SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-67547; File No. SR-CBOE-2012-048)

July 31, 2012

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order
Approving a Proposed Rule Change Relating to Distribution of Auction Messages

I.      Introduction

On June 6, 2012, the Chicago Board Options Exchange, Incorporated ("CBOE" or the

"Exchange"), filed with the Securities and Exchange Commission ("Commission"), pursuant to

Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a

proposed rule change to amend rules regarding the universe of eligible responders to certain

Exchange auctions and the redistribution of auction messages.  The proposed rule change was

published for comment in the Federal Register on June 22, 2012.[3]  The Commission received no

comment letters regarding the proposed rule change.  This order approves the proposed rule

change.

II.     Description

The Exchange proposes to amend several rules that govern its auction mechanisms to,

among other things, permit it to broaden the class of persons that may respond to auction

messages as well as specifically allow such participants to rebroadcast auction messages in

options classes that have been opened to such responders.  The proposed changes would amend

Rule 6.13A, relating to the Simple Auction Liaison ("SAL"); Rule 6.14A, relating to the Hybrid

Agency Liaison 2 system ("HAL2"); and Rule 6.53C, relating to Complex Orders on the Hybrid

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

[2]      17 CFR 240.19b-4.

[3]      See Securities Exchange Act Release No. 67209 (June 18, 2012), 77 FR 37724
        ("Notice").

System, each of which are described in more detail below. In addition, CBOE also proposes to delete Rule 6.14, relating to the Hybrid Agency Liaison system ("HAL"), because, since the rollout of HAL2 in 2009, the Exchange has phased out HAL and no longer uses it for any classes.[4]

A.    SAL

SAL is a feature within CBOE's Hybrid System designed to provide price improvement over the national best bid or offer ("NBBO") by automatically initiating an auction process for an order that is eligible for automatic execution by the Hybrid System ("Agency Order").[5] Currently, to the extent CBOE has activated SAL for a particular class, Market-Makers with an appointment in the relevant option class and Trading Permit Holders acting as agent for orders resting at the top of the Exchange's book opposite the Agency Order ("Qualifying Trading Permit Holders") are permitted to submit auction responses.[6] However, the Exchange may determine, on a class-by-class basis, to permit SAL responses by all CBOE Market-Makers in addition to Qualifying Trading Permit Holders.[7]

CBOE now proposes to eliminate the concept of Qualifying Trading Permit Holders under Interpretation and Policy .05 to Rule 6.13A, and instead provide more broadly that it may

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[4]    See id. at 37725. Further, the Exchange proposes to rename "HAL2" as "HAL" in the CBOE Rules to eliminate any potential confusion investors may have if there was a HAL2 but no HAL. For purposes of this order, however, the Commission is using the current terms to distinguish between "HAL2" and "HAL." In addition, the Exchange proposes to amend Rules 6.2B, 6.13, 6.14A, 6.25, and 6.53 to delete cross-references to Rule 6.14 and HAL and to correct other cross-references to conform to numbering changes in this proposal throughout the rules. See id.

[5]    See id. at 37724. The Exchange determines the eligible order size, eligible order types, eligible order origin code (i.e., public customer orders, non-Market-Maker broker-dealer orders, and Market-Maker broker-dealer orders), and classes in which SAL is activated. See CBOE Rule 6.13A(a).

[6]    See CBOE Rule 6.13A(b).

[7]    See CBOE Rule 6.13A, Interpretation and Policy .05.

determine on a class-by-class basis to permit <u>all</u> Trading Permit Holders,[8] rather than just CBOE

Market-Makers and Qualifying Trading Permit Holders, to respond to SAL auction messages.[9]

The Exchange also proposes to amend Interpretation and Policy .02 to Rule 6.13A to allow

Trading Permit Holders to redistribute auction messages in classes in which the Exchange allows

all Trading Permit Holders to submit SAL auction responses.[10]  Finally, CBOE proposes a new

Interpretation and Policy .05 to Rule 6.13A to provide that all pronouncements regarding

determinations by the Exchange pursuant to Rule 6.13A and the Interpretations and Policies

thereunder will be announced to Trading Permit Holders via Regulatory Circular.[11]

      B.    <u>HAL2</u>

HAL2 is a feature within CBOE's Hybrid System that provides automated order handling

in designated classes trading on Hybrid for qualifying electronic orders that are not automatically

executed by the Hybrid System.[12]  For those classes, HAL2 will process (1) an eligible order that

is marketable against the Exchange's disseminated quotation while that quotation is not the

NBBO;[13] (2) an eligible order that would improve the Exchange's disseminated quotation and

that is marketable against quotations by other exchanges that are participants in the Options

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8     According to CBOE, by definition, all Market-Makers are Trading Permit Holders; therefore, references to "Trading Permit Holders" include all Market-Makers. <u>See</u> Notice, <u>supra</u> note 3, at 37724 n. 3.

