

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53286; File No. SR-CBOE-2006-16)

February 14, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Order Granting Accelerated Approval to a Proposed Rule Change to Amend CBOE Rule 8.7 to Implement CBOE's 1-Up Program on a Permanent Basis

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 February 8, 2006, 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 CBOE. The Commission is publishing this notice to solicit comments on the proposed rule change 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

The CBOE proposes to amend CBOE Rule 8.7 to make its 1-up Pilot Program permanent. The text of the proposed rule change is available on the CBOE's Web site (<http://www.cboe.com>), at the 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of the proposed rule change is to amend CBOE Rule 8.7 to request permanent approval of the CBOE's pilot program that allows Market-Makers to submit an undecrement electronic quotation of a size as low as one 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 "Program"). 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.³

On August 17, 2004, the Commission approved the Program on a one-year pilot basis.⁴ Subsequently, on August 15, 2005, the Program was extended for an additional six months, until February 17, 2006, to allow the CBOE time to further consider whether the Program is a useful tool for Market-Makers to manage their risks when the underlying primary market quotes 1-up.⁵

The CBOE believes that the Program has been effective in serving the original purpose of the rule filing, which was to address the fact that Market-Makers may be

³ See CBOE Rule 8.7.

⁴ See Securities Exchange Act Release No. 50205 (August 17, 2004), 69 FR 51869 (August 23, 2004) (approving the pilot program as set forth in SR-CBOE-2003-39).

⁵ See Securities Exchange Act Release No. 52256 (August 15, 2005), 70 FR 48787 (August 19, 2005) (approving and extending the pilot program as set forth in SR-CBOE-2005-56).

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. Accordingly, the CBOE requests that the Program be approved on a permanent basis.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder 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) Act⁷ 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, and, in general, to protect investors and the public interest.

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

The 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.

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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. 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 at <http://www.sec.gov/rules/sro.shtml>; or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2006-16 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-2006-16. 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-2006-16 and should be submitted on or before [insert date 21 days after the date of 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 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 principals 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 the Program, by providing CBOE Market-Makers with the ability to adjust their quotation sizes to correspond to the liquidity in the underlying primary market, provides a reasonable method for Market-Makers to manage their risks

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).

when the primary market disseminates a 1-up market. The Commission notes that the Program has been operating on a pilot basis for almost 18 months and that, after evaluating quotation data relating to the Program, the CBOE believes that the Program is functioning as intended. The Commission also notes that, even though Market-Makers will have the ability to quote 1-up when the underlying primary market disseminates a 1-up market, Market-Makers should have an incentive to display competitive quotations with significant size because the CBOE's matching algorithm for allocating incoming orders in CBOE's Hybrid Trading System is based in part of the size of the Market-Maker's quotation at the best price.

The Commission finds good cause, pursuant to Section 19(b)(2) of the Act,¹⁰ for approving the proposed rule change prior to the thirtieth day after publication in the Federal Register. The Program is scheduled to expire on February 17, 2006, and as such, to allow the Program to continue to operate without interruption, the Commission believes it is appropriate to accelerate approval. The Commission notes that no comments were received in connection with the approval of the Program on a pilot basis or the approval of the extension of the pilot period for the Program. Accordingly, the Commission finds that good cause exists, pursuant to Section 6(b)(5) of the Act,¹¹ to approve the proposal on an accelerated basis.

¹⁰ 15 U.S.C. 78s(b)(2).

¹¹ 15 U.S.C. 78f(b)(5).

V. Conclusion

It is therefore ordered, pursuant to Section 19(b)(2) of the Act,¹² that the proposed rule change (SR-CBOE-2006-16), is hereby approved on an accelerated basis.

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

Nancy M. Morris
Secretary

¹² 15 U.S.C. 78s(b)(2).

¹³ 17 CFR 200.30-3(a)(12).