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SECURITIES AND EXCHANGE COMMISSION
[Release No. 34-71223; File No. SR-CBOE-2013-109]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Approving a Proposed Rule Change Relating to Market-Maker Appointment Cost Rebalances

January 2, 2014.

I. Introduction

On November 1, 2013, Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") 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 rules regarding Market-Maker appointment cost rebalances. The proposed rule change was published for comment in the Federal Register on November 19, 2013.[3] The Commission received no comment letters on the proposed rule change. This order approves the proposed rule change.

II. Description of the Proposed Rule Change

The Exchange is proposing to amend its rules regarding Market-Maker appointment cost rebalances. According to the Exchange, appointments to act as a Market-Maker "cost" different amounts for different classes (with no classes costing more than 1.0).[4] The Exchange places options classes into different tiers, with all the classes in a certain tier costing the same amount

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

2 17 CFR 240.19b-4.

3 See Securities Exchange Act Release No. 70856 (November 13, 2013), 78 FR 69491 ("Notice").

4 See id. at 69491.

per appointment.[5] Each Trading Permit held by a Market-Maker has an appointment credit of 1.0. For each Trading Permit the Market-Maker holds, the Market Maker may select any combination of Hybrid classes and Hybrid 3.0 classes, whose aggregate appointment cost does not exceed 1.0.[6]

Currently, on a quarterly basis, the Exchange may rebalance the tiers into which different classes fall, meaning that the Exchange can elect to move a class from one tier to another (with that class' corresponding appointment cost changing). The Exchange proposes to memorialize in proposed CBOE Rule 8.3(c)(iv) that the Exchange will announce any rebalances at least ten business days before the rebalance takes effect.[7] Under the proposal, such rebalances will be announced to Trading Permit Holders ("TPHs") via Regulatory Circular.

When the Exchange effects a rebalancing (i.e., changes the appointment cost tier for a certain class of options), the class is assigned the appointment cost of that new tier. Upon such rebalancing, each Market-Maker with a Virtual Trading Crowd ("VTC") appointment[8] will be required to hold the appropriate number of Trading Permits reflecting the revised appointment costs of the Hybrid classes constituting the Market-Maker's appointment. Accordingly, when classes are rebalanced, the sum of a Market-Maker's appointment costs cannot exceed the number of Trading Permits that a Market-Maker holds. Market-Makers manage their own appointments through an online appointment system. The system displays the relevant

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5 For example, all the classes in tier B cost 0.05 per class appointment, all the classes in tier E cost .01 per class appointment. See id.

6 See CBOE Rule 8.3(c)(iv).

7 It is the Exchange's current practice to announce such rebalances more than ten business days prior to taking effect, but this practice is not codified in CBOE's rules. See Notice, supra note 3, at 69491.

8 A VTC appointment allows a Market-Maker to quote electronically in a class.

appointment costs for each class, thereby facilitating the ability of a Market-Maker to manage its committed and available appointment credits.

The Exchange proposes to add language to CBOE Rule 8.3(c)(iv) to address situations in which a Market-Maker fails to adjust his or her appointments and, as a result, the sum of the Market- Maker's appointment costs otherwise would exceed the available appointment credits based on the number of Trading Permits the Market-Maker holds. The proposed new language states: "[i]f a Market-Maker with a VTC appointment holds a combination of appointments whose aggregate revised appointment cost is greater than the number of Trading Permits that Market-Maker holds, the Market-Maker will be assigned as many Trading Permits as necessary to ensure that the Market-Maker no longer holds a combination of appointments whose aggregate revised appointment cost is greater than the number of Trading Permits that Market-Maker holds." In the event that a Market-Maker's appointment costs exceed his or her available assignment credits as the result of a reassignment of appointment costs by the Exchange, and the Exchange needs to allocate another trading permit or permits to the Market-Maker, then the Exchange also will assess the Market-Maker the corresponding Trading Permit fees for the additional Trading Permit(s).[9]

III. Discussion and Commission's Findings

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[9] For example, the Exchange described a situation in which a Market-Maker's aggregate appointment cost for the classes for which it holds Market-Maker appointments prior to a rebalancing is 4.90 and the Market-Maker holds five Trading Permits (i.e., a total of 5.0 credits). The Exchange then rebalances the appointment costs of classes and announces such rebalancing at least ten days prior to the rebalancing takes effect. Upon this rebalancing taking effect, the Market-Maker's appointment cost will now be 5.40. If the Market-Maker does not adjust its appointments prior to such rebalancing taking effect, then the Exchange will simply assign that Market-Maker a sixth Market-Maker Trading Permit (for a total of 6.0 credits) to cover the Market-Maker's aggregate appointment costs . The Exchange also will begin to bill the Market-Maker for the cost of the additional sixth permit. See id.

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.[10] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[11] which requires, among other things, that the rules of a national securities 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, and not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers. The Commission also finds that the proposed rule change is consistent with Section 6(b)(1) of the Act,[12] which provides that the Exchange be organized and have the capacity to be able to carry out the purposes of the Act and to enforce compliance by its members and persons associated with its members, with the Act, the rules and regulations thereunder, and the rules of the Exchange.

The proposed rule change is designed to allow the Exchange to avoid a situation where a Market-Maker has an aggregate appointment cost that exceeds the available appointment credits that the Market-Maker holds based on the trading permits that he or she possesses. The Exchange argues that such a situation would constitute an unfair advantage in favor of that Market-Maker.[13] The Exchange argues that, by preventing such situations, the proposed rule change may remove impediments to and perfect the mechanism of a free and open market system. In its filing, the Exchange noted that it does not have the ability to adjust the VTC

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

11 15 U.S.C. 78f(b)(5).

12 15 U.S.C. 78f(b)(1).

13 See Notice, supra note 3, at 69492.

appointments of a Market-Maker whose aggregate appointment costs exceeds his or her available appointment credits. Even if it did have such ability, rectifying an appointment cost deficit by removing one or more of a Market-Maker's appointments would remove a source of liquidity and thus have the potential to negatively affect market quality in a particular class on CBOE. Further, allowing a Market-Maker to exceed his or her appointment costs would amount to unfair discrimination and provide a competitive advantage over other Market-Makers who stayed within their available appointment credits. As an alternative to incurring the expense of an additional trading permit, a Market-Maker could, in response to an increase in tier appointment costs by CBOE, adjust its appointments on its own initiative.

In addition, the revised rule would codify the Exchange's current practice of notifying TPHs at least ten business days before effecting Market-Maker class tier rebalances, which could potentially affect their fees if they are required to purchase additional trading permits. It also would enable the Exchange to adjust the VTC appointments of a Market-Maker whose aggregate appointment cost exceeds the number of trading permits that the Market-Maker holds and charge the Market-Maker for the additional permit(s). The Exchange states that this proposal would allow the Exchange to avoid the resource-intensive process of instituting regulatory proceedings against these Market-Makers who fall out of compliance with the Exchange's rule.[14] The Commission believes that CBOE's proposal is consistent with CBOE's responsibility to be organized and have the capacity to be able to enforce compliance by the Exchange's members with its rules, and is designed to allow CBOE to expeditiously and efficiently maintain a level playing field among its Market-Makers with respect to appointment costs following a rebalancing of such costs by the Exchange.

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[14] See Notice, supra note 3, at 69491.

IV. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[15] that the proposed rule change (SR-CBOE-2013-109) be, and it hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[16]

Kevin M. O'Neill,
Deputy Secretary.

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15 15 U.S.C. 78s(b)(2).

16 17 CFR 200.30-3(a)(12).