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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-69338; File No. SR-CBOE-2013-019)

April 8, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change Relating to Market-Maker Continuous Quoting Obligations

I. Introduction

On February 4, 2013, 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 CBOE’s rules relating to Market-Maker³ continuous quoting obligations. The proposed rule change was published for comment in the Federal Register on February 22, 2013.⁴ The Commission did not receive any comment letters regarding the proposal. This order approves the proposed rule change.

II. Description of the Proposal

The Exchange proposes to amend its rules to exclude intra-day add-on series (“Intra-day Adds”) from Market-Makers’ continuous quoting obligations on the day during which such series are added for trading.⁵ In addition, the Exchange proposes to permit Preferred Market-

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ CBOE Rule 8.1 defines “Market-Maker” as “an individual Trading Permit Holder [(“TPH”)] or a TPH organization that is registered with the Exchange for the purpose of making transactions as dealer-specialist on the Exchange.”

⁴ See Securities Exchange Act Release No. 68944 (February 15, 2013), 78 FR 12377 (“Notice”).

⁵ See id. at 12377. According to the Exchange, Intra-day Adds are series that are added to the Exchange system after the opening of the Exchange, rather than prior to the beginning of trading. See id.

Makers (“PMMs”),⁶ Lead Market-Makers (“LMMs”),⁷ DPMs,⁸ and Electronic DPMs (“e-DPMs”)⁹ (Market-Makers, PMMs, LMMs, DPMs, and e-DPMs are collectively referred to as “Market-Makers” unless the context provides otherwise) to receive participation entitlements in all Intra-day Adds on the day during which such series are added for trading provided that the Market-Maker meets all other requirements to receive a participation entitlement set forth in the applicable rules.¹⁰

III. Discussion and Commission’s Findings

After careful review, 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.¹¹ In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,¹² which requires, among other things, that the rules of a national securities exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect

⁶ CBOE Rule 8.13 defines “Preferred Market Maker” as a Market-Maker designated by a TPH to receive that TPH’s orders in a specific class.

⁷ CBOE Rule 8.15A defines “Lead Market-Maker” as a Market-Maker in good standing appointed by the Exchange in an option class for which a Designated Primary Market-Maker (“DPM”) has not been appointed.

⁸ CBOE Rule 8.80 defines “Designated Primary Market-Maker” as a “TPH organization that is approved by the Exchange to function in allocated securities as a Market-Maker (as defined in Rule 8.1) and is subject to the obligations under Rule 8.85.”

⁹ CBOE Rule 8.92 defines “Electronic DPM” as “a TPH organization that is approved by the Exchange to remotely function in allocated option classes as a DPM and to fulfill certain obligations required of DPMs except for Floor Broker and Order Book Official obligations.”

¹⁰ See Notice, supra note 4, 78 FR at 12377.

¹¹ In approving this proposal, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹² 15 U.S.C. 78f(b)(5).

the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.

According to CBOE, several Market-Makers have communicated to the Exchange that their trading systems do not automatically produce continuous quotes in Intra-day Adds on the trading day during which those series are added and that the only way they could quote in these series on the trading day during which they were added would be to shut down and restart their systems.¹³ Further, the Exchange states that Market-Makers have indicated that the work that would be required to modify their systems to permit quoting in Intra-day Adds would be significant and costly.¹⁴ In addition, the Exchange indicates that Intra-day Adds represent only approximately 0.0046% of the average number of series listed on the Exchange each trading day, and that Market-Makers will still be obligated to provide continuous two-sided markets in a substantial number of series in their appointed classes.¹⁵

In addition, the Exchange intends to implement changes to continuous quoting obligations. The Exchange represents that given the pending heightened quoting obligations and the considerable costs that would otherwise be involved for Market-Makers to adjust their systems to quote Intra-day Adds on the trading day during which they are listed, several PMMs have informed the Exchange that they intend to withdraw from the PMM program, while other Market-Makers have requested that the Exchange suspend their pending applications to join the PMM program.

