

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60479; File No. SR-CBOE-2009-058)

August 11, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of 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 August 6, 2009, 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 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 is proposing to introduce an additional priority overlay related to small orders executed on its Hybrid System on a pilot basis until August 31, 2009. 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.

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 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, the ultimate matching algorithm (“UMA”), as well as price-time and pro-rata priority matching algorithms with additional priority overlays. The priority overlays for price-time and pro-rata 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 small orders that can be applied to each of the three matching algorithms. The Exchange proposes to adopt the small order priority overlay on a pilot basis expiring on August 31, 2009, at which point the Exchange anticipates that this priority overlay will become operative on a permanent basis through a separate rule change.⁵

If the small order priority overlay is in effect for an option class, then the following would apply:

- Orders for five (5) contracts or fewer will be executed first by the Designated Primary Market-Maker ("DPM") or Lead Market-Maker ("LMM"), as applicable, that is appointed to the option class; provided however, that on a quarterly basis the Exchange will evaluate what percentage of the volume executed on the Exchange (excluding volume resulting from the execution of orders in AIM (see CBOE Rule 6.74A, Automated Improvement Mechanism ("AIM")) is comprised of orders for five (5) contracts or fewer executed by DPMs and LMMs, and will reduce the size of the orders included in this provision if such percentage is over forty percent (40%).
- This procedure only applies to the allocation of executions among non-customer orders and market maker quotes existing in the EBook at the time the order is received by the Exchange. No market participant is allocated any portion of an

⁵ The Exchange has submitted a separate rule change filing to adopt the small order priority overlay on a permanent basis, SR-CBOE-2009-056. That rule change is currently effective and, pursuant to Section 19(b)(3)(A) of the Act, 15 U.S.C. 78s(b)(3)(A), and Rule 19b-4(6), 17 CFR 240.19b-4(f)(6) thereunder, will become operative on or about August 31, 2009.

execution unless it has an existing interest at the execution price. Moreover, no market participant can execute a greater number of contracts than is associated with the price of its existing interest. Accordingly, the small order preference contained in this allocation procedure is not a guarantee; the DPM or LMM, as applicable, (i) must be quoting at the execution price to receive an allocation of any size, and (ii) cannot execute a greater number of contracts than the size that is associated with its quote.

- If a Preferred Market-Maker (see CBOE Rule 8.13, Preferred Market-Maker Program) is not quoting at a price equal to the national best bid or offer (“NBBO”) at the time a preferred order is received, the allocation procedure for small orders described above shall be applied to the execution of the preferred order. If a Preferred Market Maker is quoting at the NBBO at the time the preferred order is received, the allocation procedure for all other sized orders, shall be applied to the execution of the preferred order (e.g., if the default matching algorithm is pro-rata with a public customer and participation entitlement overlay, the order will execution first against any public customer orders, then the Preferred Market-Maker would receive its participation entitlement, then the remaining balance would be allocated on a pro-rata basis).
- The small order priority overlay will only be applicable to automatic executions and will not be applicable to any electronic auctions.⁶

⁶ In addition to AIM, CBOE has various electronic auctions that are described under Rules 6.13A, Simple Auction Liaison (“SAL”), 6.14, Hybrid Agency Liaison (HAL), 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.

Lastly, like the existing priority overlays, the small order priority overlay is optional. All determinations would be set forth in a regulatory circular.

According to the Exchange, because DPMs and LMMs have unique obligations to the CBOE market,⁷ they are provided with certain participation rights. Under the current rule, if the DPM or LMM, as applicable, is one of the participants with a quote at the best price, the participation entitlement is generally equal to 50% when there is one Market-Maker also quoting at the best bid/offer on the Exchange, 40% when there are two Market-Makers also quoting at the best bid/offer on the Exchange, and 30% when there are three or more Market-Makers also quoting at the best bid/offer on the Exchange.⁸ The Exchange is now seeking to expand these programs to make available an allocation procedure on a pilot basis that provides that the DPM or LMM, as applicable, has precedence to execute orders of five (5) contracts or fewer. The Exchange believes that this small order priority overlay will not necessarily result in a significant portion of the Exchange's volume being executed by the DPM or LMM, as applicable. As stated above, the DPM or LMM would execute against such orders only if it is quoting at the best price, and only for the number of contracts associated with its quotation. Nevertheless, the Exchange will evaluate what percentage of the volume executed on the Exchange is comprised of orders

