SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-53909; File No. SR-CBOE-2005-65)

May 31, 2006

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment Nos. 1 and 2 Relating to the Processing of Complex Orders in the Hybrid Trading System

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 August 24, 2005, 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 CBOE filed Amendment Nos. 1 and 2 to the proposal on March 13, 2006, and April 27, 2006, respectively.[3] 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

CBOE proposes to amend its procedures applicable to trading complex orders on the Hybrid Trading System ("Hybrid System") to provide for an automated Request for Responses ("RFR") auction process for certain eligible complex orders ("COA" process). CBOE is also proposing to make various changes to the existing routing and execution processes applicable to the complex order book ("COB") and various changes to its rules pertaining generally to the

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

2 17 CFR 240.19b-4.

3 Amendment No. 2 replaces and supersedes the original filing and Amendment No. 1 in their entirety.

minimum increments applicable to complex orders. The text of the proposed rule change appears below. Additions are <u>underlined</u>; deletions are [bracketed].

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Chicago Board Options Exchange, Incorporated

Rules

<u>Rule 6.9. Solicited Transactions</u>

A member or member organization representing an order respecting an option traded on the Exchange (an "original order"), including a spread, combination, or straddle order as defined in Rule 6.53, a stock-option order as defined in Rule 1.1(ii) [or]<u>,</u> a security future-option order as defined in Rule 1.1(zz), <u>or any other complex order as defined in Rule 6.53C,</u> may solicit a member or member organization or a non-member customer or broker-dealer (the "solicited person") to transact in-person or by order (a "solicited order") with the original order. In addition, whenever a floor broker who is aware of, but does not represent, an original order solicits one or more persons or orders in response to an original order, the persons solicited and any resulting orders are solicited persons or solicited orders subject to this Rule. Original orders and solicited orders are subject to the following conditions.

(a) – (f) No change.

. . . Interpretations & Policies:

.01 - .02 No change.

.03 In respect of any solicited order that is a spread, straddle or combination order as defined in Rule 6.53, <u>or any other complex order as defined in Rule 6.53C,</u> the terms "bid" and "offer" as used in subparagraphs (a)-(d) of this Rule 6.9 mean "total net debit" and "total net credit," respectively.

.04 - .07 No change.

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Rule 6.42. Minimum Increments for Bids and Offers

(1) – (2) No change.

(3) Bids and offers on spread, straddle, or combination orders as defined in Rule 6.53, or any other complex order as defined in Rule 6.53C, may be expressed in any increment, and the legs of such an order may be executed in one cent increments, regardless of the minimum increments otherwise appropriate to the individual legs of the order. Notwithstanding the foregoing sentence, bids and offers on spread, straddle, [or] combination, or other complex orders as defined in Rule 6.53C, in options on the S&P 500 Index or on the S&P 100 Index, except for box spreads, shall be expressed in decimal increments no smaller than $0.05. Spread, straddle, [or] combination, or other complex orders as defined in Rule 6.53C expressed in net price increments that are not multiples of the minimal increment are not entitled to the same priority under Rule 6.45 as such orders expressed in increments that are multiples of the minimum increment.

. . . Interpretations & Policies:

No change.

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<u>Rule 6.45. Priority of Bids and Offers—Allocation of Trades</u>

(a) – (d) No change.

(e) *Complex Order Priority Exception:* A spread, straddle, combination, or ratio order (or a stock-option order or security future-option order, as defined in Rule 1.1(ii)(b) and Rule 1.1(zz)(b), respectively)<u>, or any other complex order as defined in Rule 6.53C,</u> may be executed at a net debit or credit price (in a multiple of the minimum increment) with another member without giving priority to equivalent bids (offers) in the trading crowd or in the book provided at least one leg of the order betters the corresponding bid (offer) in the book. Stock-option orders and security future-option orders, as defined in Rule 1.1(ii)(a) and Rule 1.1(zz)(a) respectively, have priority over bids (offers) of the trading crowd but not over bids (offers) of public customers in the limit order book.

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<u>Rule 6.45A. - Priority and Allocation of Equity Option Trades</u>

<u>on the CBOE Hybrid System</u>

(a) No change.

(b) Allocation of Orders Represented in Open Outcry: The allocation of orders that are represented in open outcry by floor brokers or PAR Officials shall be as described below in subparagraphs (b)(i) and (b)(ii). With respect to subparagraph (b)(ii), the floor broker or PAR Official representing the order shall determine the sequence in which bids (offers) are made.

(i) – (ii) No change.

