exposure.

CBOE requests that the Pilot Program be extended for an additional six months, until February 17, 2006, to allow CBOE time to further consider whether this Pilot Program is a useful tool for Market-Makers to manage their risks when the underlying primary market quotes 1-up. This additional time would also provide Market-Makers with the opportunity to modify their systems to quote 1-up on an automated basis.

(2) Statutory Basis

The Exchange believes that the proposed rule change is consistent with the Act and the rules and regulations under the Act applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act.⁶ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁷ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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

The Exchange neither received or solicited written comments on the proposal.

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:

- 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-2005-56 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2005-56. 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 available publicly. All submissions should refer to File Number SR-CBOE-2005-56 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

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.⁸ In particular, the Commission believes that the proposal is consistent with Section 6(b)(5) of the Act,⁹ which requires 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 remove impediments to and perfect the mechanism of

⁸ In approving this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

⁹ 15 U.S.C. 78f(b)(5).

a free and open market and a national market system, and in general to protect investors and the public interest.

The Commission believes that extending the Pilot Program for an additional six months is necessary to provide the Commission with adequate information to evaluate the effect of the Pilot Program. The Commission notes that in approving the Pilot Program, it requested a report from CBOE based on ten months of data during the first year of the Pilot Program, to be due two months prior to expiration of the Pilot Program. The Commission received a letter from CBOE approximately one month prior to the end of the Pilot Program. The letter from CBOE, which was based on a very limited analysis of the program, stated that in its opinion, the Pilot Program did not have any impact on CBOE's best quote and size of best quote or the quality of the CBOE market. CBOE stated in the letter that it believed that additional Market-Makers would utilize the Pilot Program if given more time to make the required systems changes.

Should the Exchange decide to propose to extend, or to obtain permanent approval of, the Pilot Program, the Commission expects to receive a more comprehensive analysis of the entire Pilot Program two months prior to the expiration of this six-month extension, so that the Commission may evaluate the effectiveness of the Pilot Program.

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,¹⁰ for approving the proposed rule change, as amended, prior to the thirtieth day after the publication of notice thereof in the Federal Register. The Pilot Program is set to expire on August 17, 2005, and as such, to allow the Pilot Program to continue to operate pursuant to proper authority, the Commission believes it is appropriate to accelerate

¹⁰ 15 U.S.C. 78s(b)(2).

approval. Accordingly, the Commission finds that good cause exists, consistent with Section 6(b)(5) of the Act,¹¹ to approve the proposal on an accelerated basis.

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change, as amended (SR-CBOE-2005-56), is hereby approved on an accelerated basis on a pilot basis, scheduled to expire on February 17, 2006.

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

Jonathan G. Katz
Secretary

¹¹ 15 U.S.C. 78f(b)(5).

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).