

SECURITIES AND EXCHANGE COMMISSION
(Release No. 58387; File No. SR-CBOE-2008-83)

August 19, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Related to Complex Order Price Check Parameters

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 19, 2008, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ 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 amend Rule 6.53C, Complex Orders on the Hybrid System, to codify an automated system feature that prevents complex order executions from occurring at potentially erroneous prices. The text of the proposed rule change is available on the Exchange’s website (www.cboe.org/Legal), at the Exchange’s Office of the Secretary and at the Commission’s Public Reference Room.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A)(iii).

⁴ 17 CFR 240.19b-4(f)(6).

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

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

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

1. Purpose

Complex orders that are eligible for automatic execution through the CBOE's electronic complex order book ("COB") may be automatically executed in accordance with the provisions of Rule 6.53C. Complex orders that are not eligible to route to COB route to PAR. The purpose of the proposed rule change is to amend Rule 6.53C to codify a description of new complex order price check parameter functionality, which is a functionality that could be activated in certain series of a given options class that would prevent an automatic execution of a complex order from occurring at a potentially erroneous price. The complex order price check parameter is designed to help maintain a fair and orderly market. The functionality would prevent executions from automatically occurring in three types of scenarios:

Market Width Scenarios

COB would not automatically execute complex orders that are market orders if (i) the width between the Exchange's best bid and best offer in any individual series leg is not within an acceptable price range, or (ii) the width between the Exchange's best net priced bid and best net priced offer in the individual series legs comprising the complex order is not within an

acceptable price range. The applicable price ranges will be determined by the Exchange on an individual series leg basis for each series comprising the complex order and on a net price basis based on the sum of each individual series leg of the complex order, as applicable, and will be announced to the membership via Regulatory Circular generally at least one day in advance. For purposes of this provision, an “acceptable price range” shall be based on no less than 1.5 times the corresponding bid/ask differentials for the individual series legs as set forth in Rule 8.7(b)(iv)(A).⁵ In addition, the Exchange is proposing that the senior official in CBOE’s Control Room or two Floor Officials may grant intra-day relief by widening the acceptable price range. Any such intra-day changes will be announced to the membership when granted. Market orders (in whole or in part) that trigger the applicable complex order price check parameters and, thus, that are not eligible for automatic execution, will be routed on a class by class basis to PAR, BART, or at the order entry firm’s discretion to the order entry firm’s booth printer. Thus, if part of a market order may be executed within an acceptable price range, that part of the order will be executed automatically and the part of the order that would execute at a price outside the acceptable price range will be routed as described above.

For illustrative purposes, assume the Exchange determines to set a price check parameter for the series of a class that provides that complex orders would not automatically execute if they are market orders and (i) the width between the Exchange’s best bid and best offer in any individual series leg is 2 X the standard bid/ask differential, or (ii) the width between the

⁵ Rule 8.7(b)(iv)(A) sets forth the bid/ask differentials for open outcry trading in an individual series, which are as follows: no more than \$0.25 between the bid and offer for each option contract for which the bid is less than \$2, no more than \$0.40 where the bid is at least \$2 but does not exceed \$5, no more than \$0.50 where the bid is more than \$5 but does not exceed \$10, no more than \$0.80 where the bid is more than \$10 but does not exceed \$20, and no more than \$1.00 where the bid is more than \$20.

Exchange's best net bid and best net offer in the individual series legs is greater than or equal to 1.5 X the standard bid/ask differential for the individual series legs.⁶

Example 1: Assume a complex order to buy Series A and sell Series B is routed to COB. Also assume at that time the best bid and offer ("BBO") in Series A is \$1.00 - \$1.60 (wider than the 2 X series parameter), the BBO in Series B is \$3.00 - \$3.10 (within the 2 X series parameter). Because the bid/ask differential in Series A (\$0.60) is greater than 2 X the applicable standard bid/ask differential for the series,⁷ the price check parameter will be triggered. The incoming complex order will not automatically execute in COB and will instead route to PAR, BART or the booth.