(iii) Exception: Complex Order Priority: A spread, straddle, combination, or ratio order (or a stock-option order or security future-option order, as defined in Rule 1.1(ii)(b) and Rule

1.1(zz)(b), respectively), or any other complex order as defined in Rule 6.53C, may be executed at a net debit or credit price (in a multiple of the minimum increment) with another member without giving priority to equivalent bids (offers) in the trading crowd or in the book provided at least one leg of the order betters the corresponding bid (offer) in the book. Stock-option orders and security future-option orders, as defined in Rule 1.1(ii)(a) and Rule 1.1(zz)(a) respectively, have priority over bids (offers) of the trading crowd but not over bids (offers) of public customers in the limit order book.

(iv) No change.

(c) – (e) No change.

. . . Interpretations and Policies:

No change.

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Rule 6.45B - Priority and Allocation of Trades in

Index Options and Options on ETFs on the CBOE Hybrid System

(a) No change.

(b) Allocation of Orders Represented in Open Outcry: The allocation of orders that are represented in the trading crowd by floor brokers or PAR Officials shall be as described below in subparagraphs (b)(i) and (b)(ii). With respect to subparagraph (b)(ii), the floor broker or PAR Official representing the order shall determine the sequence in which bids (offers) are made.

(i) – (ii) No change.

(iii) Exception: Complex Order Priority: A member holding a spread, straddle, or combination order (or a stock-option order or security future-option order as defined in Rule

1.1(ii)(b) and Rule 1.1(zz)(b), respectively), or any other complex order as defined in Rule 6.53C, and bidding (offering) on a net debit or credit basis (in a multiple of the minimum increment) may execute the order with another member without giving priority to equivalent bids (offers) in the trading crowd or in the electronic book provided at least one leg of the order betters the corresponding bid (offer) in the book. Stock-option orders and security future-option orders, as defined in Rule 1.1(ii)(a) and Rule 1.1(zz)(a), respectively, have priority over bids (offers) of the trading crowd but not over bids (offers) of public customers in the limit order book.

(c) – (d) No change.

. . . Interpretations and Policies:

No change.

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Rule 6.53C. Complex Orders on the Hybrid System

RULE 6.53C. (a) – (b) No change.

(c) Complex Order Book

(i) No change.

[(ii) Priority of Complex Orders in the COB: Orders from public customers have priority over orders from non-public customers. Multiple public customer complex orders at the same price are accorded priority based on time.]

[(iii)](ii) Execution of Complex Orders in the COB: Notwithstanding the provisions of Rule 6.42, the appropriate Exchange committee will determine on a class-by-class basis whether complex orders that are routed to or resting in the COB may be expressed on a net price basis in a multiple of the minimum increment (i.e., $0.05 or $0.10, as applicable) or in a one cent increment. All pronouncements regarding COB increments will be announced to the membership via Regulatory Circular. Complex orders resting in the COB may be executed without consideration to prices of the same complex orders that might be available on other exchanges, and the legs of a complex order may be executed in one cent increments, regardless of the minimum quoting increments otherwise appropriate to the individual legs of the order. Complex orders resting in the COB may trade in the following way:

(1) Orders and Quotes in the [Electronic Book (“]EBook[”)]: A complex order in the COB will automatically execute against individual orders or quotes residing in EBook provided the complex order can be executed in full (or in a permissible ratio) by the orders and quotes in EBook.

(2) Orders in COB: Complex orders in the COB that are marketable against each other will automatically execute. The allocation of a complex order within the COB shall be pursuant to the rules of trading priority otherwise applicable to incoming electronic orders in the individual component legs.

(3) Market participants, as defined in [CBOE] Rule 6.45A or 6.45B, as applicable, may submit orders or quotes to trade against orders in the COB. The allocation of complex orders among market participants shall be done pursuant to CBOE Rule 6.45A(c) or 6.45B(c), as applicable.

[(iv)](iii) Complex orders in the COB may be designated as day orders or good-til-cancelled orders. Only those complex orders with no more than four legs and having a ratio of one-to-three or lower, as determined by the appropriate Exchange committee, are eligible for placement into the COB.

(d) Process for Complex Order RFR Auction: Prior to routing to the COB or once on PAR, eligible complex orders may be subject to an automated request for responses ("RFR") auction process.

(i) For purposes of paragraph (d):

(1) "COA" is the automated complex order RFR auction process.

