

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-54805; File No. SR-CBOE-2006-92)

November 21, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to the Penny Pilot Program

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 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, II, and III below, which Items have been substantially prepared by the CBOE. 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

The Exchange proposes to amend its rules to implement a Pilot Program to quote and trade certain option classes in pennies. The text of the proposed rule change is available on the Exchange’s Web site at <http://www.cboe.com>, at the Office of the Secretary, CBOE, 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 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 these statements may be examined at

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

CBOE proposes to amend its rules in connection with the Penny Pilot Program, which is scheduled to commence on January 26, 2007. Specifically, the following 12 classes<sup>3</sup> will participate in the Penny Pilot Program, which is scheduled initially to last for six months.

IWM	Ishares Russell 2000	INTC	Intel
QQQQ	QQQQ	CAT	Caterpillar
SMH	SemiConductor Holders	WFMI	Whole Foods
GE	General Electric	TXN	Texas Instruments
AMD	Advanced Micro Devices	FLEX	Flextronics International
MSFT	Microsoft	SUNW	Sun Micro

The minimum increments for all classes in the Penny Pilot Program, except for the QQQQs, will be \$0.01 for all option series below \$3 (including LEAPS), and \$0.05 for all option series \$3 and above (including LEAPS). With respect to the QQQQs, the minimum increment will be \$0.01 for all option series. For all other option classes not participating in the Penny Pilot Program, the current quoting and trading minimum increments will remain the same.

In connection with the Penny Pilot Program, CBOE proposes to amend CBOE Rule 6.42 relating to the minimum increments for option classes. In particular, CBOE proposes to include a subparagraph stating that the decimal increments for bids and offers for all series of option classes participating in the Penny Pilot Program will be announced

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<sup>3</sup> CBOE understands that another option class will be added to the Penny Pilot Program to bring the total number of classes in the Penny Pilot Program to 13.

to the membership via Regulatory Circular and published by the Exchange on its Web site. Because the Penny Pilot Program is expected to commence on January 26, 2007, on a rolling basis with one or more Pilot classes beginning on that date and the other Pilot classes quoting and trading in penny increments shortly thereafter, CBOE believes it is more appropriate to notify its members as to the minimum increments for Pilot Classes and their start date in the Pilot Program via Regulatory Circular as opposed to codifying this information in CBOE Rule 6.42. CBOE has filed for Commission approval a copy of the proposed Regulatory Circular that it intends to issue.

CBOE also proposes to amend CBOE Rule 6.54 relating to accommodation liquidations (“cabinet trades”) to state that the rule is not applicable to trading in option classes participating in the Penny Pilot Program. Currently, CBOE Rule 6.54 sets forth the terms and conditions in which cabinet trades can be executed on CBOE. Because cabinet trades involve orders priced at \$1 per option contract, the specific terms and conditions for cabinet trading are not applicable to option classes participating in the Penny Pilot Program.

Due to the anticipated demands on CBOE’s system capacity and the option industry’s capacity for processing quotations and transactions in penny increments, CBOE has implemented or intends to implement several quote mitigation strategies.

- Limitation on Messages. Pursuant to CBOE Rule 6.23A, CBOE currently limits the number of messages sent by members accessing CBOE electronically in order to protect the integrity of the Hybrid Trading System. Limiting the number of messages sent by members accessing CBOE electronically reduces the number of quotations sent by CBOE to the Options Price Reporting Authority (“OPRA”).

- Imposition of Fees. CBOE is developing an objective and fair method to encourage electronic quoters at CBOE to reduce the number of quotations that are sent to CBOE by imposing fees that will go into effect on February 1, 2007.<sup>4</sup>
- Amendment to Market-Maker Obligations. CBOE proposes to amend CBOE Rule 8.7 to modify the continuous electronic quoting obligation of Market-Makers and Remote Market-Makers (“RMMs”). Currently, as set forth in CBOE Rule 8.7(d)(ii) and (e), Market-Makers and RMMs, respectively, are obligated to provide continuous electronic quotes in 60% of the series of his/her appointed option class. CBOE proposes to amend these obligations to provide that Market-Makers and RMMs shall provide continuous electronic quotes in 60% of the series of his/her appointed class that have a time to expiration of less than nine months. CBOE believes that excluding series that are nine months or more to expiration, i.e., LEAPS, from Market-Makers’ and RMMs’ continuous quoting obligations should reduce the number of quotes CBOE disseminates to OPRA, while continuing to impose upon Market-Makers and RMMs significant quoting obligations. CBOE also notes that this proposed change is consistent with CBOE Rule 5.8 which provides that the continuity rules do not apply to option series until the time to expiration is less than nine months.<sup>5</sup>

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<sup>4</sup> See Securities Exchange Act Release No. 54804 (November 21, 2006) (File No. SR-CBOE-2006-98).

<sup>5</sup> The Commission recently approved a similar proposal from the Philadelphia Stock Exchange. See Securities Exchange Act Release No. 54648 (October 24, 2006), 71 FR 63375 (October 30, 2006) (SR-Phlx-2006-52).

- Delisting Policy. CBOE is adopting the following delisting policy: equity option classes with national average daily volume (“ADV”) of less than 20 contracts will be delisted.
- Oversight of Member Quoting. CBOE continuously monitors the quotation activity of its members submitting electronic quotations to CBOE, and regularly notifies any member that appears to be disseminating significantly more quotations than other members. CBOE also regularly communicates with independent vendors who provide quotation services to members to encourage the vendors to modify their systems to provide efficient quotation systems and to alert them whenever it appears that users of their system appear to be submitting significantly more quotations than other members.

Finally, CBOE, along with the other options exchanges, intends to submit to the Commission following the fourth month of the Penny Pilot Program (i.e., by the end of May 2007) a report analyzing the first three months of the Penny Pilot Program. In particular, CBOE anticipates that its report will assess the impact of the changes to the minimum increments during the first three months of the Program, including its effects on (i) market participants and customers; (ii) market performance and quality, such as quoted spreads, effective spreads, and the displayed size in the Pilot classes; and (iii) OPRA, vendor and exchange capacity.

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with Section

6(b) of the Act,<sup>6</sup> in general, and furthers the objectives of Section 6(b)(5) of the Act,<sup>7</sup> in particular, in that the proposed rule change is designed 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.

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

The Exchange 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

Written comments on the proposed rule change were neither solicited nor received.

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 Exchange 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

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<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(5).

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](mailto:rule-comments@sec.gov). Please include File No. SR-CBOE-2006-92 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 No. SR-CBOE-2006-92. 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 at <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 the Exchange. 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 No. SR-CBOE-2006-92 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.<sup>8</sup>

Nancy M. Morris  
Secretary

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<sup>8</sup> 17 CFR 200.30-3(a)(12).