The Exchange believes that it would be impracticable, particularly given that a number of Market-Makers use their systems to quote on multiple markets and not solely on the Exchange,

¹³ See Notice, supra note 4, 78 FR at 12378.

¹⁴ See id.

¹⁵ See id. at 12379.

for Market-Makers to turn off their entire systems to accommodate quoting in Intra-day Adds on the day during which those series are added on the Exchange. In addition, the Exchange believes this would interfere with the continuity of its market and reduce liquidity, which would ultimately harm investors and contradicts the purpose of the Market-Maker continuous quoting obligations.

The Exchange does not believe that the proposed rule change would adversely affect the quality of the Exchange's markets or lead to a material decrease in liquidity. Rather, the Exchange believes that its current market structure, with its high rate of participation by Market-Makers, permits the proposed rule change without fear of losing liquidity. The Exchange also believes that market-making activity and liquidity could materially decrease without the proposed rule change to exclude Intra-day Adds from Market-Maker continuous quoting obligations on the trading day during which they are added for trading.

The Exchange believes that this proposed relief will encourage Market-Makers to continue appointments and other TPHs to request Market-Maker appointments, and, as a result, expand liquidity in options classes listed on the Exchange to the benefit of the Exchange and its TPHs and public customers. The Exchange believes that its Market-Makers would be disadvantaged without this proposed relief, and other TPHs and public customers would also be disadvantaged if Market-Makers withdrew from appointments in options classes, resulting in reduced liquidity and volume in these classes.

In addition, the Exchange believes that the proposed rule change to clarify that Market-Makers may receive participation entitlements in Intraday Adds on the day during which such series are added for trading if it satisfies the other entitlement requirements as set forth in Exchange rules, even if the rules do not require the Market-Makers to continuously quote in

those series, will incentivize Market-Makers to quote in series in which they are not required to quote, which may increase liquidity in their appointed classes.

The Exchange's proposal to exclude Intra-day Adds from Market-Makers' continuous electronic quoting obligations on the day during which such series are added for trading would not affect Market-Makers' other obligations. For example, Market-Makers will still be required to engage in activities that constitute a course of dealings reasonably calculated to contribute to the maintenance of a fair and orderly market,¹⁶ including (1) to compete with other Market-Makers to improve markets in all series of options classes comprising their appointments; (2) to make markets that, absent changed market conditions, will be honored in accordance with firm quote rules; and (3) to update market quotations in response to changed market conditions in their appointed options classes and to assure that any market quote it causes to be disseminated is accurate.¹⁷ In addition, the proposed rule change would not excuse a Market-Maker from its obligation to submit a single quote or to maintain continuous quotes in one or more series of a class to which the Market-Maker is appointed when called upon by an Exchange official if, in the judgment of such official, it is necessary to do so in the interest of maintaining a fair and orderly market.¹⁸

The Commission notes that the Exchange believes that Market-Makers would be required to shut down and restart their systems, or make costly systems changes, in order to quote in Intra-day Adds. A requirement for Market-Makers to maintain continuous electronic quotes in

¹⁶ See CBOE Rule 8.7(a).

¹⁷ See CBOE Rule 8.7(b).

¹⁸ See CBOE Rule 8.7(d)(iv).

Intra-day Adds, which represents a minor part of Market-Makers' overall obligations, may not justify the system resources, or the disruption to trading, the Exchange states would be necessary to accommodate quoting in Intra-day Adds. Accordingly, the Commission believes that the Exchange's proposal concerning Intra-day Adds would 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.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,¹⁹ that the proposed rule change (SR-CBOE-2013-019) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.²⁰

Kevin M. O'Neill
Deputy Secretary

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¹⁹ 15 U.S.C. 78s(b)(2).

²⁰ 17 CFR 200.30-3(a)(12).