(2) A "COA-eligible order" means a complex order that, as determined by the appropriate Exchange committee on a class-by-class basis, is eligible for a COA considering the order's marketability (defined as a number of ticks away from the current market), size and complex order type, as defined in paragraph (a) above. All pronouncements regarding COA eligibility will be announced to the membership via Regulatory Circular. Complex orders processed through a COA may be executed without consideration to prices of the same complex orders that might be available on other exchanges.

(3) The "Response Time Interval" means the period of time during which responses to the RFR may be entered.

(ii) Initiation of a COA: On receipt of a COA-eligible order and request from the member representing the order that it be COA'd, the Exchange will send an RFR message to all members who have elected to receive RFR messages. The RFR message will identify the component series, the size of the COA-eligible order and any contingencies, if applicable, but will not identify the side of the market.

(iii) Bidding and Offering in Response to RFRs: Each Market-Maker with an appointment in the relevant option class, and each member acting as agent for orders resting at the top of the COB in the relevant options series, may submit responses to the RFR message ("RFR Responses") during the Response Time Interval.

(1) RFR Response sizes will be limited to the size of the COA-eligible order for allocation purposes and may be expressed on a net price basis in a multiple of the minimum increment (i.e., $0.05 or $0.10, as applicable) or in a one cent increment as determined by the appropriate Exchange committee on a class-by-class basis. RFR Responses will not be visible (other than by the COA system).

(2) The appropriate Exchange committee will determine the length of the Response Time Interval on a class-by-class basis; provided, however, that the duration shall not exceed three (3) seconds.

All pronouncements regarding COA increments and the Response Time Interval will be announced to the membership via Regulatory Circular.

(iv) Processing of COA-Eligible Orders: At the expiration of the Response Time Interval, COA-eligible orders will be allocated in accordance with subparagraph (v) below or routed in accordance with subparagraph (vi) below.

(v) Execution of COA-Eligible Orders: COA-eligible orders may be executed without consideration to prices of the same complex orders that might be available on other exchanges, and the legs of a COA-eligible order may be executed in one cent increments, regardless of the minimum quoting increments otherwise appropriate to the individual legs of the order. COA-eligible orders will trade first based on the best net price(s) and, at the same net price, will be allocated in the following way:

(1) The individual orders and quotes residing in the EBook shall have first priority to trade against a COA-eligible order provided the COA-eligible order can be executed in full (or in a permissible ratio) by the orders and quotes in the EBook. The allocation of a COA-eligible order against the EBook shall be consistent with the UMA allocation described in Rule 6.45A or 6.45B, as applicable.

(2) Public customer complex orders resting in the COB before, or that are received during, the Response Time Interval and public customer RFR Responses shall, collectively have second priority to trade against a COA-eligible order. The allocation of a COA-eligible order against the public customer complex orders resting in the COB shall be according to time priority.

(3) Non-public customer orders resting in the COB before the Response Time Interval shall have third priority to trade against a COA-eligible order. The allocation of a COA-eligible order against non-public customer orders resting in the COB shall be pursuant to the UMA allocation described in Rule 6.45A or 6.45B, as applicable.

(4) Non-public customer orders resting in the COB that are received during the Response Time Interval and non-public customer RFR responses shall, collectively, have fourth priority. The allocation of a COA-eligible order against these opposing orders shall be consistent with the CUMA allocation described in Rule 6.45A or 6.45B, as applicable.

(vi) Routing of COA-Eligible Orders: If a COA-eligible order cannot be filled in whole or in a permissible ratio, the order (or any remaining balance) will route to the COB or back to PAR, as applicable.

(vii) Firm Quote Requirement for COA-Eligible Orders: RFR Responses represent non-firm interest that can be modified or withdrawn at any time prior to the end of the Response Time Interval. At the end of the Response Time Interval, RFR Responses shall be firm only with respect to the COA-eligible order for which it is submitted, provided that RFR Responses that exceed the size of a COA-eligible order are also eligible to trade with other incoming COA-eligible orders that are received during the Response Time Interval. Any RFR Responses not accepted in whole or in a permissible ratio will expire at the end of the Response Time Interval.

(viii) Handling of Unrelated Complex Orders: Incoming complex orders that are received prior to the expiration of the Response Time Interval for a COA-eligible order (the “original COA”) will impact the original COA as follows:

(1) Incoming complex orders that are received prior to the expiration of the Response Time Interval for the original COA that are on the opposite side of the market and are marketable against the starting price of the original COA-eligible order will cause the original COA to end. The processing of the original COA pursuant to subparagraphs (d)(iv) through (d)(vi) remains the same. For purposes of this Rule, the “starting price,” shall mean the better of the original COA-eligible order’s limit price or the best price, on a net debit or credit basis, that existed in the EBook or COB at the beginning of the Response Time Interval.

