

proposal.⁶ No comments were received regarding the proposal. This order approves the proposal, as amended.

II. Description of the Proposal

The CBOE proposes to increase from five trading stations to ten the maximum number of trading stations at which a market maker's appointed classes of options may be traded pursuant to CBOE Rule 8.3(c).⁷ In addition, the MPC maintains its authority to provide exemptions to the trading station limitation. The CBOE's proposal also will have the effect of allowing market makers to rely on the market maker exemption to the NASD's short sale rule for hedging a greater number of options classes, provided that the requirements of the exemption are met.⁸

III. Discussion

The Commission finds the proposed rule change consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange. Specifically, the proposed rule change is consistent with the requirements of Section 6(b)(5) of the Act because the proposal is designed to remove impediments to and perfect the mechanism of a free and open market, and protect investors and the public interest.

The Commission believes that increasing the number of trading

stations which may be included in a market maker's appointment from five stations to ten stations is a reasonable measure designed by the Exchange to help ensure adequate market maker participation in each class of options traded on the Exchange. The Exchange has stated that the effect of increasing the trading station maximum will be to increase the maximum number of options classes in which a market maker may hold an appointment. Accordingly, out of a total of 644 classes of options at the CBOE, the change can result in increases from 137 to 241 in appointed classes, representing an increase from 21% to 37% of the total number of classes traded on the Exchange.⁹

The Commission believes that the CBOE's proposal will benefit the market and investors by increasing the potential number of options classes to which the obligations of a market maker will apply.¹⁰ Although the Commission recognizes that the proposal can result in increasing a market maker's appointed classes by over 100 classes, we believe adequate market making capabilities and obligations will continue to exist in such classes. In this regard, the Commission expects CBOE to assess whether market makers have adequate capital to fulfill their continual market making obligations under CBOE Rule 8.7 in all their appointed classes. Further, the in-person and general trading requirements applicable to market makers under CBOE Rule 8.7, Interpretation and Policy .03¹¹ should

continue to ensure that market making is adequate in all appointed classes.¹² Finally, in light of the growth of the number of options traded on the Exchange in recent years, the increase from 21% to 37% of the classes traded on the CBOE is reasonable.¹³

The Commission finds good cause for approving Amendment No. 1, as modified by, and together with, Amendment Nos. 2 and 3, prior to the thirtieth day after the date of publication of notice of filing thereof in the **Federal Register**. Amendment No. 1 provides additional information regarding the number of options classes affected by the Exchange's proposal, as well as general information regarding the structure of its trading floor. Amendment No. 2 modifies Amendment No. 1 by stating that the CBOE will consult with Commission staff regarding the manner in which to file any future changes to the maximum number of trading stations at which market makers may hold appointments. Amendment No. 3 effects changes to Proposed Rule 8.3(c), but does not change the effect of the Exchange's proposal.

The Commission believes that these changes do not affect the substance of the Exchange's proposal because they merely serve to provide additional data regarding the proposal, describe guidelines for seeking Commission approval of future changes by the MPC in trading station appointments, and fashion minor textual changes to the proposed language of Rule 8.3(c). Accordingly, the Commission believes the Amendments raise no new or unique regulatory issues. Therefore, the Commission believes it is consistent with Sections 6(b)(5) and 19(b)(2) of the Act¹⁴ to approve Amendment Nos. 1, 2, and 3 to the proposal on an accelerated basis.

⁶ Amendment No. 3 amends the original proposed changes to Rule 8.3(c) by removing reference to the Market Performance Committee ("MPC")

designating the maximum number of trading stations, and by removing Proposed Interpretation and Policy .02 which stated that the MPC had designated such maximum number to be ten. Proposed Rule 8.3(c) now replaces five with ten as the maximum number of trading stations at which a market maker may hold an appointment. Amendment No. 3 also discusses the alternative means by which future proposed changes to Rule 8.3(c) may be filed, and states that the MPC, when assigning station appointments to market makers, considers, among other matters, the physical location of stations to be assigned to a market maker. See letter from Mary L. Bender, Senior Vice President, Division of Regulatory Services, CBOE, to Michael Walinskas, Branch Chief, Division, Commission, dated April 10, 1995.

⁷ See Amendment No. 3, *supra* note 6.

⁸ The NASD short sale rule prohibits broker-dealers from effecting short sales for themselves or their customers at or below the "bid" when the current "inside" or best price is below the previous inside bid. See NASD Rules of Fair Practice, Art. III, section 48. The CBOE's market maker exemption to the short sale rule allows options market makers to hedge options positions in their appointed classes of options by buying or selling (including selling short) shares of underlying stocks or underlying component stocks contained in stock indexes. Such an "exempt hedge transaction" is defined by the Exchange as a short sale effected to hedge, and which in fact serves to hedge, an existing offsetting options position or an offsetting options position that was created in one or more transactions contemporaneous with the short sale. See CBOE Rule 15.10.

⁹ See Amendment No. 1, *supra* note 4. In comparison, the CBOE notes that a registered options trader on the Amex may be assigned to 300 classes of options or more representing 70% of the 430 classes of options traded on the Amex. *Id.*

¹⁰ For example, CBOE Rule 8.7 requires generally that a market maker's transactions constitute a course of dealing reasonably calculated to contribute to the maintenance of a fair and orderly market. Specific requirements include a market maker's continuous obligation to deal for his or her own account when there is a lack of price continuity; or when there is a disparity between supply and demand for a particular option contract, or between options contracts of the same class. In fulfilling these requirements, market maker must, among other things, compete with other market makers to improve markets, make markets, and update market quotations in response to changed market conditions.

The Commission notes that increasing the number of trading stations at which a market maker may hold an appointment does not in any way lessen a market maker's obligation to make a market. The CBOE has stated that the MPC, when assigning station appointments to market makers, considers, among other matters, the physical location of the stations to be assigned to a market maker. See amendment No. 3, *supra* note 6.

¹¹ CBOE Rule 8.7, Interpretation .03 generally requires that at least 25% of a market maker's transactions be executed in person, and not through the use of orders. Moreover, at least 75% of a market maker's total contract volume must be in option classes to which the market maker has been appointed.

¹² The Commission notes that any further increases may warrant the development of additional standards to ensure adequate market making performance.

¹³ The CBOE has indicated in its proposal that, in the future, it will consult with Commission staff in order to determine the appropriate rule filing method for proposing any further increases to the maximum trading stations at which a market maker may hold an appointment. The alternatives would include: (1) filing a proposal pursuant to Section 19(b)(2) of the Act, which requires that the Commission publish notice of the proposal and provide an opportunity for public comment; or (2) filing a proposal pursuant to Section 19(b)(3)(A) of the Act, including either a filing that would be effective immediately upon filing, or operative 30 days after the filing date, if filed as a non-controversial rule proposal. See Amendment Nos. 2 and 3, *supra* notes 5 and 6, respectively.

¹⁴ 15 U.S.C. 78f(b)(5) and 78s(b)(2) (1988).