SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-52659; File No. SR-CBOE-2005-85)

October 24, 2005

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Rule Change to Adopt a Market Turner Priority for Index Options and Options on ETFs on the Exchange's Hybrid 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 October 14, 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 and II below, which Items have been prepared by the CBOE. The Exchange has filed the proposal pursuant to Section 19(b)(3)(A) of the Act[3] and Rule 19b-4(f)(6) thereunder,[4] which renders the proposal effective upon filing with the Commission. 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 proposes to modify its Hybrid System rule regarding priority and allocation of trades in index options and options on ETFs to adopt a market turner priority. The Exchange has designated this proposal as non-controversial and has requested that the Commission waive the 30-day pre-operative waiting period contained

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

2 17 CFR 240.19b-4.

3 15 U.S.C. 78s(b)(3)(A).

4 17 CFR 240.19b-4(f)(6).

in Rule 19b-4(f)(6)(iii) under the Act.[5] The text of the proposed rule change is available on CBOE's Web site (www.cboe.com), at the CBOE's Office of the Secretary, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The Exchange proposes to add a market turner priority (which has already been approved for CBOE's screen-based trading ("SBT") rules)[6] to its Hybrid trading rules for index options and options on ETFs.

In April 2003, the Commission approved the CBOE's SBT rules (Chapters 40-46).[7] CBOE Rule 43.1 is the matching algorithm rule applicable to trading on the SBT platform.[8] The Exchange states that, essentially, CBOE Rule 43.1 calls for the use of either price-time priority or pro-rata priority as the base order allocation methodology. The rule then allows for three additional priority overlays: public customer priority for

5 17 CFR 240.19b-4(f)(6)(iii).

6 See Securities Exchange Act Release No. 47628 (Apr. 3, 2003), 68 FR 17697 (Apr. 10, 2003) (SR-CBOE-00-55) ("SBT Order").

7 See SBT Order.

8 The Exchange states that no products currently trade pursuant to the SBT rules.

public customer orders resting on the SBT system; participation right guarantees for certain qualifying market-makers; and a market turner priority for participants that are first to improve the CBOE's disseminated quote. These overlays are optional.

The Exchange states that recently approved CBOE Rule 6.45B,[9] relating to priority and order allocation for index options and options on ETFs trading on the Exchange's Hybrid System, is based in part on CBOE Rule 43.1 in that it allows for the selection of price-time or pro-rata as an order allocation methodology (CBOE's Ultimate Matching Algorithm is also an option) and allows for customer priority and participation entitlement overlays. The Exchange now seeks to add a market turner overlay to CBOE Rule 6.45B so that index products trading on the Hybrid System may trade with a market turner priority.

Here is how the market turner priority overlay works under CBOE Rule 43.1: assume the pro-rata allocation methodology is in place for option class ABC and that no other overlays are in effect. Also assume that the market for a particular series is 1.00 - 1.15. If Market-Maker A enters a bid for 1.05 for 100 contracts, Market-Maker A becomes the market turner at 1.05. To the extent others join the 1.05 bid, Market-Maker A would have priority at that price until its bid size is exhausted. Thus, the market turner will receive 100% of an incoming order until its quote is exhausted. This is true even if a 1.10 bid is entered and is then traded while the market turner's 1.05 bid remains unexecuted (i.e., the market turner priority at a given price is retained once it is earned, even if the disseminated quote changes).

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9 See Securities Exchange Act Release No. 51822 (Jun. 10, 2005), 70 FR 35321 (Jun. 17, 2005) (SR-CBOE-2004-87).

The Exchange is proposing to add this priority overlay to its index Hybrid rules,[10] but with flexibility to allow the Exchange to allocate less than 100% of an incoming order to the market turner. For example, taking the same facts as the example described above, assume that the Exchange has in place a 40% allocation for market turners and that Market-Maker A is joined at 1.05 by Market-Maker B for 60 contracts and Market-Maker C for 60 contracts. Also assume a sell market order is received for 100 contracts. As proposed, Market-Maker A would have priority for 40 contracts. The remaining 60 contracts would be divided pro-rata between all three participants at 1.05 (20 contracts to each). Thus, with this "modified" market turner priority, Market-Maker A receives 60 contracts of the order (but is only guaranteed 40), whereas under CBOE Rule 43.1, Market-Maker A would be guaranteed 100 contracts. The Exchange states that this is the only material difference between CBOE Rule 43.1 and what the Exchange is proposing to adopt for CBOE Rule 6.45B.

The Exchange is also clarifying in the proposed rule that the market turner priority only remains in effect for the duration of the trading day and that it cannot be established until after the opening rotation.

Finally, the Exchange notes that, like public customer priority and the participation entitlement, the market turner priority is optional. The Exchange states that the appropriate Exchange procedures committee would determine whether one or more of these priority overlays would apply to a product and if more than one is selected, the sequence in which they would apply (consistent with applicable rules). The Exchange states that all determinations would be set forth in a regulatory circular.

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10 The Exchange states that most options trading on CBOE currently trades on the Hybrid System.

2. Statutory Basis

The Exchange states that this change will provide it with another method to reward aggressive pricing in index options and options on ETFs trading on the Hybrid System. Accordingly, the Exchange believes that the proposed rule change is consistent with Section 6(b) of the Act[11] in general, and furthers the objectives of Section 6(b)(5) of the Act[12] in particular, in that the rules of an exchange be designed to promote just and equitable principles of trade, and to protect investors and the public interest.

B. Self-Regulatory Organization's Statement on Burden on Competition

The Exchange does not believe that the proposed rule change will result in 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

Written comments were neither solicited nor received.

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

The foregoing proposed rule change is subject to Section 19(b)(3)(A)(iii) of the Act[13] and Rule 19b-4(f)(6) thereunder[14] because the proposal: (i) does not significantly affect the protection of investors or the public interest; (ii) does not impose any significant burden on competition; and (iii) does not become operative prior to 30 days after the date of filing or such shorter time as the Commission may designate if consistent

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[11] 15 U.S.C. 78f(b).

[12] 15 U.S.C. 78f(b)(5).

[13] 15 U.S.C. 78s(b)(3)(A)(iii).

[14] 17 CFR 240.19b-4(f)(6).

with the protection of investors and the public interest; provided that the Exchange has given the Commission notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission.

The CBOE has satisfied the five-day pre-filing requirement. In addition, the Exchange has requested that the Commission waive the 30-day operative delay. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver will permit the Exchange to implement the proposed rule change without delay and thereby provide an incentive to parties on the Exchange to quote more aggressively as soon as possible. For these reasons, the Commission designates the proposal to be effective and operative upon filing with the Commission.[15]

At any time within 60 days of the filing of such proposed rule change, the Commission may summarily abrogate such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors or otherwise in furtherance of the purposes of the Act.[16]

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:

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15 For purposes only of accelerating the operative date of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

16 See Section 19(b)(3)(C) of the Act, 15 U.S.C. 78s(b)(3)(C).

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-2005-85 on the subject line.

Paper comments:

- Send paper comments in triplicate to Jonathan G. Katz, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-0609.

All submissions should refer to File Number SR-CBOE-2005-85. 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 CBOE. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to

File Number SR-CBOE-2005-85 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.[17]

Jonathan G. Katz
Secretary

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