(2) Incoming COA-eligible orders that are received prior to the expiration of the Response Time Interval for the original COA that are on the same side of the market, at the same price or worse than the original COA-eligible order and better than or equal to the starting price will join the original COA. The processing of the original COA pursuant to subparagraphs (d)(iv) through (d)(vi) remains the same with the addition that the priority of the original COA-eligible order and incoming COA-eligible order(s) shall be according to time priority.

(3) Incoming COA-eligible orders that are received prior to the expiration of the Response Time Interval for the original COA that are on the same side of the market and at a better price than the original COA-eligible order will join the original COA, cause the original COA to end, and a new COA to begin for any remaining balance on the incoming COA-eligible order. The processing of the original COA pursuant to subparagraphs (d)(iv) through (d)(vi) remains the same with the addition that the priority of the original COA-eligible order and incoming COA-eligible order shall be a according to time priority.

… Interpretations and Policies:

.01 - .02 No change.

.03 With respect to the initiation of a COA (as described in Rule 6.53C(d)(ii)), members routing complex orders directly to the COB may request that the complex orders be COA'd on a class-by-class basis and members with resting complex orders on PAR may request that complex orders be COA'd on an order-by-order basis.

.04 A pattern or practice of submitting orders that cause a COA to conclude early will be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 4.1.

.05 Disseminating information regarding COA-eligible orders to third parties will be deemed conduct inconsistent with just and equitable principles of trade and a violation of Rule 4.1 and other Exchange Rules.

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Rule 6.74. Crossing Orders

(a) – (f) No change.

. . . Interpretations & Policies:

.01 - .02 No change.

.03 Spread, straddle, stock-option (as defined in Rule 1.1(ii)), inter-regulatory spread as defined in Rule 1.1(ll) (including security future-option orders as defined in Rule 1.1(zz) [or], combination orders, or any other complex orders as defined in Rule 6.53C on opposite sides of the market may be crossed, provided that the Floor Broker holding such orders proceeds in the manner described in paragraphs (a) or (b) above as appropriate. Members may not prevent a spread, straddle, stock-option, inter-regulatory spread (including a security future-option order), [or] combination, or any other complex order cross from being completed by giving a competing bid or offer for one component of such order.

.04 - .08 No change.

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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 CBOE 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 in Item IV below. The CBOE 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 Commission recently approved Exchange Rule 6.53C, "Complex Orders on the Hybrid System," which sets forth the procedures for trading complex orders on CBOE's Hybrid System.[4] As an enhancement to the current COB system, CBOE intends to develop a COA process, which the Exchange believes will, in turn, facilitate more automated handling of complex orders. The purpose of this proposed rule change is to adopt corresponding revisions to Exchange Rule 6.53C. In addition, CBOE is proposing to make certain changes to the existing COB provisions contained in Exchange Rule 6.53C to better describe the allocation methodology for executing orders in the COB. Lastly, CBOE is proposing to make certain modifications and clarifications to its rules generally pertaining to complex order minimum increments.

a. Automated RFR Auction Process for Complex Orders

Exchange Rule 6.53C sets forth the process for trading complex orders in the Hybrid

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4 See Securities Exchange Act Release No. 51271 (February 28, 2005), 70 FR 10712 (March 4, 2005) (order approving File No. SR-CBOE-2004-45).

System, including whether complex orders will be routed to a PAR workstation (for manual handling) or the complex order book (for automated handling) and, once in the COB, the manner in which complex orders execute against the electronic book ("the EBook"), orders resting in the COB, and market participants' orders submitted to trade against the COB. The proposed COA-related amendments will introduce new functionality that will give certain eligible complex orders an opportunity for price improvement before being booked in the COB or once on PAR.[5] Proposed paragraph (d) of Exchange Rule 6.53C will describe the COA process. The proposed rule change will give the appropriate Exchange committee the authority to determine on a class-by-class basis what incoming complex orders are eligible for a COA based on marketability (defined as a number of ticks away from the current market), size and the complex order type ("COA-eligible orders").[6]

Upon receiving a COA-eligible order and a request by the member representing the order that it be COA'd,[7] the Exchange will send an RFR message to CBOE members with an interface connection to CBOE that have elected to receive such RFR messages. This RFR message will

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5 Currently, stock-option orders, security futures-option orders, and conversions and reversals are not eligible for routing to COB and, similarly, will not be eligible for routing to COA.

