

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-54823; File No. SR-CBOE-2005-111)

November 28, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating to Multiple Representation Exception Procedures

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 December 16, 2005, 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 prepared by the CBOE. On October 17, 2006, the Exchange filed Amendment No. 1 to the proposed rule change.³ The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

CBOE proposes to amend CBOE Rule 6.55, “Multiple Representation Prohibited,” to establish certain exceptions to the rule requirements prohibiting multiple representation by Market-Makers and to update other procedures in the rule that have become outdated. The Exchange also proposes to make a corresponding change to CBOE Rule 6.74, “Crossing Orders.” The text of the proposed rule change appears below. Additions are underlined; deletions are [bracketed].

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ Amendment No. 1 replaces and supersedes the original filing in its entirety.

Chicago Board Options Exchange, Incorporated

Rules

Rule 6.55. Multiple Representation Prohibited

(a) No member, for any account in which the member has an interest or on behalf of a customer, shall maintain with more than one broker orders for the purchase or sale of the same option contract or other security, or the same combination of option contracts or other securities, with the knowledge that such orders are for the account of the same principal.

(b) Except in accordance with procedures established by the appropriate Procedure Committee or with such Committee's permission in individual cases, no Market-Maker shall enter or be present in a trading crowd while a Floor Broker present in the trading crowd is holding an order on behalf of the Market-Maker's individual account or an order initiated by the Market-Maker for an account in which the Market-Maker has an interest.

. . . Interpretations and Policies:

.01 A Market-Maker may permissibly enter a trading crowd in which a Floor Broker is present who holds an order on behalf of the Market-Maker's individual account or an order initiated by the Market-Maker for an account in which the Market-Maker has an interest if one of the following [three] procedures is followed:

(a) The Market-Maker makes the Floor Broker aware of the Market-Maker's intention to enter the trading crowd and the Floor Broker cancels the order[time stamps the order ticket for the order and writes the notation "Cancel" or "CXL" next to the time stamp]. If the Market-Maker wishes to re-enter the order upon the Market-Maker's exit from the trading crowd, a new

order must be entered[Floor Broker must at that time again time stamp the order ticket and write the notation "Reentry" or "RNTRY" next to such subsequent time stamp].

(b) The Market-Maker cancels the order [by giving the Floor Broker a written cancellation of the order which is time-stamped by the Market-Maker immediately] prior to [its transmission to the Floor Broker]the Market-Maker's entry into the trading crowd. If the Market-Maker wishes to re-enter the order upon the Market-Maker's exit from the trading crowd, a new order [ticket] must be [used]entered.

[(c) The Market-Maker cancels the order by taking the order ticket for the order back from the Floor Broker, provided that the Market-Maker allows the Floor Broker to retain a copy of the order ticket (which copy the Floor Broker must time-stamp at the time of cancellation and retain for the Floor Broker's records). If the Market-Maker wishes to re-enter the order upon the Market-Maker's exit from the trading crowd, a new order ticket must be used.]

.02 Exchange regulatory circulars concerning joint accounts should be consulted in connection with procedures governing the simultaneous presence in a trading crowd of participants in and orders for the same joint account.

.03 Subject to the requirements of Rule 6.9 or 6.74, as applicable, a Market-Maker may permissibly enter or be present in a trading crowd in which a Floor Broker is present who holds (a) a solicited order on behalf of the Market-Maker's individual or joint account or (b) a solicited order initiated by the Market-Maker for an account in which the Market-Maker has an interest, provided that the Market-Maker makes the Floor Broker aware of the Market-Maker's intention to enter or to be present in the trading crowd and the Market-Maker refrains from trading in-person on the same trade as the original order. It is the responsibility of the Market-Maker

utilizing these procedures to ascertain whether solicited orders for the Market-Maker's joint account have been entered in a trading crowd prior to the Market-Maker trading the joint account in-person.

