SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-64354; File No. SR-CBOE-2011-041)

April 27, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Establishing Qualified Contingent Cross Orders

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")[1] and Rule 19b-4 thereunder,[2] notice is hereby given that, on April 18, 2011, the Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. 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 Exchange is proposing rules to create a new order type referred to as a qualified contingent cross order ("QCC Order"). The text of the rule proposal is available on the Exchange's website (http://www.cboe.org/legal), at the Exchange's Office of the Secretary and at the Commissions 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 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.

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

2 17 CFR 240.19b-4.

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

1. Purpose

The International Securities Exchange, LLC ("ISE") recently received Commission approval of a proposed rule change which adopted a qualified contingent cross order type (the "ISE Proposal"). CBOE has opposed the ISE Proposal, but believes we now need to adopt rules to introduce a similar order type for competitive reasons, as indicated in our qualified contingent order briefs and comment letters responding to the ISE Proposal.[3] Therefore, CBOE is proposing to adopt rules related to a new QCC Order type.

3 ISE first proposed to adopt a qualified contingent cross order type through SR-ISE-2009-35. This proposal was approved by the Commission's Division of Trading and Markets (the "Division") pursuant to delegated authority on August 28, 2009, Securities Exchange Act Release No. 60584 (August 28, 2009), 74 FR 45663 (September 3, 2009) (SR-ISE-2009-35), but this approval was stayed by a CBOE petition seeking full Commission review. See Letters from Joanne Moffic-Silver, General Counsel and Corporate Secretary, CBOE, dated September 4 and 14, 2009. ISE thereafter submitted its modified rule change, SR-ISE-2010-73, and a letter requesting that the Commission vacate the Division's approval of SR-ISE-2009-35 simultaneous with the approval of SR-ISE-2010-73. CBOE submitted numerous letters objecting to ISE's original and modified qualified contingent cross proposals, however, the Commission approved SR-ISE-2010-73 and set aside SR-ISE-2009-35 on February 24, 2011. See Securities Exchange Act Release Nos. 62523 (July 16, 2010), 75 FR 43211 (July 23, 2010) (SR-ISE-2010-73) (ISE Proposal), 63955 (February 24, 2011) (SR-ISE-2010-73) (ISE Approval), and 69354 (February 24, 2011) (SR-ISE-2009-35); see also, e.g., CBOE comment letters and materials dated July 16, 2009, September 4, 2009, September 14, 2009, September 17, 2009, December 3, 2009, January 20, 2010, April 7, 2010, and April 9, 2010, which can be viewed at the following links: http://www.sec.gov/comments/sr-ise-2009-35/ise200935.shtml#notice; http://www.sec.gov/rules/sro/ise/isearchive/isearchive2009.shtml#SR-ISE-2009-35; and http://www.sec.gov/comments/sr-ise-2010-73/ise201073.shtml. As a result, CBOE is submitting the instant rule change proposal as a competitive response to SR-ISE-2010-73.

Background

The Exchange is currently a party to the Options Order Protection and Locked/Crossed Market Plan ("Distributive Linkage Plan"),[4] and has implemented Exchange rules in conjunction with that plan (the "Distributive Linkage Rules").[5] Similar to Regulation NMS under the Act, the Distributive Linkage Plan requires, among other things, that the Exchange establish, maintain and enforce written policies and procedures that are reasonably designed to prevent "Trade-Throughs."[6] A Trade-Through is a transaction in an option series at a price that is inferior to the best price available in the market.[7]

The Distributive Linkage Plan replaced the Plan for the Purpose of Creating and Operating an Intermarket Option Linkage ("Old Linkage Plan"), and the Distributive Linkage Rules replaced the then-existing CBOE rules implementing the Old Linkage Plan ("Old Linkage Rules"). The Old Linkage Plan and the Old Linkage Rules provided a limited Trade-Through exemption for "Block Trades," defined to be trades of 500 or more contracts with a premium value of at least $150,000.[8] However, as with Regulation NMS, the Distributive Linkage Plan does not provide a Block Trade exemption.