6 For example, the appropriate Exchange committee could determine that spread orders are eligible for a COA to the extent they are less than two ticks away from the "top of the book," which would be the best price considering the net prices available in the complex order book and the individual component legs quoted in the CBOE market. All pronouncements, including changes thereto, regarding COA eligibility and Response Time Intervals will be announced to the membership via Regulatory Circular.

7 Systemically, members will be able to make this request for incoming orders routing directly to COB on a class-by-class basis and for resting PAR orders on an order-by-order basis. If an incoming order is not COA-eligible or not designated for a COA, it will be routed to either PAR or the COB in accordance with Exchange Rule 6.53C(c)(i).

identify the component series, the size of the COA-eligible order and any contingencies, if applicable. However, the RFR message will not identify the side of the market (i.e., whether the COA-eligible order is to buy or to sell).

Market-Makers with an appointment in the relevant options class, and members acting as agent for orders resting at the top of the COB in the relevant options series, may electronically submit responses ("RFR Responses"), and modify or withdraw them, at any time during the request response time interval (the "Response Time Interval"). RFR Responses must be in a permissible ratio, and may be expressed on a net price basis in a multiple of the minimum increment (i.e., \$0.05 or \$0.10, as applicable) or in a one-cent increment as determined by the appropriate Exchange committee on a class-by-class basis. In addition, RFR Response sizes will be limited to the size of the COA-eligible order for allocation purposes. RFR Responses will not be visible (other than by the COA system). The applicable Response Time Interval will be determined by the appropriate Exchange committee on a class-by-class basis and, in any event, will not exceed three seconds.[8]

When the Response Time Interval expires, the COA-eligible order will be executed and allocated to the extent it is marketable, or routed to the COB or back to PAR to the extent it is not marketable.[9] If executed, the rules of trading priority will provide that the COA-eligible

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8 For example, the appropriate Exchange committee could determine to set the timer for a particular class to a random time interval determined by the Exchange system between two and three seconds.

9 For example, if no RFR Responses are received in the Response Time Interval and the COA-eligible order is not marketable against the individual orders and quotes in the EBook, the COA-eligible order would be routed to the COB or, as applicable, back to PAR at the expiration of the Response Time Interval. If routed to COB, the order would then be subject to execution in accordance with the provisions of Exchange Rule 6.53C(c)(iii) (proposed to be renumbered as Exchange Rule 6.53C(c)(ii)). If routed back

order be executed based first on net price and, at the same net price: (i) the individual component orders and quotes in the EBook shall have first priority to trade against the COA-eligible order; (ii) public customer complex orders resting in the COB before, or that are received during, the Response Time Interval and public customer RFR Responses shall, collectively, have second priority; (iii) non-public customer complex orders resting in the COB before the Response Time Interval shall have third priority; and (iv) non-public customer complex orders resting in the COB that are received during the Response Time Interval and non-public customer RFR Responses shall, collectively, have fourth priority.[10] Allocations within the first category above (orders residing in the EBook) shall be based upon the Hybrid System ultimate matching algorithm ("UMA") pertaining to equity options or index/exchange-traded fund options in Exchange Rules 6.45A and 6.45B, respectively, as applicable.[11] Allocations within the second category above (public customer complex orders resting in the COB and public customer RFR Responses) shall be based on time when multiple public customer complex orders or RFR Responses exist at the same price. Allocations within the third category above (non-public customer orders resting in the COB before the Response Time Interval) shall be based on the applicable UMA algorithm. Allocations within the fourth category above (non-public customer

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to PAR, the member holding the order would have the ability to represent the order in open outcry, trade the order against the COB in accordance with Exchange Rule 6.53C(c)(iii)(3) (proposed to be renumbered as Exchange Rule 6.53C(c)(ii)(3)), or route the order to COB in accordance with Exchange Rule 6.53C(c)(i).

10 RFR Responses that exceed the size of the COA-eligible order are also eligible to trade with other marketable COA-eligible orders that may be received during the Response Time Interval. See proposed Exchange Rule 6.53C(d)(vii) and (viii).

11 Exchange Rule 6.45A pertains to the priority and allocation of trades in equity options on the Hybrid System. Exchange Rule 6.45B pertains to the priority and allocation of trades in index options and options on exchange-traded funds on the Hybrid System.

orders received during the Response Time Interval in the COB and non-public customer RFR Responses) shall be based on the Hybrid System ultimate matching algorithm in Exchange Rule 6.45A or 6.45B, as applicable, which caps the maximum quote size to be no greater than the underlying order for allocation purposes ("CUMA").