.04 A Market-Maker may permissibly enter or be present in a trading crowd in which a Floor Broker is present who holds an order on behalf of the Market-Maker's individual account or an order initiated by the Market-Maker for an account in which the Market-Maker has an interest, provided that the Market-Maker makes the Floor Broker aware of the Market-Maker's intention to enter or to be present in the trading crowd and the Market-Maker refrains from trading in-person on the same trade as the order being represented by the Floor Broker.

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Rule 6.74. "Crossing" Orders

(a) – (f) No change.

. . . Interpretations and Policies:

.01 - .06 No change.

.07 [A Floor Broker, pursuant to paragraph (d) of this Rule, may not cross an order that he is holding with an order from a market-maker that is then in the trading crowd.]Reserved.

.08 No change.

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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 the places specified in Item IV below. The CBOE 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

Currently, CBOE Rule 6.55 provides in relevant part that, except in accordance with procedures established by the appropriate Procedure Committee or with such Procedure Committee's permission in individual cases, no Market-Maker shall enter or be present in a trading crowd while a Floor Broker present in the trading crowd is holding an order on behalf of the Market-Maker's individual account or an order initiated by the Market-Maker for an account in which the Market-Maker has an interest. As discussed below, this principle against multiple representation of a Market-Maker account has also been extended to cover joint account activity in certain circumstances.

Exceptions to the multiple presentation prohibition are noted in the Interpretations and Policies to CBOE Rule 6.55. For example, Interpretation and Policy .01 provides procedures under which a Market-Maker may enter a trading crowd in which a Floor Broker is present who holds an order on behalf of the Market-Maker's individual account or an order initiated by the

Market-Maker for an account in which the Market-Maker has an interest.⁴ In addition, Interpretation and Policy .02 advises CBOE members to consult Exchange regulatory circulars for procedures governing the simultaneous presence in a trading crowd of participants in and orders for the same joint account.⁵ CBOE Rule 6.55, and the exceptions thereto, are designed to prevent persons such as Market-Makers from being disproportionately represented in the trading crowd.⁶

The Exchange is now proposing to adopt additional exception procedures for the handling of solicited orders, as well as for the handling of a Market-Maker's orders generally. These new exception procedures are intended to be in addition to, and not a limitation of, the existing exception procedures identified in CBOE Rule 6.55, its Interpretations and Policies, and related regulatory circulars concerning joint accounts. In addition, the Exchange is proposing to amend the text of Interpretation and Policy .01 to CBOE Rule 6.55, which has become outdated.

⁴ These procedures generally require the cancellation of the order resting with the Floor Broker upon the Market-Maker's entry into the trading crowd and allow the Market-Maker to re-enter the order with the Floor Broker upon the Market-Maker's exit from the crowd.

⁵ Exchange Regulatory Circulars RG01-60 and RG01-128 set forth Exchange procedures and requirements for trading in joint accounts in equity options, index options, and options on exchange-traded funds ("ETFs"). See Securities Exchange Act Release No. 44152 (April 5, 2001), 66 FR 19262 (April 13, 2001) (order approving Regulatory Circular RG01-60 governing joint account trading in equity options) and Securities Exchange Act Release No. 44433 (June 15, 2001), 66 FR 33589 (June 22, 2001) (order approving Regulatory Circular RG01-128 governing joint account trading in certain index options and options on ETFs).

⁶ An account using multiple orders or quotes could be represented disproportionately because, when an execution is divided among competing brokers, an account using multiple orders or quotes would receive a larger share of the execution than an account using a single order or quote.