⁷ For example DPMs must, among other things, (i) provide continuous electronic quotes in at least 90% of the series of each multiply-listed option class allocated to it and in 100% of the series of each singly-listed option class allocated to it, and assure that its disseminated market quotes are accurate; (ii) comply with bid/ask differential requirements; (iii) ensure that a trading rotation is initiated promptly following the opening of the underlying security (or promptly after 8:30 am Central Time in an index class) in 100% of the series of each allocated class by entering opening quotes as necessary. See CBOE Rule 8.85, DPM Obligations; see also CBOE Rule 8.15A, Lead Market-Makers in Hybrid Classes.

⁸ See CBOE Rules 6.45A(a)(i)(C) and (ii)(2), 6.45B(a)(i)(2) and (ii)(C), 8.15B, Participation Entitlement for LMMs, and 8.87, Participation Entitlement of DPMs and e-DPMs.

for five (5) contracts or fewer executed by DPMs and LMMs, and will reduce the size of the orders included in this provision if such percentage is over forty percent (40%).

The small order priority overlay described above is part of CBOE's careful balancing of the rewards and obligations that pertain to each of the Exchange's classes of memberships. This balancing is part of the overall market structure that is designed to encourage vigorous price competition between Market-Makers on the Exchange, as well as maximize the benefits of price competition resulting from the entry of customer and non-customer orders, while encouraging participants to provide market depth. The Exchange believes the proposed small order priority overlay, which includes participation rights for DPMs and LMMs only when they are quoting at the best price, strikes the appropriate balance within its market and maximizes the benefits of an electronic market for all participants.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act⁹ and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.¹⁰ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹¹ 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. In particular, as described further above, the Exchange believes the proposed rule change is part of the balancing of CBOE's overall market structure, which is designed to encourage vigorous price competition between Market-Makers on

⁹ 15 U.S.C. 78s(b)(1).

¹⁰ 15 U.S.C. 78f(b).

¹¹ 15 U.S.C. 78f(b)(5).

the Exchange, as well as maximize the benefits of price competition resulting from the entry of customer and non-customer orders, while encouraging participants to provide market depth.

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 proposed rule change: (i) does not significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) by its terms, does not 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, it has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³

A proposed rule change filed under Rule 19b-4(f)(6) normally may not become operative prior to 30 days after the date of filing.¹⁴ However, Rule 19b-4(f)(6)(iii)¹⁵ permits the Commission

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6).

¹⁴ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires a self-regulatory organization to give 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 Commission deems this requirement to be met.

¹⁵ 17 CFR 240.19b-4(f)(6)(iii).

to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has requested that the Commission waive the 30-day operative delay to encourage fair competition among brokers and dealers and the exchanges by allowing the CBOE to effectively compete with options exchanges that offer a similar program. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest because such waiver would allow the pilot to be implemented immediately.¹⁶ In addition, the Commission notes that the Exchange has filed the proposed rule change that permanently adopts the small order priority overlay,¹⁷ based on substantially similar rules already in place at other national securities exchanges.¹⁸ Accordingly, the Commission designates the proposed rule change, to adopt the small order priority overlay on a pilot basis until August 31, 2009, operative upon filing.

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.

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:

¹⁶ For purposes only of waiving the 30-day operative delay of this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

¹⁷ See SR-CBOE-2009-056.

¹⁸ See, e.g., ISE Rule 713.01 and 713.03.

- 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-2009-058 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-2009-058. 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, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 am and 3:00 pm. Copies of such 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-2009-058 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.¹⁹

Florence E. Harmon
Deputy Secretary

¹⁹ 17 CFR 200.30-3(a)(12).