9     <u>See</u> <u>id.</u> at 37724.  The Exchange also proposes to move this language from Interpretation and Policy .05 to Rule 6.13A to paragraph (b) of Rule 6.13A.

10    <u>See</u> <u>id.</u>

11    <u>See</u> <u>id.</u> at 37725.

12    <u>See</u> CBOE Rule 6.14A.  The Exchange determines the eligible order size, eligible order types, eligible order origin code (<u>i.e.,</u> public customer orders, non-Market-Maker broker-dealer orders, and Market-Maker broker-dealer orders), and classes in which HAL2 is activated.  <u>See</u> CBOE Rule 6.14A(a).

13    Except that HAL2 will not be used to process such an order when the Exchange's quotation contains resting orders and does not contain sufficient Market-Maker quotation interest to satisfy the entire order.  <u>See</u> CBOE Rule 6.14A(a)(i).

Order Protection and Locked/Crossed Plan; (3) for Hybrid 3.0 classes, an eligible order that would improve the Exchange's disseminated quotation; and (4) an order submitted to HAL2 as a result of the price check parameters of Rule 6.13(b)(v).[14] HAL2 electronically exposes these orders at the NBBO price to allow Market-Makers appointed in that class as well as Trading Permit Holders acting as agent for orders at the top of the Exchange's book in the relevant series to step-up to the NBBO price.[15] Alternatively, the Exchange may determine on a class-by-class basis to make the exposure message available to all Market-Makers or to all Trading Permit Holders.[16]

Without making a substantive change to this provision, the Exchange now proposes to amend the HAL2 rule to conform the language to the new SAL and COA provisions that it has proposed in this filing. In other words, CBOE would continue to be able to allow all Trading Permit Holders to submit responses to the HAL2 exposure message.[17] CBOE also proposes to amend Interpretation and Policy .01 to Rule 6.14A to allow Trading Permit Holders to redistribute HAL2 exposure messages in classes in which the Exchange allows all Trading Permit Holders to submit HAL2 auction responses.[18]

In addition, the Exchange proposes a new Interpretation and Policy .03 to Rule 6.14A to provide that all pronouncements regarding determinations by the Exchange pursuant to Rule 6.14A and the Interpretations and Policies thereunder will be announced via Regulatory

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[14] See CBOE Rule 6.14A(a)(i)–(iv).

[15] See Notice, supra note 3, at 37725; CBOE Rule 6.14A(b). The duration of the exposure period may not exceed one second. See CBOE Rule 6.14A(b).

[16] See CBOE Rule 6.14A(b).

[17] See id.

[18] See Notice, supra note 3, at 37725.

Circular.[19]  Further, CBOE proposes to clarify that the existing provision that allows Trading

Permit Holders acting as agent for orders at the top of the Exchange's book in the relevant option

series to respond to exposure messages applies to such Trading Permit Holders that are

representing orders on the <u>opposite</u> <u>side</u> of the order submitted to HAL.  According to CBOE, the

Hybrid System currently only accepts responses that are on the opposite side of the exposed

order, and the proposed rule change amends Rule 6.14A to reflect this current practice.[20]

Finally, the Exchange proposes to amend Rule 6.14A(b) to change the word "flashed" to

"exposed" to create consistency of terminology in the Rule.

  C.  <u>COA</u>

  COA is the automated complex order request for responses ("RFR") auction process by

which eligible complex orders[21] may be given an opportunity for price improvement before

being booked in the electronic complex order book ("COB") or on a PAR workstation.[22]  To the

extent COA is activated in a particular class, Market-Makers with an appointment in the relevant

option class and Trading Permit Holders acting as agent for orders resting at the top of the COB

in the relevant option series may submit responses to the RFR messages during the Response

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19  See <u>id.</u>

20  See <u>id.</u>

21  The Exchange determines, on a class-by-class-basis, complex orders eligible for a COA considering the order's marketability (defined as a number of ticks away from the current market), size, complex order type, and complex order origin types (<u>i.e.</u>, non-broker-dealer public customer; broker-dealers that are not Market-Makers or specialists on an options exchange; and Market-Makers or specialists on an options exchange).  <u>See</u> CBOE Rule 6.53C(d)(i)(2).

22  <u>See</u> Notice, <u>supra</u> note 3, at 37725–26; CBOE Rule 6.53C(d).  CBOE determines whether to activate COA on a class-by-class basis.  <u>See</u> Notice, <u>supra</u> note 3, at 37725.

