

*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**

Because the forgoing rule change does not: (1) Significantly affect the protection of investors or the public interest; (2) impose any significant burden on competition; and (3) become operative for 30 days after the date of this filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>11</sup> and Rule 19b-4(f)(6) thereunder.<sup>12</sup>

A proposed rule change filed under 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.<sup>13</sup> However, Rule 19b-4(f)(6)(iii)<sup>14</sup> permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would permit position and exercise limits for options on IWM to remain at 500,000 option contracts for a six-month pilot period. For this reason, the Commission designates the proposed rule change to be effective and operative upon filing with the Commission.<sup>15</sup>

At any time within 60 days of the filing of such proposed rule change the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.

<sup>11</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>12</sup> 17 CFR 240.19b-4(f)(6).

<sup>13</sup> 17 CFR 240.19b-4(f)(6)(iii). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Commission has decided to waive the five-day pre-filing notice requirement.

<sup>14</sup> *Id.*

<sup>15</sup> For the purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

**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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2007-08 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-2007-08. 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 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-2007-08 and should be submitted on or before February 22, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-55154; File No. SR-CBOE-2006-92]

**Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval to Proposed Rule Change as Modified by Amendment No. 1 Thereto, Relating to the Penny Pilot Program**

January 23, 2007.

**I. Introduction**

On November 8, 2006, 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"),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend its rules to permit certain option classes to be quoted in pennies on a pilot basis. The proposed rule change was published for comment in the **Federal Register** on November 29, 2006.<sup>3</sup> The Commission received one comment letter on the proposed rule change.<sup>4</sup> On January 9, 2007, the Exchange filed Amendment No. 1 to the proposed rule change.<sup>5</sup> The Exchange responded to the comment letter on January 10, 2007.<sup>6</sup> This order approves the proposed rule change as modified by Amendment No. 1.

<sup>16</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> See Securities Exchange Act Release No. 54805 (November 21, 2006), 71 FR 69151.

<sup>4</sup> See letter to Nancy M. Morris, Secretary, Commission, from Christopher Nagy, Chair, Securities Industry and Financial Markets Association ("SIFMA") Options Committee, dated December 20, 2006 ("SIFMA Letter").

<sup>5</sup> Amendment No. 1 revised the Regulatory Circular CBOE will distribute to its members to reflect the replacement of Glamis Gold, which was delisted, with Agilent Tech, Inc. in the list of options classes permitted to be quoted in pennies. Amendment No. 1 is technical in nature, and the Commission is not publishing Amendment No. 1 for public comment.

<sup>6</sup> See letter to Nancy M. Morris, Secretary, Commission, from Patrick Sexton, Associate General Counsel, CBOE, dated January 10, 2007 ("CBOE Letter").

## II. Description of the Proposal

### A. Scope of the Penny Pilot Program

CBOE proposes to amend its rules to permit certain option classes to be quoted in pennies during a six-month pilot ("Penny Pilot Program"), which would commence on January 26, 2007. Specifically, proposed CBOE Rule 6.42 would include a subparagraph stating that decimal increments for bids and offers for all series of option classes participating in the Penny Pilot Program will be announced by Regulatory Circular. The Regulatory Circular would set forth the parameters of the Penny Pilot Program.

Currently, all six options exchanges, including CBOE, quote options in nickel and dime increments. The minimum price variation for quotations in options series that are quoted at less than \$3 per contract is \$0.05 and the minimum price variation for quotations in options series that are quoted at \$3 per contract or greater is \$0.10. Under the Penny Pilot Program, beginning on January 26, 2007, market participants would be able to begin quoting in penny increments in certain series of option classes.

The Penny Pilot Program would include the following thirteen options: Ishares Russell 2000 (IWM); NASDAQ-100 Index Tracking Stock (QQQQ); Semiconductor Holders Trust (SMH); General Electric Company (GE); Advanced Micro Devices, Inc. (AMD), (Microsoft Corporation (MSFT); Intel Corporation (INTC); Caterpillar, Inc. (CAT); Whole Foods Market, Inc. (WFMI); Texas Instruments, Inc. (TXN); Flextronics International Ltd. (FLEX); Sun Microsystems, Inc. (SUNW); and Agilent Tech, Inc. (A). The Exchange would communicate the list of options to be included in the Penny Pilot Program to its membership via Regulatory Circular.

The minimum price variation for all classes included in the Penny Pilot Program, except for the QQQQs, would be \$0.01 for all quotations in option series that are quoted at less than \$3 per contract and \$0.05 for all quotations in option series that are quoted at \$3 per contract or greater. The QQQQs would be quoted in \$0.01 increments for all options series.

CBOE commits to deliver a report to the Commission during the fourth month of the pilot, which would be composed of data from the first three months of trading. The report would analyze the impact of penny pricing on market quality and options systems capacity.

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.

### B. Quote Mitigation Strategies

To mitigate quote message traffic, CBOE has represented to the Commission that it has already implemented or intends to implement the following 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").

- *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>7</sup>

- *Delisting Policy.* CBOE is adopting the following delisting policy: equity

<sup>7</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).