Example 2: Assume a complex order to buy Series A and sell Series B is routed to COB. Also assume at the time the BBO in Series A is \$1.00 - \$1.40 (within the 2 X series parameter), the BBO in Series B is \$2.00 - \$2.60 (within the 2 X series parameter). Because the net price bid/ask differential for the two series (\$1.00) is greater than 1.5 X the applicable standard bid/ask differential for the series (\$0.975), the price check parameter will be triggered. The incoming complex order will not automatically execute in COB and will instead route to PAR, BART or the booth.

Example 3: Assume a complex order to buy 50 Series A contracts and sell 50 Series B contracts is routed to COB. Also assume at that time the BBO in Series A is \$1.00 - \$1.20

⁶ Following from the example above, on an intra-day basis the senior official or two Floor Officials may determine based on market conditions to grant relief by widening the applicable individual series or net priced price check parameters (e.g., the ranges for the individual series and/or net priced price check parameters might be temporarily widened to 3 X).

⁷ 2 X the standard bid/ask differentials would be as follows: \$0.50 between the bid and offer for each option contract for which the bid is less than \$2, \$0.80 where the bid is at least \$2 but does not exceed \$5, \$1.00 where the bid is more than \$5 but does not exceed \$10, \$1.60 where the bid is more than \$10 but does not exceed \$20, and \$2.00 where the bid is more than \$20.

(within the 2 X series parameter) for 100 contracts, the BBO in Series B is \$2.00 - \$2.20 (within the 2 X series parameter) for 10 contracts, and the next available bid in Series B is \$0.05 for 100 contracts. The incoming complex order would execute paying \$1.20 for 10 Series A contracts and collecting \$2.00 for 10 Series B contracts. When the market in Series B decrements to \$0.05 - \$2.20, the price check parameter would be triggered for any one of three reasons: the width of Series B is \$0.05 - \$2.20 (wider than the 2 X series parameter), the net price width of Series A and B is \$2.35 (wider than the 2 X net price parameter of \$1.30), and the net price has moved from a credit to debit (discussed below). The balance of the incoming complex order will route to PAR, BART or the booth.

Credit-to-Debit (Debit-to-Credit) Scenarios

In classes designated by the Exchange, COB would not automatically execute market orders that would be executed at a net credit (debit) price after receiving a partial execution at a net debit (credit) price. The remaining balance of any such market orders that trigger this complex order price check parameters will be routed on a class by class basis to PAR, BART, or at the order entry firm's discretion to the order entry firm's booth printer. The designated classes for which this price check parameter is activated will be announced to the membership via Regulatory Circular.

Example 3 above illustrates the operation of this parameter. In the example, the incoming order would initially receive an execution for 10 spreads at a net credit price of \$0.80 each (i.e., the net sale proceeds from Series B are larger than the net purchase cost from Series A). When the bid in Series B decrements to \$0.05, the net execution price would become a net debit price of \$1.15 each (i.e., the net sale proceeds from Series B are less than the net purchase

cost from Series A). Such an execution would appear to be erroneous because normally a person in this scenario would expect to execute its entire market order at a net credit price.

Vertical Scenarios

In classes designated by the Exchange, COB would not automatically execute certain vertical complex orders⁸ that appear to be erroneously priced. This functionality is designed to detect and prevent executions in limited scenarios where (i) a market order would be executed at a net debit price when it clearly should be executed at a net credit price (but not vice versa),⁹ and (ii) a order is entered at a net credit price when it clearly should have been entered at a net debit price (or vice versa). Specifically, a market order that would trade at a net (debit) price or a complex order priced at net credit (debit) price that consists of at least two series legs would be automatically rejected by COB if the complex order would result in an execution to:

- buy (sell) a number of call option contracts and sell (buy) the same number or applicable ratio (as determined by the Exchange on a class by class basis) of call option contracts in a series with the same underlying security and expiration date but a higher exercise price; or
- buy (sell) a number of put option contracts and sell (buy) the same number or applicable ratio (as determined by the Exchange on a class by class basis) of put

⁸ As referenced herein, a “vertical” complex order is one in which all the component series have the same expiration date.