First, with respect to solicitations, under the Exchange's rules, a member representing an order (the "original order") may solicit customers, non-member broker-dealers, members and member firms, and Market-Makers to transact in-person or by order with the original order. When the solicitation and crossing procedures in CBOE Rules 6.9, "Solicited Transactions,"⁷ and 6.74, "Crossing Orders",⁸ as applicable, are read in conjunction with the current multiple representation prohibitions of CBOE Rule 6.55, the result is that a Market-Maker present in the trading crowd is generally able to represent a solicited order in-person for his individual account or for an account in which he has an interest (including a joint account). However, unless otherwise excepted, a Market-Maker is generally prohibited from being present in the trading crowd at the same time a Floor Broker is representing (i) a solicited order on behalf of the Market-Maker's individual account or a joint account in which the Market-Maker is a participant while the Market-Maker is trading on behalf of that account, or (ii) a solicited order initiated by

⁷ An original order and the solicited person or order are subject to the procedures and priority provisions of CBOE Rule 6.9, which generally provide that a solicited person or order gains priority over the trading crowd only if the terms of the original order are disclosed to the crowd prior to solicitation, the original order is continuously represented, and the solicited person or order betters the market and matches the original order bid or offer. If these requirements are not satisfied, non-solicited Market-Makers and Floor Brokers with non-solicited discretionary orders in the trading crowd have priority over the solicited person or order.

⁸ CBOE Rule 6.74 describes the manner in which a Floor Broker may cross orders, including solicitation orders. Crossing procedures in the Rule provide the solicited person or order generally with priority over all other parties (other than public customer orders) for a certain percentage of contracts of the original order. For example, paragraph (d) of CBOE Rule 6.74, which supercedes the priority provisions of paragraph (d) of CBOE Rule 6.9, provides procedures pursuant to which a Floor Broker is entitled to cross 40% (or 20%, as applicable) of an original order with a solicited order (after public customer orders are satisfied).

the Market-Maker for an account in which he has an interest, and is crossing that solicited order pursuant to CBOE Rule 6.74(d).⁹

The Exchange believes that, if certain procedures are followed to ensure that a Market-Maker present in the trading crowd is not disproportionately represented, it is not necessary to limit crossing transactions in this manner. Therefore, the Exchange is proposing to adopt Interpretation and Policy .03 to CBOE Rule 6.55 to specify additional procedures that would permit representation of solicited orders when a Market-Maker is present in the trading crowd. These procedures will be applicable for solicited orders represented by a Floor Broker while the Market-Maker is present in the crowd in essentially three scenarios: first, instances where the

⁹ Interpretation and Policy .07 to CBOE Rule 6.74 provides that a Floor Broker, pursuant to paragraph (d), may not cross an order he is holding with an order from a Market-Maker that is then present in the trading crowd. The clarification was added to CBOE Rule 6.74 because this type of multiple representation had generally been prohibited by CBOE Rule 6.55(b). See Securities Exchange Act Release No. 44394 (June 6, 2001), 66 FR 31726 (June 12, 2001) (SR-CBOE-00-43) (order approving a rule change that, among other things, adopted Interpretation and Policy .07 to CBOE Rule 6.74). Conversely, a Floor Broker can cross an order he is holding with an order from a Market-Maker that is not present in the trading crowd.

As discussed below, CBOE is proposing to eliminate the restriction in CBOE Rule 6.74, Interpretation and Policy .07 in light of the revisions being proposed to CBOE Rule 6.55. In this regard, the Exchange also notes that an exception to this prohibition currently applies in the case of joint accounts involving certain broad-based index options and options on ETFs. In those classes, joint account participants who are not trading in-person in the crowd may enter orders for the joint account with Floor Brokers even if other participants are trading in their individual accounts or the same joint account in-person. In such instances, there are no restrictions on the other joint account participants' ability to be present in the trading crowd or on the number of joint account participants that may participate on the same trade. Additionally, for equity options classes, it is currently permissible for a joint account participant to be trading in a crowd for his individual account or acting as a Floor Broker for accounts unrelated to his joint account while another participant of the joint account enters a solicited order for the joint account with other Floor Brokers. See Regulatory Circulars RG01-60 and RG01-128.

solicited order is for the Market-Maker's individual account;¹⁰ second, instances where the solicited order is for the Market-Maker's joint account, whether initiated by the Market-Maker or another joint account participant;¹¹ and, third, instances where the solicited order is initiated by a Market-Maker for an account in which he has an interest.¹²

The new procedures would provide that a Market-Maker may permissibly enter or be present in a trading crowd in which a Floor Broker is present who holds either a solicited order

¹⁰ Only a Market-Maker may initiate an order for his individual account, either in-person or by order with a Floor Broker.