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.<sup>8</sup>

## III. Discussion

After careful review of the proposal and consideration of SIFMA's comment letter and the Exchange's response thereto, the Commission finds that the proposed rule change, as modified by Amendment No. 1, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>9</sup> In particular, the Commission finds that the proposal is consistent with Section 6(b)(5) of the Act,<sup>10</sup> which requires, among other things, that the rules of an exchange be designed to promote just and equitable principles 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 that the implementation of a limited six-month Penny Pilot Program by CBOE and the five other options exchanges will provide valuable information to the exchanges, the Commission and others about the impact of penny quoting in the options market. In particular, the Penny Pilot Program will allow analysis of the impact of penny quoting on: (1)

<sup>8</sup> In addition to the quote mitigation strategies discussed above, to encourage more efficient quoting by its members, the Exchange filed a proposed rule change on November 20, 2006, that assesses an additional monthly fee, commencing on February 1, 2007, on all Market Makers who submit electronic quotes to the Exchange of \$.03 per 1,000 quotes in excess of 1,000,000 quotes. The proposed rule change was immediately effective under Section 19(b)(3)(A) of the Act. See Securities Exchange Act Release No. 54804 (November 21, 2006), 71 FR 69150 (November 29, 2006) (File No. SR-CBOE-2006-98).

<sup>9</sup> In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

<sup>10</sup> 15 U.S.C. 78f(b)(5).

Spreads; (2) transaction costs; (3) payment for order flow; and (4) quote message traffic.

The Commission believes that the thirteen options classes to be included in the penny pilot program represent a diverse group of options classes with varied trading characteristics. This diversity should facilitate analyses by the Commission, the options exchanges and others. The Commission also believes that the Penny Pilot Program is sufficiently limited that it is unlikely to increase quote message traffic beyond the capacity of market participants' systems and disrupt the timely receipt of quote information.

Nevertheless, because the Commission expects that the Penny Pilot Program will increase quote message traffic, the Commission is also approving the Exchange's proposals to reduce the number of quotations it disseminates.

SIFMA commented on the CBOE's quote mitigation proposal.<sup>11</sup> SIFMA recommends that all six of the option exchanges adopt a comprehensive and uniform quote mitigation strategy. In particular, SIFMA strongly supports the adoption of the "holdback timer" mitigation proposal as the most efficient means of reducing quotation traffic. SIFMA, however, expressed concern that the lack of uniformity among the quote mitigation proposals adopted by the exchanges will impose a burden on member firms and cause confusion for market participants, especially retail investors.

Although SIFMA urges the adoption of a uniform and comprehensive approach to quote mitigation, it does not oppose CBOE's quote mitigation proposals. In fact, SIFMA acknowledges that certain of CBOE's proposals, such as notifying members whose quote activity suggests systems malfunctions or wrong settings and delisting inactive series can contribute to quote mitigation. SIFMA, however, expressed its belief that these proposals do not go far enough to resolve the industry's concerns regarding systems capacity.

Although the Commission supports efforts to implement a uniform, industry-wide quote mitigation plan, it does not believe such efforts preclude individual exchanges from initiating their own quote mitigation strategies. The Commission agrees with CBOE that its proposed quote mitigation strategies will not lead to confusion among market participants.<sup>12</sup>

#### IV. Conclusion

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>13</sup> that the proposed rule change (SR-CBOE-2006-92), as modified by Amendment No. 1, be, and hereby is, approved on a six month pilot basis, which will commence on January 26, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>14</sup>

**Florence E. Harmon,**

*Deputy Secretary.*

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-55172; File No. SR-CBOE-2006-110]

#### Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Establishment of CBOE Stock Exchange, LLC

January 25, 2007.

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 December 26, 2006, the Chicago Board Options Exchange, Incorporated (the "CBOE" or "Exchange") filed with the Securities and Exchange Commission (the "SEC" or "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been substantially prepared by the Exchange. CBOE filed Amendment No. 1 to the proposed rule change on January 10, 2007. 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 establish CBOE Stock Exchange ("CBSX") as a facility, as that term is defined in Section 3(a)(2) of the Act,<sup>3</sup> of CBOE. CBSX will administer a fully automated marketplace for the trading of securities other than options by CBOE members. CBSX will be operated by CBOE Stock Exchange, LLC ("CBSX LLC"), a Delaware limited liability company. In

this filing, CBOE submitted to the Commission the First Amended and Restated Operating Agreement ("Operating Agreement") of CBSX LLC. The Certificate of Formation and the Operating Agreement are the source of CBSX LLC's governance and operating authority, and therefore, function in a similar manner as articles of incorporation and bylaws for a corporation. Additionally, CBOE proposes to adopt Rule 3.32 pertaining to ownership concentration and affiliation limitations.

The text of the proposed rule change is available on the Exchange's Web site (<http://www.cboe.com>), at the Office of the Secretary, CBOE, and at the Commission's Public Reference Room. The text of the proposed rule change is also available on the Commission's Web site (<http://www.sec.gov/rules/sro.shtml>).

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, 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. 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

CBOE is a registered national securities exchange under Section 6 of the Act and a self-regulatory organization ("SRO"). CBOE indicates that CBSX will be a facility of CBOE, subject to self-regulation by CBOE and oversight by the SEC. CBOE will act as the SRO for CBSX pursuant to a Services Agreement to be entered into between CBOE and CBSX LLC. CBOE will have the primary regulatory responsibility for the activities of CBSX. CBOE represents that it has adequate funds to discharge all regulatory functions related to the facility that it has undertaken to perform under the Services Agreement.<sup>4</sup>

<sup>13</sup> 15 U.S.C. 78s(b)(2).

<sup>14</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> 15 U.S.C. 78c(a)(2).

<sup>4</sup> CBOE represents that CBSX LLC will not be entitled to any revenue generated in connection with penalties, fines, and regulatory fees that may be assessed by CBOE against CBOE members in connection with trading on CBSX. Rather, all

<sup>11</sup> See SIFMA Letter, *supra* note 4.

<sup>12</sup> See CBOE Letter, *supra* note 6.