The ISE Proposal stated that the loss of the Block Trade exemption, among other things, adversely affects the ability of its members to effect large trades that are tied to stock,[9] and therefore proposed a QCC as a limited substitute for the Block Trade exemption. While we

---

4 See Securities Exchange Act Release No. 60405 (July 30, 2009), 74 FR 39362 (August 6, 2009) (File No. 4-546).

5 See Securities Exchange Act Release No. 60551 (August 20, 2009), 74 FR 43196 (August 26, 2009) (SR-CBOE-2009-040).

6 Section 5(a) of the Distributive Linkage Plan.

7 Section 2(21) of the Distributive Linkage Plan.

8 Old Linkage Plan Sections 2(3) and 8(c)(i)(C); and former CBOE Rule 6.80(2).

9 See ISE Proposal at 43212.

continue to disagree with the premise that QCC serves as a limited substitute for the Block Trade exemption (e.g., the Block Trade exemption is designed to provide Trade-Through relief, as discussed above; whereas QCC does not provide Trade-Through relief, as discussed below) and our views with respect to the potential impact that the ISE Proposal may have on market structure remain unchanged,[10] we nonetheless are proposing to adopt rules related to QCC Orders in order to permit the Exchange to remain competitive with ISE, and the other options exchanges that may also adopt rules for QCCs, by making QCC Orders available to CBOE Trading Permit Holders ("TPHs") and their customers through the Exchange.

Proposal

The Exchange is proposing to amend CBOE Rule 6.53, Certain Types of Orders Defined, to include a new QCC Order type. When a CBOE TPH effects a qualified contingent trade ("QCT")[11] in a Regulation NMS stock,[12] the TPH will be permitted to cross the options leg(s) of the trade on CBOE immediately without exposure if the order is for at least 1000 contracts, is part of a QCT,[13] is executed at a price at least equal to the national best bid or offer ("NBBO"),

---

10 See note 3, supra.

11 The Commission, by order, has provided Trade-Through relief for QCTs from Rule 611(a) of Regulation NMS, 17 CFR 242.611(a). See Securities Exchange Act Release No. 57620 (April 4, 2008) (the "QCT Release," which supersedes a release initially granting the QCT exemption, Securities Exchange Act Release No. 54389 (August 31, 2006)). The QCT Release provides an exemption from Trade-Through liability in the equity market for multi-component, fully-hedged trades where one order is contingent on the execution of one or more additional orders.

12 An "NMS stock" is defined in Rule 600 of Regulation NMS under the Exchange Act, 17 CFR 242.600.

13 The Exchange is proposing to define a qualified contingent cross trade substantively identical to the Commission's definition in the QCT Release. A qualified contingent cross trade must meet the following conditions: (i) at least one component must be an NMS stock, as defined in Rule 600 of Regulation NMS, 17 CFR 242.600; (ii) all components must be effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as

and there are no public customer orders resting in the Exchange's electronic book at the same price.

The QCC Order type would permit TPHs to provide their customers a net price for the entire trade, and then allow the TPH to execute the options leg(s) of the trade on CBOE at a price at least equal to the NBBO while using the QCT exemption to effect the trade in the equities leg at a price necessary to achieve the net price.[14] Under the proposal, CBOE will not permit the options component(s) of a QCC Order to trade through the NBBO.[15]

Under this proposal, CBOE would permit QCC Orders to be submitted electronically from on or off the floor through the CBOE Hybrid Trading System. In this regard, we note that, in order to effect proprietary orders (including QCC Orders) electronically from on the floor of the Exchange, TPHs must ensure that they qualify for an exemption from Section 11(a)(1) of the

---

principal or agent; (iii) the execution of one component must be contingent upon the execution of all other components at or near the same time; (iv) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed; (v) the component orders must bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (vi) the transaction must be fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade. Consistent with the QCT Release and the ISE Proposal, TPHs must demonstrate that the transaction is fully hedged using reasonable risk-valuation methodologies. See QCT Release, supra note 11, at footnote 9.