¹¹ Depending on the circumstance, any joint account participant can initiate an order for a joint account, either in-person or by order with a Floor Broker. The new procedure would therefore apply to solicited orders that the Market-Maker in the trading crowd initiates for the joint account himself and to solicited orders that other joint account participants initiate for the joint account. In this regard, the Exchange notes that certain exception procedures already exist that relate to instances where one participant in a joint account is present in the trading crowd while another participant is trading in-person or by order. For example, in the case of certain index options and options on ETFs, joint accounts may be simultaneously represented in a crowd by participants trading in-person for the joint account. In addition, joint account participants who are not trading in-person in a crowd may enter orders for the joint account with Floor Brokers even if other participants are trading the same joint account in-person. See Regulatory Circular RG01-128. In the case of equity options, currently a joint account may be simultaneously represented in a trading crowd only by participants trading in-person and orders for a joint account may not be entered in a crowd where a participant of the joint account is trading in-person for the joint account. However, if no participant is trading in-person for the joint account, orders may be entered via Floor Broker so long as the same option series is not represented by more than one Floor Broker. In addition, when a Market-Maker is trading in a crowd for his individual account or acting as a Floor Broker for accounts unrelated to his joint account, another participant of the joint account may either trade in-person for the joint account or enter orders for the joint account with other Floor Brokers. See Regulatory Circular RG01-60.

¹² The procedures in proposed Interpretation and Policy .03 to CBOE Rule 6.55 relate only to the "solicited order" in a solicitation transaction. Instances where a Market-Maker order is the "original order" in a solicitation transaction may qualify for another one of the exception procedures described in Interpretations and Policies .01, .02, and proposed .04 of CBOE Rule 6.55.

on behalf of the Market-Maker's individual or joint account or a solicited order initiated by the Market-Maker for an account in which he has an interest, provided that the Market-Maker advises the Floor Broker of the Market-Maker's intention to enter or be present in the trading crowd. The Market-Maker must also refrain from trading in-person on the same trade as the original order. In the case of joint accounts, the proposal also provides that it is the responsibility of the Market-Maker to ascertain whether solicited orders for his joint account have been entered with a Floor Broker in a trading crowd prior to the Market-Maker trading for the joint account in-person.

In light of the new procedures in proposed Interpretation and Policy .03 to CBOE Rule 6.55, the Exchange is proposing a corresponding amendment to eliminate Interpretation and Policy .07 to CBOE Rule 6.74.¹³ A corresponding amendment to the text of CBOE Rule 6.9 is not necessary.

On the one hand, the Exchange believes these procedures will provide members with additional flexibility in determining how to handle crossing transactions. The Exchange also believes these changes will ensure that a Market-Maker in the trading crowd is not disadvantaged when participating in solicited trades compared to other solicited persons that are not present in the trading crowd, and will thus promote liquidity in the marketplace by encouraging the Market-Maker to be present in the crowd. This is because a Market-Maker will now be permitted to have a solicited order represented by a Floor Broker pursuant to CBOE Rule 6.74(d) while he is

¹³ See supra note 9.

present in the trading crowd if the required procedures are followed.¹⁴ This would be permissible whether the solicited order is initiated by the Market-Maker himself (in the case of an individual account or an account in which he has an interest) or the solicited order is initiated by another joint account participant (in the case of the Market-Maker's joint account(s)).