⁹ A vertical market order that would result in an execution at a net credit price (i.e., the net sale proceeds from the series being sold are more than the net purchase cost from the series being bought) but that would normally execute at a net debit price (i.e., the net sale proceeds from the series being sold are less than the net purchase cost from the series being bought) would be a favorable execution for the market order and would not trigger this price check parameter.

option contracts in a series with the same underlying security and expiration date but a lower exercise price.

As with the other price check parameters, the designated classes for which this parameter is activated, as well as any applicable ratio, will be announced to the membership via Regulatory Circular. If these conditions exist when an order is routed to COB, the complex order will be rejected. To the extent the parameters are triggered once an order is resting in COB or after an incoming order receives a partial execution, such complex orders will be routed on a class by class basis to PAR, BART, or at the order entry firm's discretion to the order entry firm's booth printer. The following examples illustrate this price check parameter:

Example 1: Assume a complex order to buy 50 Jan 45 XYZ calls and sell 50 Jan 50 XYZ calls is entered at a net credit price (i.e., the net sale proceeds from the Jan 50 calls are larger than the net purchase cost from the Jan 45 calls). Such an order would appear to be erroneously priced as a net credit – it should instead be a net debit - because normally a person would expect that the Jan 50 calls would not cost more than the Jan 45 calls.

Example 2: Assume a butterfly spread to buy 50 Jan 45 XYZ calls, sell 100 Jan 50 XYZ calls and buy 50 Jan 55 XYZ calls is entered at a net credit price (i.e., the net sale proceeds from the Jan 50 calls are more than the net purchase cost from the Jan 45 and 55 calls). Such an order would appear to be erroneously priced as a net credit – it should instead be a net debit – because normally a person would expect that selling the middle 50 strike would result in less than the cost of buying the upper 55 and lower 45 strikes.

Example 3: Assume a market order to buy 50 Jan 45 XYZ calls and sell 50 Jan 40 XYZ calls is entered. Also assume that the Jan 45 XYZ calls are quoted \$4.00 - \$4.10 for 10 contracts and the next available offer is \$4.30 for 100 contracts, and that the Jan 40 XYZ calls are quoted

\$4.50 - \$4.60 for 10 contracts and the next available bid is \$4.20 for 100 contracts. The incoming market order would receive an execution for 10 spreads at a net credit price of \$0.40 each (i.e., the net sale proceeds from the Jan 40 Series are larger than the net purchase cost from the Jan 45 Series). When the series decrement, the net execution price would become a net debit price of \$0.10 each (i.e., the net sale proceeds from the Jan 40 Series are less than the net purchase cost from the Jan 45 Series). Such an execution would appear to be erroneous because normally a person in this scenario would expect to execute the vertical spread at a net credit price.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act¹⁰ and the rules and regulations under the Act applicable to national securities exchanges and, in particular, the requirements of Section 6(b) of the Act.¹¹ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹² requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. The proposed rule change will contribute to the maintenance of fair and orderly markets because it will provide an automated process for preventing potentially erroneous executions in complex orders from occurring.

¹⁰ 15 U.S.C. 78s(b)(1).

¹¹ 15 U.S.C. 78f(b).

¹² 15 U.S.C. 78f(b)(5).

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

The Exchange neither solicited nor received comments on the proposal.

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

Because the foregoing rule does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file 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 proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹³ and Rule 19b-4(f)(6) thereunder.¹⁴ 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.

¹³ 15 U.S.C. 78s(b)(3)(A).

¹⁴ 17 CFR 240.19b-4(f)(6).

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-2008-83 on the subject line.

Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2008-83. 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, on official business days between the hours of 10:00 a.m. and 3:00 p.m. 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-2008-83 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Florence E. Harmon
Acting Secretary

¹⁵ 17 CFR 200.30-3(a)(12).