The following is an example of a COA: assume the CBOE's derived spread market, considering the individual series prices in the EBook, is offered at $1.15 for 20 contracts. In addition, assume a public customer order resting in the COB is offered at $1.15 for five contracts and two non-public customer orders resting in the COB are offered at $1.15 for five contracts each (for a total of 10 contracts). A COA-eligible order is then received to buy 100 spreads at $1.15. COA will auction the order. An RFR message is sent to members indicating the complex order series and 100 contracts (but not the side of the market). The Response Time Interval for submitting RFR Responses will be for no more than three seconds. Before the conclusion of the Response Time Interval, the following RFR Responses on the offer side are received: public customer RFR Responses to sell five at a price of $1.14 and five at a price of $1.15; and non-public customer RFR Responses to sell 15 at a price of $1.13, 35 at a price of $1.14, and 100 at a price of $1.15. The execution of the COA-eligible order will proceed as follows:

- 15 contracts get filled at $1.13 (against non-public customer RFR Responses);
- 40 contracts get filled at $1.14 (five contracts against public customer RFR Responses, then 35 contracts against non-public customer RFR Responses); and
- 45 contracts get filled at $1.15 (20 contracts against the individual series legs in the EBook allocated by UMA, then 10 contracts against the public customer orders in COB and public customer RFR Responses allocated by time priority, then 10

contracts against the non-public customer orders resting in the COB before the COA began allocated by UMA, then five contracts against the non-public customer RFR Responses allocated via CUMA).

The proposed rule change also describes the handling of unrelated incoming complex orders that may be received prior to the expiration of a COA.[12] Specifically, the proposed rule change provides the following:

- An incoming complex order received prior to the expiration of the Response Time Interval for a pending COA (the "original COA") that is on the opposite side of the original COA-eligible order and is marketable against the starting price[13] of the original COA-eligible order will cause the original COA to end. The processing of

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12 See proposed Exchange Rule 6.53C(d)(viii). The COA system cannot be used to trade a COA-eligible order against a facilitated or solicited order. Instead, facilitations and solicitations of complex orders are subject to Interpretations and Policies .01 and .02 of Exchange Rule 6.45A (with respect to equity options) and Interpretations and Policies .01 and .02 of Exchange Rule 6.45B (with respect to index options and options on exchange-traded funds). These rules also apply to complex orders that are COA'd. Interpretation and Policy .01 of both Exchange Rules 6.45A and 6.45B pertains to principal transactions and prohibit an order entry firm from executing as principal against an order it represents as agent unless: (1) the agency order is first exposed on the Hybrid System for at least three seconds; (2) the order entry firm has been bidding or offering for at least three seconds prior to receiving an agency order that is executable against such bid or offer; or (3) the order entry firm proceeds in accordance with the crossing rules in Exchange Rule 6.74. Interpretation and Policy .02 of both Exchange Rules 6.45A and 6.45B pertains to solicitation orders and requires an order entry firm to expose for at least three seconds an order it represents as agent before the order may be executed electronically via the electronic execution mechanism of the Hybrid System, in whole or in part, against orders solicited from members and non-member broker-dealers to transact with the order.

13 The "starting price," which is not visible (other than by the COA system), is the better of the original COA-eligible order's limit price or the best price, on a net debit or credit basis, that existed in the EBook or COB at the beginning of the Response Time Interval. See proposed Exchange Rule 6.53C(d)(viii)(1).

the original COA pursuant to proposed subparagraphs (d)(iv) through (d)(vi) of Exchange Rule 6.53C is the same. Specifically, the COA-eligible order will be allocated in accordance with proposed subparagraph (d)(v) of Exchange Rule 6.53C or, if the COA-eligible order cannot be filled in whole or in a permissible ratio, the order (or any remaining balance) will route to the COB or back to PAR, as applicable, in accordance with proposed subparagraph (d)(vi) of Exchange Rule 6.53C.[14]

- Incoming COA-eligible orders that are received prior to the expiration of the Response Time Interval for the original COA that are on the same side of the market, at the same price or worse than the original COA-eligible order and that are better than or equal to the starting price, will join the original COA. The processing of the original COA pursuant to proposed subparagraphs (d)(iv) through (d)(vi) of Exchange Rule 6.53C is the same (as described above) with the addition that the priority of the original COA-eligible order and incoming COA-eligible order(s) shall be according to time priority.[15]

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14 For example, assume that a COA-eligible order to buy with a net price of $1.20 is received when the starting price is a net price of $1.10. A COA will be initiated at a net price of $1.10. An incoming order to sell at a price less than or equal to $1.10 will cause the COA to end. To the extent possible, the original COA-eligible order will be filled and any remaining balance would route to COB or back to PAR.