Time Interval.[23]  The Exchange may determine on a class-by-class basis to permit COA

responses by all CBOE Market-Makers in addition to Qualifying Trading Permit Holders.[24]

CBOE now proposes changes to the COA rules that mirror the changes, discussed above,

that it is proposing for SAL.  Specifically, CBOE now proposes to eliminate the concept of

Qualifying Trading Permit Holders under Interpretation and Policy .07 to Rule 6.53C, and

instead allow the Exchange to determine on a class-by-class basis to permit all Trading Permit

Holders to respond to RFR messages.[25]  In addition, the proposed rule change clarifies that only

Trading Permit Holders acting as agent for orders at the top of the Exchange's book in the

relevant option series may respond to RFR messages if they represent orders on the opposite side

of the order submitted to COA.[26]  Finally, the Exchange proposes to amend Interpretation and

Policy .05 to Rule 6.53C to allow Trading Permit Holders to redistribute RFR messages in

classes in which the Exchange allows all Trading Permit Holders to submit RFR responses.[27]

III.    Discussion and Commission's Findings

After careful review, the Commission finds that the proposed rule change is consistent with

the requirements of the Act and the rules and regulations thereunder applicable to a national

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[23]    See CBOE Rule 6.53C(d)(iii).  "Response Time Interval" means the period of time during which responses to the RFR may be entered, the length of which is determined by the Exchange on a class-by-class basis, but which shall not exceed three seconds.  See CBOE Rule 6.53C(d)(ii).

[24]    See CBOE Rule 6.53C, Interpretation and Policy .07.

[25]    See Notice, supra note 3, at 37726.  The Exchange also proposes to move this language from Interpretation and Policy .07 to Rule 6.53C to paragraph (d)(iii) of Rule 6.53C.

[26]    According to the Exchange, the CBOE Hybrid System currently only accepts responses that are on the opposite side of the Agency Order, and the proposed rule change amends Rule 6.53C to reflect this current practice.  See id.

[27]    See id.

securities exchange.[28]  In particular, the Commission finds that the proposed rule change is

consistent with Section 6(b)(5) of the Act,[29] which requires, among other things, that the rules of a

national securities exchange be 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 Commission believes the Exchange's proposal to permit it to open up

SAL and COA auctions in specified classes to all Trading Permit Holders and allow redistribution

of SAL, HAL2, and COA auction messages in those classes where the Exchange has broadened

the universe of participation could protect investors and the public interest by enhancing

competition in these auctions.  CBOE's stated purpose in opening these auctions is to allow a

greater number of market participants to submit responses to SAL auctions and COA RFRs, which

CBOE believes has the potential to result in better prices for customers as responses to exposure or

RFR messages could be at prices better than the NBBO.[30]  The Commission agrees that

broadening the universe of participants that receive these auction messages and that may respond

to those messages is consistent with the protection of investors and the public interest.  Among

other things, if CBOE takes advantage of these new provisions to open up the SAL and COA

auctions to more participants, these changes should promote broader awareness of, and provide

increased opportunities for greater participation in, these auctions and, consequentially, facilitate

the ability of CBOE to bring together participants and encourage more robust competition for price

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[28]     In approving this proposal, the Commission has considered the proposed rule's impact on
         efficiency, competition, and capital formation.  See 15 U.S.C. 78c(f).

[29]     15 U.S.C. 78f(b)(5).

[30]     See Notice, supra note 3, at 37726.

improvement in these auctions. Consistent with the protection of investors and the public interest, increased opportunities for participation and competition in these auctions could result in better prices for customers and participants

In addition, CBOE proposes to reorganize provisions of Rules 6.13A, 6.14A, and 6.53C regarding which Trading Permit Holders are eligible to respond to auction messages so that the requirements related to auction responses for SAL auctions, HAL2 auctions, and COAs all use similar language. These changes should make these substantially similar provisions easier to understand. CBOE also proposes to delete Rule 6.14, relating to HAL, while renaming "HAL2" as "HAL." The Exchange has indicated that HAL is outdated and no longer in use.[31] The Commission believes that the deletion of the obsolete HAL rule and the renaming of "HAL2" as "HAL" should alleviate any potential confusion by CBOE Trading Permit Holders as well as investors.

For the reasons stated above, the Commission believes that the proposed changes to the SAL, COA, HAL, and HAL2 rules, discussed above, are consistent with Section 6(b)(5) of the Act.[32]

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[31]     See id. at 37725.

[32]     15 U.S.C. 78f(b)(5).

IV.    Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[33] that the proposed rule change (SR-CBOE-2012-048) is approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[34]

Kevin M. O'Neill
Deputy Secretary

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[33]    15 U.S.C. 78s(b)(2).

[34]    17 CFR 200.30-3(a)(12).