

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60746; File No. SR-CBOE-2009-070)

September 30, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Related to Preferred Market Makers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 28, 2009, the Chicago Board Options Exchange, Incorporated (“CBOE” 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 CBOE. 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 CBOE is proposing to amend its Preferred Market-Maker program to allow for the preferencing of complex orders entered into the complex order book (“COB”) and the complex order RFR auction (“COA”). In addition, CBOE is proposing to make a clarification regarding the existing operation of the Preferred Market-Maker program for simple orders. The text of the proposed rule change is available on the Exchange’s Web site at (<http://www.cboe.org/Legal>), at the Office of the Secretary, CBOE, 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 Exchange 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 a Preferred Market-Maker program for complex orders that is modeled after its existing Preferred Market-Maker program for simple orders, Rule 8.13. Under the proposal, the Exchange may allow, on a class-by-class basis, for the receipt of Preferred Market-Maker complex orders through the COB and/or COA systems, and a qualifying recipient of a Preferred Market-Maker complex order shall be afforded a participation entitlement.

Under the proposal, any Exchange Market-Maker type could be designated as a Preferred Market-Maker (e.g., Lead Market-Maker, Designated Primary Market-Maker, Market-Makers), however, the Hybrid System is programmed so that a recipient of a Preferred Market-Maker complex order would only receive a participation entitlement for such complex order if the following provisions are met: First, whether the participation entitlement is applied to COB and/or COA, the Preferred Market-Maker has an appointment/allocation in the relevant option class. Second, with respect to classes where there is a participation entitlement for COB, the Preferred Market-Maker is quoting in COB at the best net priced bid/offer when the order is received. With respect to classes where there is a participation entitlement for COA, (i) at the beginning of the auction, the Preferred Market-Maker is quoting at either (a) the best bid/offer on the Exchange in at least one of the component series of the complex order or (b) the best net

priced bid/offer in COB for the complex order; and (ii) at the conclusion of the auction, the Preferred Market-Maker is quoting at the best net priced bid/offer in COA.³

Provided the eligibility requirements have been met, the Preferred Market-Maker participation entitlement would be 40% when there are two or more Market-Makers also quoting at the best net priced bid/offer execution price (which is the price at the time a complex order is received in the case of a COB participation entitlement or the price at the conclusion of the auction in the case of a COA participation entitlement), and 50% when there is only one other Market-Maker quoting at the best net priced bid/offer execution price.⁴ In addition, the following would apply: First, the Preferred Market-Maker would not be allocated a total quantity greater than the quantity that the Preferred Market-Maker is quoting at the best net priced bid/offer execution price. Second, the entitlement would be based on the number of contracts remaining after the incoming complex order has traded against equivalent derived net priced orders and quotes in the individual series of the EBook and equivalent net priced public customer complex orders resting in COB that have priority over the Preferred Market-Maker in accordance with Rule 6.53C, Complex Orders on the Hybrid System. Third, if a Preferred Market-Maker receives a participation entitlement for its complex order resting in COB or its

³ In this regard, CBOE's proposal prohibits an order flow provider from notifying a Preferred Market-Maker regarding its intention to submit a preferred complex order so that such Preferred Market-Maker could change its quotation to match the NBBO immediately prior to submission of the preferred order, and then fade its quote. CBOE states that Rule 4.18, Prevention of the Misuse of Material, Nonpublic Information, prohibits this sort of misuse of material, non-public information. Further, CBOE represents that it will conduct surveillance for, and enforce against, such violations.

⁴ The Exchange notes that, if a Market-Maker is also eligible for an allocation pursuant to the operation of the applicable algorithm in effect for a class (for example, an allocation based on price-time or a pro-rata percentage), the Market-Maker would be entitled to receive an allocation (not to exceed the size of the Market-Maker's quote) of the greater of the amount the Market-Maker would be entitled to pursuant to the participation entitlement or the amount it would otherwise receive pursuant to the operation of the algorithm in accordance with Rule 6.45A or 6.45B, as applicable.

response to COA, then no other participation entitlements for complex orders set forth in Exchange Rules (e.g., Rule 8.87, Participation Entitlement of DPMs and e-DPMs, and Rule 8.15B, Participation Entitlement of LMMs) shall apply to complex orders resting in COB or entered in response to COA.⁵

Lastly, the proposed rule text notes that a Preferred Market-Maker must comply with the quoting obligations applicable to its Market-Maker type under Exchange rules and must provide continuous electronic quotes (as defined in Rule 1.1(ccc)) in at least 90% of the series of each class for which it receives Preferred Market-Maker orders in accordance with the requirements for the preferencing of simple orders (the “90% quoting obligation”).

In this regard, the Exchange is proposing to revise the existing text of Rule 8.13 regarding the current operation of its preferencing program for simple orders to more specifically reflect the way the Hybrid System operates. Substantively, the requirements of the rule are not changing. The existing rule text indicates that a recipient of a Preferred Market-Maker order will only receive a participation entitlement for such order if the following provisions are met: (i) the Preferred Market-Maker must have an appointment/allocation in the relevant option class; (ii) the Preferred Market-Maker must be quoting at the best bid/offer on the Exchange; and (iii) the Preferred Market-Maker must comply with the quoting obligations applicable to its Market-

⁵ The Exchange notes that, to the extent a complex order trades with the equivalent derived net priced orders and quotes in the individual series of the EBook, there may also be a participation entitlement applied to those individual series legs in accordance with Rule 6.45A or 6.45B, as applicable. For example, if a complex order executes against the individual series legs, then the remainder executes against COB resting orders or COA responses, a Preferred Market-Maker entitlement may apply both on the individual series legs execution and on the COB or COA execution. Also, if a complex order automatically exercises against the individual series legs upon receipt or at the conclusion of a COA, a Preferred Market-Maker entitlement may apply to the individual series legs. Similarly, if a resting complex order becomes marketable against the individual series legs, a Preferred Market-Maker entitlement may apply to the individual series legs.

Maker type under Exchange rules and must provide continuous electronic quotes (as defined in Rule 1.1(ccc)) in at least 90% of the series of each class for which it receives Preferred Market-Maker orders. The Exchange is amending the text to clarify that the Hybrid System is programmed so that the recipient of a Preferred Market-Maker order will only receive a participation entitlement for such order if provisions (i) and (ii) above are met. Separately, a Preferred Market-Maker must also comply with the quoting obligations applicable to its Market-Maker type under Exchange rules and the 90% quoting obligation. The 90% quoting obligation, as with the various other Market-Making quoting obligations, are subject to Exchange market performance, surveillance, and/or disciplinary programs to assess and enforce compliance.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act⁶ in general and furthers the objectives of Section 6(b)(5) of the Act⁷ in particular in that it should 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. The proposed rule change will help generate greater complex order flow for the Exchange and provide additional incentives for Market-Makers to trade with that order flow, which in turn adds depth and liquidity to CBOE's markets.

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 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

⁶ 15 U.S.C. 78f(b).

⁷ 15 U.S.C. 78f(b)(5).

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

Within 35 days of the date of publication of this notice in the Federal Register or within such longer period (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

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. Please include File Number SR-CBOE-2009-070 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2009-070. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of the 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-2009-070 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Florence E. Harmon
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).