15 For example, assume that a COA-eligible order to buy with a net price of $1.20 is received when the starting price is a net price of $1.10. A COA will be initiated at a net price of $1.10. Incoming orders to buy at net prices ranging from $1.10 to $1.20 will join the COA. To the extent possible, the original COA-eligible order will be filled and then the incoming COA-eligible order will be filled. Any remaining balance on either the original COA-eligible order or the incoming COA-eligible order will route to COB or back to PAR.

- An incoming COA-eligible order that is received prior to the expiration of the Response Time Interval for the original COA that is on the same side of the market and at a better price than the original COA-eligible order will join the COA, cause the original COA to end, and a new COA to begin for any remaining balance on the incoming COA-eligible order. The processing of the original COA pursuant to proposed subparagraphs (d)(iv) through (d)(vi) of Exchange Rule 6.53C is the same (as described above), with the addition that the priority of the original COA-eligible order and incoming COA-eligible order shall be according to time priority.[16]

A pattern or practice of submitting unrelated orders that cause a COA to conclude early will be deemed conduct inconsistent with just and equitable principles of trade and a violation of Exchange Rule 4.1, "Just and Equitable Principles of Trade." Dissemination of information related to COA-eligible orders to third parties will also be deemed conduct inconsistent with just and equitable principles of trade and a violation of Exchange Rule 4.1 and other Exchange rules.

In addition, the CBOE notes that COA-eligible orders may be executed without consideration of prices of the same complex orders that might be available on other exchanges.[17]

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16 For example, assume that a COA-eligible order to buy with a net price of $1.20 is received when the starting price is a net price of $1.10. A COA will be initiated at a net price of $1.10. An incoming order to buy at a net price higher than $1.20 will join the COA, cause the COA to end, and a new COA to begin for any remaining balance of the incoming order. To the extent possible, the original COA-eligible order will be filled, and then the incoming COA-eligible order will be filled. Any remaining balance on the original COA-eligible order will route to COB or back to PAR. Any remaining balance on the incoming COA-eligible order will be subject to a new COA.

17 This principle also applies currently to complex orders that are executed through the COB. See Exchange Rule 6.53C(c)(iii).

Finally, CBOE is proposing that RFR Responses be firm only to the extent they may exist at the end of the Response Time Interval and only with respect to COA-eligible orders. As such, RFR Responses that collectively exceed the size of a COA-eligible order would be eligible to trade with other incoming COA-eligible orders that are received prior to the expiration of the Response Time Interval. Any RFR Response not accepted to trade against COA-eligible orders either in whole or in a permissible ratio would expire at the end of the Response Time Interval and would not be eligible to trade with the EBook or the COB.

b. Revisions to the Complex Order Book

CBOE is also proposing to make certain revisions to the existing complex order execution procedures to better describe the allocation algorithm applicable to the trading of complex orders that are entered into the COB. With respect to complex orders that trade against the EBook, the filing will clarify in renumbered paragraph (c)(ii)(1) of Exchange Rule 6.53C that the "EBook" consists of electronic orders and quotes residing in the Hybrid System, which would include public and non-public orders and market participants' quotes. With respect to complex orders that trade with other orders in the COB, renumbered paragraph (c)(ii)(2) of Exchange Rule 6.53C will provide that such trades will be allocated based on the rules of trading priority otherwise applicable to the individual component leg series in the EBook. With respect to the allocation of complex orders among market participants' orders submitted to trade against the COB, renumbered paragraph (c)(ii)(3) of Exchange Rule 6.53C will provide that market participants may enter both orders and quotes and that resulting trades will be allocated based on the rules of trading otherwise applicable to the interaction of quotes and/or orders with orders in the EBook in the individual component leg series contained in Exchange Rules 6.45A(c) or

6.45B(c), as applicable. Currently the rule text makes specific reference to only Exchange Rule 6.45A(c). The Exchange believes that these revisions will help to clarify and simplify the COB rules such that similar priority and allocation algorithms apply whether trading an individual series or a complex order.

