

a merger arbitrage may also qualify for the Strategy Fee Cap. The word “simultaneous” is also not included in the new definition because the purchase and sale transactions do not necessarily need to be executed simultaneously.

The Exchange defines a short stock interest spread for purposes of the Strategy Fee Cap as a spread that uses two deep in-the-money put options followed by the exercise of the resulting long position of the same class in order to establish a short stock interest arbitrage position. The Exchange proposes to change “short stock interest spread” to “short stock interest strategy”, and proposes to define a short stock interest strategy as “transactions done to achieve a short stock interest arbitrage involving the purchase, sale and exercise of in-the-money options of the same class.” The words “spread” and “two” are not included in the new definition so that transactions involving only a single options series that are done to achieve a short stock interest arbitrage may also qualify for the Strategy Fee Cap. The word “deep” is not included in the new definition for the same reasons it was removed from the definition of dividend strategy. Also, “put” is not included in the new definition because a short stock interest strategy can be accomplished using either calls or puts.

The Exchange proposes one additional minor clarifying change to footnote 13 of the Fees Schedule. The Exchange proposes to clarify that the \$50,000 per month fee cap is “per initiating member” as well as per initiating firm, because the cap also applies to individual members effecting these strategies.

The Exchange believes that accommodating these transactions by keeping fees low will attract additional liquidity to the Exchange.

## 2. Statutory Basis

The Exchange believes that its proposal to amend its schedule of fees is consistent with Section 6(b) of the Act<sup>6</sup> in general, and furthers the objectives of Section 6(b)(4) of the Act<sup>7</sup> in particular, in that it is an equitable allocation of reasonable dues, fees, and other charges among its members and issuers and other persons using its facilities.

### *B. Self-Regulatory Organization's Statement on Burden on Competition*

CBOE does not believe that the proposed rule change will impose any burden on competition that is not

necessary or appropriate in furtherance of the purposes of the Act.

### *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 on the proposed rule change.

### **III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The foregoing rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act<sup>8</sup> and subparagraph (f)(2) of Rule 19b-4 thereunder<sup>9</sup> because it establishes or changes a due, fee, or other charge. At any time within 60 days of the filing of the 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.

### **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-2006-07 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 20549-9303.

All submissions should refer to File Number SR-CBOE-2006-07. 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 such 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-2006-07 and should be submitted on or before February 21, 2006.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>10</sup>

Nancy M. Morris,

Secretary.

[FR Doc. E6-1165 Filed 1-30-06; 8:45 am]

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## **SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-53167; File No. SR-CBOE-2005-89]

### **Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting Approval of a Proposed Rule Change and Amendment No. 1 Thereto Relating to the Adoption of a Hybrid Agency Liaison System for Automated Handling of Inbound Orders That Are Not Automatically Executed**

January 23, 2006.

On October 27, 2005, 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 adopt a Hybrid Agency Liaison (“HAL”) system for automated handling of inbound orders for option classes trading on CBOE's Hybrid System (“Hybrid”). On December 7, 2005, the Exchange filed Amendment No. 1 to the

<sup>6</sup> 15 U.S.C. 78f(b).

<sup>7</sup> 15 U.S.C. 78f(b)(4).

<sup>8</sup> 15 U.S.C. 78s(b)(3)(A)(ii).

<sup>9</sup> 17 CFR 240.19b-4(f)(2).

<sup>10</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.

proposed rule change.<sup>3</sup> The proposed rule change and Amendment No. 1 were published for comment in the **Federal Register** on December 15, 2005.<sup>4</sup> No comments were received regarding the proposal, as amended. This order approves the proposed rule change, as amended.

## I. Description of the Proposal

Hybrid currently provides electronic executions on the Exchange for orders that are marketable against the Exchange's quote when it represents the National Best Bid or Offer ("NBBO"). The entire process for those orders is automated; however, many electronically-received orders that are not automatically executed upon receipt by the Hybrid System (usually because CBOE's disseminated quote is not the NBBO) are routed to a PAR terminal for manual handling.<sup>5</sup> In proposed CBOE Rule 6.14, the Exchange proposes to automate the handling process for certain orders in designated classes that would be routed to a PAR terminal under the current rules—specifically, market orders and limit orders that are marketable against CBOE's disseminated quote while that quote is not the NBBO, and limit orders that improve CBOE's disseminated quote (whether or not they are marketable against the NBBO). These orders would be electronically exposed to all CBOE Market-Makers appointed to the relevant option class as well as to all members acting as agent for orders at the top of the Exchange's book in the relevant option series ("Qualifying Members").<sup>6</sup> Like open outcry, this exposure and subsequent allocation period<sup>7</sup> (together, the "HAL auction" or "auction") would afford crowd members an opportunity to match the away NBBO price.<sup>8</sup>

If any portion of an exposed order remains unexecuted at the end of a HAL auction, then the remaining order would be booked if it is a limit order that is not marketable, or, if marketable, routed to the Exchange showing the NBBO via the options intermarket linkage. If the price of the Linkage Order is no longer available on any market, then HAL would execute the remainder of the order against the Exchange's existing quote provided such execution would not result in a trade-through. However, if the Exchange's quote is inferior to the Exchange's best bid or offer at the time the order was received by HAL ("Exchange Initial BBO"), then the order would be executed against the Market-Makers that constituted the Exchange Initial BBO at a price equal to the Exchange Initial BBO.

