

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60420; File No. SR-CBOE-2009-052)

August 3, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Related to the Hybrid Matching Algorithms

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 July 17, 2009, the Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II, and III 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 proposes to amend Rules 6.45A, Priority and Allocation of Equity Option Trades on the CBOE Hybrid System, and 6.45B, Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System, to adopt a modified participation entitlement priority overlay. The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.org/Legal>), at the Office of the Secretary, CBOE and at the Commission.

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

CBOE Rules 6.45A and 6.45B set forth, among other things, the manner in which electronic Hybrid System trades in options are allocated. Paragraph (a) of each rule essentially governs how incoming orders received electronically by the Exchange are electronically executed against interest in the CBOE quote. Paragraph (a) of each rule currently provides a “menu” of matching algorithms to choose from when executing incoming electronic orders. The menu format allows the Exchange to utilize different matching algorithms on a class-by-class basis. The menu includes, among other choices, price-time and pro-rata priority matching algorithms with additional priority overlays.³ The priority overlays currently include: public customer priority for public customer orders resting on the Hybrid System, participation entitlements for certain qualifying market-makers, and a market turner priority for participants that are first to improve CBOE’s disseminated quote. These overlays are optional.

The purpose of this rule filing is to adopt an additional priority overlay for the price-time and pro-rata matching algorithms, which the Exchange will refer to as the “modified participation entitlement.” The modified participation entitlement will operate in the same

³ The menu also includes a matching algorithm called the Ultimate Matching Algorithm (“UMA”). CBOE is not proposing any changes to the UMA matching algorithm at this time.

manner as the existing participation entitlement with a few exceptions described below.⁴ In particular, if the modified participation entitlement is in effect for an option class, then the following would apply:

- If at the time of execution there are no public customer orders resting at the execution price, then the Market-Maker participation entitlement would be applied. This outcome is no change from how the existing participation entitlement works today.
- If at the time of execution there is a public customer order that was entered first in time sequence among all other resting trading interest at the execution price, then the Market-Maker participation entitlement would be applied after public customer orders are satisfied. This outcome is no change from how the existing participation entitlement works today.

⁴ Under the existing participation entitlement, the Exchange may determine to grant Market-Makers participation entitlements pursuant to the provisions of Rules 8.87, Participation Entitlement of DPMs and e-DPMs, 8.13, Preferred Market-Maker Program, or 8.15B, Participation Entitlement of LLMs. More than one such participation entitlements may be activated for an option class (including at different priority sequences), however in no case may more than one participation entitlement be applied on the same trade. In allocating the participation entitlement, all of the following apply: (i) To be entitled to their participation entitlement, the Market-Maker's order and/or quote must be at the best price on the Exchange. (ii) The Market-Maker may not be allocated a total quantity greater than the quantity that it is quoting (including orders not part of quotes) at that price. If pro-rata priority is in effect, and Market-Maker's allocation of an order pursuant to its participation entitlement is greater than its percentage share of quotes/orders at the best price at the time that the participation entitlement is granted, the Market-Maker shall not receive any further allocation of that order. (iii) In establishing the counterparties to a particular trade, the participation entitlement must first be counted against that Market-Maker's highest priority bids or offers. (iv) The participation entitlement shall not be in effect unless the public customer priority is in effect in a priority sequence ahead of the participation entitlement and then the participation entitlement shall only apply to any remaining balance. See Rules 6.45A(a)(ii)(2) and 6.45B(a)(i)(2).

- In all other cases involving the allocation of an incoming electronic order, i.e., if at the time of execution there is one or more public customer orders resting at the execution price but none was entered first in time sequence, then the Market-Maker participation entitlement and public customer priority overlays would not be applied to the allocation. This outcome is a change from how the existing participation entitlement works today.⁵
- The modified participation entitlement would not be used for any electronic auctions, instead the existing participation entitlement parameters would be applied.⁶ Thus, the outcome would be no change from how the existing participation entitlement works today for electronic auctions.

Lastly, it should be noted that, like the existing priority overlays, the modified participation entitlement is optional. As with the existing procedures, the Exchange will continue to determine whether one or more of the priority overlays shall apply to an option class and if more than one is selected, the sequence in which they shall apply (consistent with applicable rules). All determinations would be set forth in a regulatory circular.

⁵ For example, assume the matching algorithm for an options class is established so that public customer orders have first priority, the modified participation entitlement has second priority, and any remaining balance is allocated using the pro-rata matching algorithm. If at the time of execution there is one or more public customer orders at the execution price but none is first in time sequence (say because a Market-Maker quote was the first trading interest posted at the execution price), then the Market-Maker participation entitlement and public customer priority overlays would not be applied and the incoming order would be allocated solely on a pro-rata basis.

⁶ CBOE has various electronic auctions that are described under Rules 6.13A, Simple Auction Liaison (“SAL”), 6.14, Hybrid Agency Liaison (HAL), 6.53C(d), Process for Complex Order RFR Auction (“COA”), 6.74A, Automated Improvement Mechanism (“AIM”), and 6.74B, Solicitation Auction Mechanism (“AIM SAM”). Each of these auctions generally allocates executions pursuant to the matching algorithm in effect for the options class with certain exceptions noted in the respective rules. For example, no participation entitlement is applied to orders executed through HAL or AIM.

2. Statutory Basis

This change will allow the Exchange another method to reward aggressive pricing in options trading on the Hybrid System. Accordingly, CBOE believes the proposed rule change is consistent with Section 6(b) of the Act⁷ in general and furthers the objectives of Section 6(b)(5) of the Act⁸ in particular in that it is designed to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, 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.

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 self-regulatory organization consents, the Commission will:

(A) By order approve such proposed rule change, or

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

(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 No. SR-CBOE-2009-052 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 No. SR-CBOE-2009-052. 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 changes 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, 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 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 No. SR-CBOE-2009-052 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.⁹

Florence E. Harmon
Deputy Secretary

⁹ 17 CFR 200.30-3(a)(12).