14 CBOE will adopt policies and procedures to ensure that TPHs use the QCC Order properly. First, we will require TPHs to properly mark all QCC Orders as such. In addition, CBOE will implement an examination and surveillance program to assess TPH compliance with the requirements applicable to QCC Orders, including the requirement that the stock leg of the transaction be executed at or near the same time as the options leg. We believe that ISE and other exchanges adopting a QCC-type order are also required to adopt similar policies and procedures.

15 While the QCC Order type does not provide exposure for price improvement for the options leg(s) of a stock-option order, the options leg(s) must be executed at the NBBO or better. The Commission has previously approved crossing transactions with no opportunity for price improvement. See, e.g., ISE Rules 715 and 721, and Interpretation and Policy .08 of CBOE Rule 6.74A.

Act,[16] which concerns proprietary trading on an exchange by an exchange member. Generally, Section 11(a)(1) of the Act restricts any member of a national securities exchange from effecting any transaction on such exchange for (i) the member's own account, (ii) the account of a person associated with the member, or (iii) an account over which the member or a person associated with the member exercises discretion, unless a specific exemption is available. Examples of common exemptions include the exemption for transactions by broker dealers acting in the capacity of a market maker under Section 11(a)(1)(A),[17] the "G" exemption for yielding priority to non-members under Section 11(a)(1)(G) of the Act and Rule 11a1-1(T) thereunder,[18] and "Effect vs. Execute" exemption under Rule 11a2-2(T) under the Act.[19] In this regard, we note that, consistent with existing Exchange Rules for effecting proprietary orders from on the floor of the Exchange, TPHs effecting QCC Orders and relying on the G exemption would be required to yield priority to any interest in the electronic book at the same price (not just public customer orders) to ensure that non-member interest is protected.[20]

The Exchange's proposal addresses the mechanics of executing the stock and options components of a net-price transaction. The Exchange believes that it is necessary that it provide TPHs and their customers with the same trading capabilities available on other exchanges with

16 15 U.S.C. 78k(a)(1).

17 15 U.S.C. 78k(a)(1)(A).

18 15 U.S.C. 78k(a)(1)(G) and 17 CFR 240.11a1-1(T).

19 17 CFR 240.11a2-2(T).

20 See, e.g., Securities Exchange Act Release No. 59546 (March 10, 2009), 74 FR 11144 (March 16, 2009)(SR-CBOE-2009-016) and related CBOE Regulatory Circular RG09-35 (regulatory circular provides TPHs guidance on the application of Section 11(a)(1) to trading on CBOE's Hybrid Trading System; the circular describes Section 11(a)(1) and certain of the exemptions to Section 11(a)(1) as well as the application of the (G) Order exemption and the Effect vs. Execute exemption (Rule 11a2–2(T)) to trading on the Hybrid Trading System).

respect to QCCs, including the change proposed herein, which would permit TPHs to execution the options leg(s) of large complex orders on the Exchange. This rule change is being proposed as a competitive response, and is substantially similar in all material respects, to the ISE Proposal that was recently approved by the Commission.[21]

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act,[22] in general, and furthers the objectives of Section 6(b)(5) of the Act,[23] in particular, in that an exchange should have rules that are designed to prevent fraudulent and manipulative acts and practices, 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, in general, to protect investors and the public interest. In particular, the proposed QCC Order type will prevent executions from occurring when there is a public customer order resting in the electronic book at the same price and will assure that only large-size orders (i.e., orders of at least 1000 contracts) are eligible. The proposed rule will facilitate the ability of CBOE TPHs to execute large options orders that are tied to stock in an efficient manner, while also protecting the national market system against Trade-Throughs.

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

The Exchange neither solicited nor received comments on the proposal.

---

[21] See note 3, supra.

[22] 15 U.S.C. 78f(b).

[23] 15 U.S.C. 78f(b)(5).

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

Within 45 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 self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove 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-2011-041 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-2011-041. 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 website (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 website viewing and printing 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 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 No. SR-CBOE-2011-041 and should be submitted on or before [insert date 21 days from date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[24]

Cathy H. Ahn
Deputy Secretary

[24] 17 CFR 200.30-3(a)(12).