In addition, the proposal provides for early termination of an auction in certain cases—for instance, when the Hybrid System receives an unrelated order on the opposite side of the market from the exposed order that could trade against the exposed order at the prevailing NBBO price; when the Hybrid System receives an unrelated order on the same side of the market as the exposed order that is priced equal to or better than the exposed order; or, in the case of exposure of an order that is marketable against the Exchange Initial BBO, when a Market-Maker whose quote is part of the Exchange Initial BBO attempts to move its quote to an inferior price.<sup>9</sup> In this last case, the auction would terminate and the Exchange would not permit any Market-Maker quotes to move to an inferior price until the exposed order was routed through the Linkage or, if a superior price is no longer available on another exchange, executed at the Exchange Initial BBO against the Market-Makers that constituted the Exchange Initial BBO.<sup>10</sup>

## II. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>11</sup> In particular, the Commission believes that the proposal is consistent with the requirements of Section 6(b)(5) of the Act, which

requires, among other things, that the rules of a national securities exchange be designed to promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest.<sup>12</sup>

The Exchange noted in its proposal that the proposed Hybrid Agency Liaison system would be an improvement over open outcry auctions because HAL, an automated process, would reduce the duration of the auction to three seconds or less.<sup>13</sup> In addition, customer order protections built into proposed CBOE Rule 6.14 (such as, most significantly, the guarantee that the customer order will receive an execution at the Exchange Initial BBO if no better price is available when the auction ends or is terminated)<sup>14</sup> should guarantee that any order that is the subject of a HAL auction will be executed at a price at least as good as the price disseminated by the Exchange at the time the order was received by HAL.<sup>15</sup> Thus, the HAL auction provisions should ensure both that orders that are ineligible for automatic execution under the CBOE's rules because the CBOE is not at the NBBO are handled electronically rather than manually, and that CBOE Market-Makers honor their disseminated quotes, regardless of whether an auction has been initiated.

In addition, the Commission notes that the Exchange proposes to incorporate into its proposed rule provisions that would provide that a pattern or practice of submitting unrelated orders that cause an exposure period to conclude early and the dissemination of information regarding exposed orders to third parties will be deemed conduct inconsistent with just and equitable principles of trade and a violation of CBOE Rule 4.1 and other Exchange rules.<sup>16</sup> The Commission believes that these provisions will require the CBOE to surveil for, and hopefully help to limit, any potential "gaming" of the HAL system.

*It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>17</sup> that the proposed rule change (File No. SR—

<sup>3</sup> Amendment No. 1 replaced the original filing in its entirety.

<sup>4</sup> See Securities Exchange Act Release No. 52928 (December 8, 2005), 70 FR 74388 ("Notice").

<sup>5</sup> See CBOE Rule 7.12, PAR Officials (setting forth the rules for manual handling by the PAR Officials of orders routed to PAR terminals).

<sup>6</sup> Of course, eligible recipients of these messages (CBOE Market-Makers and Qualifying Members) may need to undertake some programming modifications to receive and respond to these messages. The Exchange will not require those programming changes.

<sup>7</sup> The allocation period affords Market-Makers and Qualifying Members that were interested in trading with an exposed order an opportunity to participate in the execution of an order following an exposure period. Each Market-Maker or Qualifying Member that submits an order or quote to trade with an order during the exposure or allocation periods would be entitled to receive an allocation of the order in accordance with the allocation algorithm in effect for the options class pursuant to CBOE Rule 6.45A or 6.45B. See proposed CBOE Rule 6.14(c).

<sup>8</sup> For a full description of the operation of the proposed HAL auction, see Notice, *supra* note 4.

<sup>9</sup> For a full discussion of the auction termination provisions in proposed CBOE Rule 6.14(d) and (e), see Notice, *supra* note 4.

<sup>10</sup> See proposed CBOE Rule 6.14(d)(iii) and (e)(iii).

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

<sup>12</sup> 15 U.S.C. 78f(b)(5).

<sup>13</sup> CBOE's proposed Rule 6.14(b) limits the total exposure and allocation time to three seconds.

<sup>14</sup> See proposed CBOE Rule 6.14(b)(i), (b)(ii), (d)(iii), and (e)(iii).

<sup>15</sup> See proposed CBOE Rule 6.14(b)(i) and (ii).

<sup>16</sup> See proposed CBOE Rule 6.14, Interpretations and Policies .01 and .02.

<sup>17</sup> 15 U.S.C. 78s(b)(2).

