

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-61024; File No. SR-CBOE-2009-025)

November 18, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change, As Modified by Amendment No. 1, Related to the Simple Auction Liaison (SAL)

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 4, 2009, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) 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 Exchange. On November 13, 2009, the Exchange filed Amendment No. 1 to the proposal, which replaced the original filing in its entirety. The Commission is publishing this notice to solicit comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to amend Rule 6.13A, Simple Auction Liaison (SAL), to revise the Designated Primary Market-Maker (“DPM”)/Lead Market-Maker (“LMM”) participation entitlement formula that is applicable to SAL executions in Hybrid 3.0 classes. The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.org/Legal>), at the Office of the Secretary, CBOE and at the Commission.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

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

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 self-regulatory organization 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 those 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 parts of such statements.

A. Self-Regulatory Organization’s Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

The purpose of Amendment No. 1, which replaces the original filing in its entirety, is to modify the proposed rule change so that the revised DPM/LMM participation entitlement formula applicable to SAL executions in selected Hybrid 3.0 classes will operate on a 1-year pilot basis.

SAL is a feature within CBOE’s Hybrid System that auctions marketable orders for price improvement over the national best bid or offer (“NBBO”). For Hybrid 3.0 Classes, the Exchange determines, on a class-by-class basis, which electronic matching algorithm from Rule 6.45B, Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System, shall apply to SAL executions (e.g., pro-rata, price-time, UMA priority with public customer, participation entitlement and/or market turner priority overlays). Additionally, the Exchange may establish, on a class-by-class basis, a DPM/LMM participation entitlement that is applicable only to SAL executions. Pursuant to Rules 8.15B and 8.87, the participation entitlement generally is 50% when there is one other Market-Maker also quoting at the best bid/offer on the Exchange, 40% when there are two Market-Makers also quoting at the best

bid/offer on the Exchange, and 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange. In addition, the participation entitlement must be in compliance with Rule 6.45B(a)(i)(2). In relevant part, Rule 6.45B(a)(i)(2) provides that the DPM or LMM may not be allocated a total quantity greater than the quantity that it is quoting (including orders not part of quotes) at that price. In addition, if pro-rata priority is in effect and the DPM or LMM's allocation of an order pursuant to its participation entitlement is greater than its percentage share of quotes/orders at the best price at the time that the participation entitlement is granted (the "pro-rata share"), the DPM or LMM shall not receive any further allocation of that order. The rule also provides that the participation entitlement shall not be in effect unless public customer priority is in effect in a priority sequence ahead of the participation entitlement and then the participation entitlement shall only apply to any remaining balance.<sup>3</sup> In addition, responses to SAL auctions are capped to the size of the Agency Order for allocation purposes pursuant to Rule 6.13A.

Thus, for example, assume an incoming agency order to buy 250 contracts is received and at the conclusion of the SAL auction the LMM is offered at the best price for 200 contracts, 1 customer is offered at the best price for 50 contracts and 4 other Maker-Makers are offered at the best price for 140 contracts each. In this scenario, the customer would be allocated 50 contracts, the LMM would be allocated 60 contracts (30% X 200 remaining contracts), and the 4 other Market-Makers would be allocated the remaining 140 contract balance on a pro-rata basis with each receiving 35 contracts.

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<sup>3</sup> Rule 6.45B(a)(i)(2) also provides that, to be entitled to their participation entitlement, the DPM/LMM's order and/or quote must be at the best price on the Exchange. For purposes of SAL executions, the Exchange interprets this to mean that the DPM/LMM must be at the best price at both the start and the conclusion of the SAL auction.

In order to offer additional incentives for DPMs or LMMs to support and participate in SAL auctions in Hybrid 3.0 classes (which currently only includes options on the Standard and Poor's 500 Index, SPX), and thus offer additional opportunities for price improvement, we are proposing to modify the DPM/LMM entitlement when the pro-rata algorithm is in effect for SAL in selected Hybrid 3.0 classes as part of a pilot program that will operate on a 1-year basis. For such pro-rata classes, after all public customer orders in the book at the best bid/offer and the DPM/LMM participation entitlement have been satisfied, the DPM/LMM shall be eligible to participate in any remaining balance on a pro-rata basis (regardless of whether its participation entitlement is greater than its pro-rata share).

Using the example above, the customer would be allocated 50 contracts, the LMM would be allocated 60 contracts (30% X 200 remaining balance), and the LMM and 4 other Market-Makers would be allocated the remaining 140 contract balance on a pro-rata basis with each receiving 28 contracts (140 remaining balance / (MM1's 140 contract offer + MM2's 140 contract offer + MM3's 140 contract offer + MM4's 140 contract offer + LMM's 140 decremented contract offer) X applicable pro-rata share). Thus, the LMM would receive a total of 88 contracts under the revised algorithm.

As part of the pilot program, on a quarterly basis the Exchange will evaluate the number of SAL executions in each pilot class where the DPM/LMM participation entitlement was applied and the allocation was greater than what it would have been under the pre-pilot allocation algorithm, i.e., the allocation was greater than (i) the DPM/LMM's pro-rata share as calculated prior to the pilot and (ii) the DPM/LMM's participation entitlement share as calculated prior to the pilot. The Exchange will reduce the DPM/LMM participation entitlement for the class if the number of SAL executions that exceeded the benchmark is more than 1% of

the total number of SAL executions in the class evaluated during the quarter. This evaluation will be based on a random sampling of three days for each month in each quarter. The “benchmark” will be 60% where there is one Market-Maker also quoting at the best bid/offer on the Exchange; 40% where there are two Market-Makers also quoting at the best bid/offer on the Exchange; and 40% where there are three or more Market-Makers also quoting at the best bid/offer on the Exchange. The benchmark percentages, which in some instances are greater than CBOE’s DPM/LMM participation entitlement percentages contained in Rules 8.15B and 8.87 (see discussion above), are based on the market-maker participation entitlement percentages that are available on other options exchanges.<sup>4</sup>

During the pilot, the Exchange will submit a quarterly report containing certain data related to this evaluation to the Commission and any such data submitted will be provided on a confidential basis. The report will be submitted within 10 business days of the conclusion of each quarter. The report will provide data on the total number of SAL executions evaluated during the period. It will also provide data on SAL executions where a DPM/LMM participation entitlement was applied and the allocation was greater than it would have been under the pre-pilot allocation algorithm, including information on the number of Market-Makers also quoting at the NBBO and on the actual allocation percentage the DPM/LMM received per execution as compared to the benchmark. For purposes of the report, the “actual allocation percentage” will be calculated by adding the participation entitlement contracts plus the pro-rata share contracts,

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<sup>4</sup> See, e.g., International Securities Exchange Rule 7.13.01(b)(provides a 60% participation right if there is only one other Professional Order or market maker quotation at the best price) and NYSE Arca, Inc. Rule 6.76A(a)(1)(A)(i)(provides a 40% participation right regardless of the number of other market participants at the best price).

and dividing the sum by the number of contracts executed on SAL less public customer orders that were satisfied.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>5</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>6</sup> in particular in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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. In particular, the Exchange believes that the proposed change would provide additional incentives for DPMs or LMMs to support and participate in SAL auctions in Hybrid 3.0 classes, which would result in additional opportunities to provide orders executions at improved prices.

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

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

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

<sup>6</sup> 15 U.S.C. 78f(b)(5).

such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization 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](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2009-025 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-2009-025. 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 am and 3:00 pm. Copies of the filing also will be available for inspection and copying at the principal office of the Exchange. 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-2009-025 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.<sup>7</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>7</sup> 17 CFR 200.30-3(a)(12).