The Exchange is also proposing to make some clarifications with respect to the minimum increments applicable to the pricing and trading of complex orders in the COB. Exchange Rule 6.42(3), "Minimum Increments for Bids and Offers," currently provides that complex orders may be entered in any increment. This provision also applies to orders entered into the COB. However, CBOE is proposing to include a clarification in Exchange Rule 6.53C to provide that complex orders that are routed to, or resting in, the COB may be expressed on a net price basis only in a multiple of the minimum increment (i.e., \$0.05 or \$0.10, as applicable) or in a one-cent increment as determined by the appropriate Exchange committee. As discussed further below, the Exchange is also proposing to clarify that the individual legs of a complex order entered into COB may be executed in one-cent increments.

c. Revisions Related to Complex Order Minimum Increments

The Exchange is proposing to revise and clarify the minimum increments that are permissible for bids and offers on complex orders. CBOE believes these changes will facilitate the orderly execution of complex orders in open outcry and via the COB and COA systems. With respect to minimum increments, Exchange Rule 6.42(3) currently provides that complex orders may generally be expressed in any increment, regardless of the minimum increment otherwise appropriate to the individual legs of the order. Thus, for example, a complex order could be entered at a net debit or credit price of \$1.03 even though the standard minimum increment for the individual series is generally $0.05 or $0.10. As an exception to this provision, Exchange Rule 6.42(3) also provides that complex orders in options on the S&P 500 Index ("SPX") that are not box spreads[18] are to be expressed in decimal increments no smaller than $0.05. The Exchange is proposing to amend this provision of Exchange Rule 6.42(3) to provide that complex orders in options on the S&P 100 Index ("OEX") that are not box spreads must be expressed in decimal increments no smaller than $0.05. Thus, the minimum increment applicable to OEX options will be the same as that which is currently applicable to SPX options. The Exchange believes that this change is appropriate given the complexity of these orders and the size of the underlying S&P 100 Index. As discussed above, the Exchange is also proposing to clarify in Exchange Rule 6.53C that complex orders entered into and resting in the COB may be expressed on a net price basis in a multiple of the minimum increment (i.e., $0.05 or $0.10, as applicable) or in a one-cent increment as determined by the appropriate Exchange committee on a class-by-class basis.

The Exchange is also proposing to make some clarifications with respect to the execution of the individual legs of a complex order. By way of background, after a complex order has been executed at the total net debit or credit price, the contract quantity and price for each individual component leg of the trade are reported as executions. However, the Exchange's rules are silent as to the minimum increment in which these resulting legs may be reported for execution. In the

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18 A "box spread" (also referred to as a "box/roll spread") means "an aggregation of positions in a long call option and short put option with the same exercise price ('buy side') coupled with a long put option and short call option with the same exercise price ('sell side') all of which have the same aggregate current underlying value, and are structured as either: A) a 'long box spread' in which the sell side exercise price exceeds the buy side exercise price or B) a 'short box spread' in which the buy side exercise price

past, when a complex order was expressed in increments smaller than $0.05 or $0.10 in open outcry, each of the component legs of a resulting trade typically would be reported in "split" prices in order to reach the quoted debit or credit price. However, with the introduction of the COB, that system may report the legs of a resulting trade in one-cent increments. Because the Exchange rules do not specifically address the minimum increment in which the legs of a resulting complex order transaction are to be reported, CBOE is proposing to include language in Exchange Rules 6.42 and 6.53C to clarify that the legs of a complex order may be executed in open outcry, via COB or via a COA in one-cent increments, regardless of the minimum quoting increments otherwise appropriate to the individual legs of the order. This change applies a consistent standard for reporting the legs of a complex order transaction whether the transaction takes place in open outcry or via electronic trading, and the Exchange believes that it will enable members to more efficiently execute transactions with less component parts in the transaction.

Lastly, the Exchange is proposing to update the provisions of its rules that refer to the trading of various types of complex orders such as spreads, straddles and combinations. These provisions will now include a cross reference to the various other types of complex orders defined in Exchange Rule 6.53C.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,[19] in general, and furthers the objectives of Section 6(b)(5) of the Act,[20] in particular, in that

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exceeds the sell side exercise price." See Exchange Rule 6.42, Interpretation and Policy .05, and Exchange Rule 6.53C(a)(7).

19 15 U.S.C. 78f(b).

20 15 U.S.C. 78f(b)(5).

it is 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 to protect investors and the public interest.

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 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-2005-65 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 20549-1090.

All submissions should refer to File Number SR-CBOE-2005-65. 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 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-2005-65 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.[21]

Nancy M. Morris
Secretary

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[21] 17 CFR 200.30-3(a)(12).