CBOE-2005-89), as amended, is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>18</sup>

Nancy M. Morris,  
Secretary.

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-53173; File No. SR-ISE-2006-03]

### Self-Regulatory Organizations; International Securities Exchange, Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Relating to Fee Changes for Transactions in Options on Three Narrow-Based Indexes

January 24, 2006.

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 January 5, 2006, the International Securities Exchange, Inc. ("ISE" or "Exchange") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II and III below, which Items have been prepared by the ISE. The ISE has designated this proposal as one establishing or changing a due, fee, or other charge imposed by a self-regulatory organization pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(2) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The ISE proposes to amend its Schedule of Fees to establish fees for transactions in options on three narrow-based indexes: the ISE-B&S Water Index ("HHO"), the ISE-CCM Alternative Energy Index ("POW") and the ISE-CCM Nanotechnology Index ("TNY"). The text of the proposed rule change is available at the Exchange, at the Exchange's Web site <http://www.iseoptions.com/legal/>

[proposed\\_rule\\_changes.asp](http://www.iseoptions.com/legal/proposed_rule_changes.asp)) and at the Commission's Public Reference Room.

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

In its filing with the Commission, the ISE included statements concerning the purpose of, and basis for, the proposed rule change and discussed any comments it received on the proposal. The text of these statements may be examined at the places specified in Item IV below. The Exchange 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

The Exchange is proposing to adopt an execution fee and a comparison fee for all transactions in options on HHO, POW and TNY.<sup>5</sup> These fees will be charged only to Exchange members. The amount of the execution fee and comparison fee for products covered by this filing shall be \$0.15 and \$0.03, respectively, for all Public Customer and Firm Proprietary orders. The amount of the execution fee and comparison fee for all Market Maker orders shall be equal to the execution fee and comparison fee currently charged by the Exchange for Market Maker transactions in equity options.<sup>6</sup> The Exchange believes the proposed rule change will further its goal of introducing new products to the marketplace that are competitively priced.

Additionally, the Exchange has entered into separate development agreements with Cronus Capital Markets and Boenning & Scattergood, Inc., in connection with the development, listing and trading of options on POW and TNY and HHO, respectively. As with certain other licensed options, the Exchange is adopting a fee of \$0.05 per contract for trading in these options to defray the licensing costs. The Exchange believes charging the participants that trade this instrument is the most

equitable means of recovering the costs of the license. However, because of competitive pressures in the industry, the Exchange proposes to exclude Public Customer Orders<sup>7</sup> from this surcharge fee. Accordingly, this surcharge fee will only be charged to Exchange members with respect to non-Public Customer Orders (e.g., Market Maker and Firm Proprietary orders) and shall apply to Linkage Orders<sup>8</sup> under a pilot program that is set to expire on July 31, 2006.<sup>9</sup> Further, since options on HHO, POW and TNY are not multiply-listed, the Payment for Order Flow fee shall not apply.

###### 2. Statutory Basis

The Exchange states that the basis under the Act for this proposed rule change is the requirement under Section 6(b)(4)<sup>10</sup> that an exchange have an equitable allocation of reasonable dues, fees and other charges among its members and other persons using its facilities.

##### B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange believes that the proposed rule change will not impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

##### C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others

The Exchange has neither solicited nor received comments on the proposed rule change. The ISE has not received any unsolicited written comments from members or other interested parties.

#### III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

The foregoing proposed rule change has become effective pursuant to Section 19(b)(3)(A)(ii) of the Act,<sup>11</sup> and paragraph (f)(2) of Rule 19b-4 thereunder<sup>12</sup> because it establishes or changes a due, fee, or other charge. At any time within 60 days of the filing of the proposed rule change, the

<sup>7</sup> Public Customer Order is defined in Exchange Rule 100(a)(33) as an order for the account of a Public Customer. Public Customer is defined in Exchange Rule 100(a)(32) as a person that is not a broker or dealer in securities.

<sup>8</sup> See Exchange Rule 1900.

<sup>9</sup> See Securities Exchange Act Release No. 52168 (July 29, 2005), 70 FR 45454-01 (August 5, 2005), SR-ISE-2005-32 (extending the expiration date for this pilot program from July 31, 2005 to July 31, 2006).

<sup>10</sup> 15 U.S.C. 78f(b)(4).

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

<sup>12</sup> 17 CFR 240.19b-4(f)(2).

<sup>18</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> 15 U.S.C. 78s(b)(3)(A)(iii).

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

<sup>5</sup> The Exchange states that the HHO, POW and TNY meet the standards of ISE Rule 2002(b), which allows the Exchange to begin trading these products by filing Form 19b-4(e) at least five business days after commencement of trading these new products pursuant to Rule 19b-4(e) of the Act, 17 CFR 240.19b-4(e).

<sup>6</sup> The execution fee is currently between \$.21 and \$.12 per contract side, depending on the Exchange Average Daily Volume, and the comparison fee is currently \$.03 per contract side.