SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56860; File No. SR-CBOE-2007-59)

November 29, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change to Amend the Minimum Quote Size Requirements for Hybrid Opening System Rotations

On September 17, 2007, the Chicago Board Options Exchange, Incorporated ("CBOE" or "Exchange") filed with the Securities and Exchange Commission ("Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a proposed rule change to amend its minimum quote size requirements that are applicable to trading rotations conducted via the Hybrid Opening System ("HOSS"). The proposed rule change was published for comment in the Federal Register on October 25, 2007.[3] The Commission received no comments on the proposal. This order approves the proposed rule change.

Currently, CBOE Rule 8.7 generally requires that the initial size a market maker electronically quotes must be at least ten contracts (undecremented size) (the "10-up" requirement).[4] The Exchange proposes to amend CBOE Rule 6.2B to modify the minimum quote size requirements applicable to Market-Makers, Remote Market-Makers, Designated Primary Market-Makers, Electronic Designated Primary Market-Makers and

1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 56680 (October 19, 2007), 72 FR 60697 ("Notice").

4 If, however, the underlying primary market disseminates a 100-share best bid or offer quote (which is the equivalent of one option contract), a Market-Maker's undecremented quote may be for as low as one contract ("1-up") if the process is automated and the quote automatically returns to at least 10-up when the underlying market no longer disseminates a 100-share quote. See, e.g., CBOE Rule 8.7(d)(ii)(B).

Lead Market-Makers (collectively referred to as "Market-Makers")[5] with respect to opening rotations in CBOE Hybrid Trading System ("Hybrid") classes. Specifically, the 10-up requirement would continue to apply, except that a Market-Maker would be permitted to enter an opening quote for as low as one contract if the underlying primary market[6] disseminates less than a 1000-share best bid or offer quote (which is the equivalent of ten contracts) immediately prior to an option series opening. In contrast to the intra-day quoting requirements under CBOE Rule 8.7, this exception would not require that the opening quote process be automated or that the Market-Maker's quote size automatically return to at least 10-up when the underlying primary market no longer disseminates a minimum1000-share quote.

The Commission notes that, while the Exchange believes that the existing opening quote size requirement imposes a reasonable obligation on Market-Makers who receive certain benefits for satisfying this and other obligations, the Exchange also believes that there are instances where requiring Market-Makers to quote 10-up during an opening rotation imposes a heightened level of risk on them.[7] Accordingly, CBOE's proposal would provide limited relief from this quoting requirement during the opening rotation only.

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5 Currently, Designated Primary Market-Makers, Electronic Designated Primary Market-Makers and Lead Market-Makers are required to enter opening quotes in accordance with CBOE Rule 6.2B in 100% of the series of each appointed class; other Market-Makers and Remote Market-Makers are permitted, but not required, to enter opening quotes in accordance with CBOE Rule 6.2B. See CBOE Rules 6.2B, 8.15A (subparagraph (b)(iv) of this rule has been interpreted by the Exchange to require an LMM to enter opening quotes in 100% of the series of each appointed class), 8.85, and 8.93.

6 CBOE Rule 1.1(v) defines the term "primary market" of an underlying security as "the principal market in which the underlying security is traded."

7 See Notice, supra note 3, at 60698.

The Commission finds that the proposed rule change is consistent with the requirements of Section 6 of the Act[8] and the rules and regulations thereunder applicable to a national securities exchange.[9] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[10] which requires that a national securities exchange's rules be designed to facilitate transactions in securities, to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts and, in general, to protect investors and the public interest. The Commission notes that Market-Makers hedge their options transactions by buying and/or selling the underlying securities. When the underlying primary market for the particular equity security on which a CBOE option is based disseminates less than a 1000-share quote during CBOE's opening rotation in the respective option series, the amount of readily-accessible liquidity available to a CBOE Market-Maker in the underlying security on that particular side of the market to hedge a 10-up quote in the respective option may potentially be limited. Correspondingly, Market-Makers' ability to hedge their positions at the open might be restricted, increasing their financial exposure and risk, particularly when the Market-Maker is required to quote over multiple series during the typically active open rotation period.[11]

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8 15 U.S.C. 78(f)(b).

9 In approving this rule change, the Commission notes that it has considered the proposal's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

10 15 U.S.C. 78f(b)(5).

11 According to the Exchange, an options exchange may list 20 or more options series for an underlying stock. For example, if a Maker-Maker posts 10-up markets in twenty series, that Market-Maker would provide liquidity equivalent to 20,000 shares.

While the Commission continues to believe that CBOE's existing quote size requirements are appropriate, given the benefits that are provided to Market-Makers such as favorable margin treatment, the Commission also believes that it is reasonable to allow a limited exception for Market-Makers to lower their quote sizes to as low as one contract during opening rotations on HOSS when there is a diminished amount of liquidity in the underlying primary market. By permitting Market-Makers to limit their exposure at the opening, the Commission believes that this proposal may encourage Market-Makers to quote more competitively during HOSS opening rotations.[12] The Commission notes that CBOE's proposal would permit Market-Makers to submit an opening quote for as low as one contract only in connection with opening rotations on HOSS, though a Market-Maker would be free to quote more if it so choose. Further, the proposal would permit a Market-Maker to maintain its 1-up quote during the opening rotation until it is decremented or the Market-Maker updates its quote, at which point CBOE's continuous quoting obligation rules would apply. Finally, the Commission believes that the proposal should not detract from CBOE's ability to maintain fair and orderly openings on HOSS because, to the extent that there may be a market order imbalance on the opening, such imbalances would continue to be addressed in the same manner as they are currently handled under existing CBOE rules.

[12] Nothing in this proposal would affect a Market-Maker's obligation to honor its firm quote obligations imposed by CBOE Rule 8.51.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[13] that the proposed rule change (SR-CBOE-2007-59) be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[14]

Florence E. Harmon
Deputy Secretary

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[13] 15 U.S.C. 78s(b)(2).

[14] 17 CFR 200.30-3(a)(12).