On the other hand, the changes are also consistent with the purpose of CBOE Rule 6.55 because the new procedures would only allow a Market-Maker present in the trading crowd to have a solicited order represented by a Floor Broker if the requirements of CBOE Rules 6.9 or 6.74, as applicable, are satisfied and the Market-Maker refrains from trading in-person on the same trade as the original order. As a result, the new procedures will continue to ensure that a Market-Maker participating in a solicitation (whether in-person or by order) is not disproportionately represented in the trading crowd. For the foregoing reasons, the Exchange believes the proposed changes are reasonable and appropriate, and should help CBOE maintain a fair and orderly market.

As for the second aspect of this proposal, the Exchange is also seeking to adopt procedures for an exception pertaining to the handling of orders initiated by a Market-Maker. In particular, these new procedures will provide that a Market-Maker may permissibly enter or be present in a trading crowd in which a Floor Broker is present who holds an order on behalf of the Market-Maker's individual account or an order initiated by the Market-Maker for an account in which the Market-Maker has an interest provided that the Market-Maker advises the Floor

¹⁴ By comparison, unless another exception procedure were applicable, the existing procedures would require that the Market-Maker not be present in the trading crowd to participate in a CBOE Rule 6.74(d) crossing transaction.

Broker of the Market-Maker's intention to enter or be present. The Market-Maker must also refrain from trading in-person on the same trade as the order being represented by the Floor Broker.

In comparison to proposed Interpretation and Policy .03 to CBOE Rule 6.55 (which pertains to solicited orders on behalf of a Market-Maker's individual or joint account, or solicited orders initiated by a Market-Maker for an account in which he has an interest), the procedures in proposed Interpretation and Policy .04 to CBOE Rule 6.55 will be applicable only for orders that the Market-Maker himself has placed with the Floor Broker. These procedures will not apply to instances where a joint account participant other than the Market-Maker present in the crowd is initiating an order. Rather, other joint account participants' activity via Floor Broker will continue to be subject to CBOE Rule 6.55 and the exception procedures as provided in Interpretations and Policies .02 and proposed .03 thereto.

As with the exception procedures for solicited orders, these general procedures for handling orders from a Market-Maker that is then in the trading crowd will provide members with additional flexibility in executing orders. By requiring that a Market-Maker's presence be made known to the Floor Broker and by prohibiting the Market-Maker from trading in-person in the same trade as the order represented,¹⁵ these procedures are designed to prevent a Market-Maker from being disproportionately represented in the trading crowd and have no detrimental effect on other market participants. As such, the Exchange believes that these changes are consistent with the purpose of CBOE Rule 6.55.

¹⁵ Because the Market-Maker would initiate such orders himself, he would know at all times whether a Floor Broker is concurrently representing an order on his behalf.

Finally, the Exchange is proposing to make various revisions to the text of CBOE Rule 6.55 to remove outdated references to manual processes. In particular, the Exchange is proposing to delete references in Interpretation and Policy .01 to CBOE Rule 6.55 relating to time stamping and written notations on order tickets. Due to technological advancements, these processes are now generally done electronically. In light of these changes, the Exchange is proposing to update this text by consolidating and simplifying these procedures. Whereas the procedures currently describe three different ways for a Market-Maker entering a trading crowd to manually cancel an order pending with a Floor Broker, the revised procedures under the proposal simply provide that a Market-Maker entering a crowd may either request that the Floor Broker cancel his order or the Market-Maker can cancel the order himself. If the Market-Maker wishes to re-enter the order upon his exit from the crowd, a new order must be entered.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,¹⁶ in general, and furthers the objectives of Section 6(b)(5) of the Act,¹⁷ in particular, in that it should promote just and equitable principles of trade, serve to remove impediments to, and perfect the mechanism of, a free and open market and a national market system, and protect investors and the public interest.

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.

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 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. 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 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-2005-111 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-2005-111. 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 the 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 Number SR-CBOE-2005-111 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.¹⁸

Nancy M. Morris
Secretary

¹⁸ 17 CFR 200.30-3(a)(12).