

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57849; File No. SR-CBOE-2008-16)

May 22, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change to Reduce Certain Order Exposure Times from Three Seconds to One Second

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 May 16, 2008, 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, II, and III below, which Items have been substantially prepared by CBOE. 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 reduce the order handling and exposure periods contained in certain of its rules from three seconds to one second. The text of the proposed rule change is available on the Exchange’s Web site (<http://www.cboe.org/Legal>), at CBOE’s principal office, 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, CBOE 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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

below. CBOE 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 purpose of the proposed rule change is to reduce the order handling and exposure periods contained in Rules 6.45A, Priority and Allocation of Equity Option Trades on the CBOE Hybrid System, 6.45B, Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System, 6.74A, Automated Improvement Mechanism (“AIM”), and 6.74B, Solicitation Auction Mechanism, from three seconds to one second.

Rules 6.45A and 6.45B provide that an order entry firm may not execute an order it represents as agent with a facilitation or solicited order (referred to herein as “crossing orders”) using the Hybrid Trading System (“Hybrid”) unless it first complies with the three-second exposure requirement. Specifically, order entry firms may not execute a facilitation cross unless: (i) the agency order is first exposed on Hybrid for at least three seconds; (ii) the order entry firm has been bidding or offering for at least three seconds prior to receiving the agency order that is executable against such bid or offer; or (iii) the order entry firm proceeds in accordance with the floor-based open outcry crossing rules contained in CBOE Rule 6.74, Crossing Orders.

Similarly, order entry firms may not execute an order they represent as agent against orders solicited from members and non-member broker-dealers unless the agency order is first exposed on Hybrid for at least three seconds. During this three-second exposure period for crossing

orders, other members may enter orders to trade against the exposed order. Under the proposal, these exposure periods would be reduced to one second.³

Rule 6.74A contains the requirements applicable to the execution of orders using AIM. AIM allows members to enter cross transactions on Hybrid. Currently, orders entered into AIM are exposed for a random time period determined by the system that is not less than three seconds and not more than five seconds, giving an opportunity for additional trading interest to be entered before the orders are automatically executed. Under the proposal, the random exposure period for AIM would be reduced to one second.

Rule 6.74B contains the requirements applicable to the execution of orders using the Solicitation Auction Mechanism (the “SAM Auction”). The SAM Auction allows members to enter larger-sized cross transactions on Hybrid (i.e., orders of 500 contracts or more). Orders entered into the SAM Auction are currently exposed for a three second period, giving an opportunity for additional trading interest to be entered before the orders are automatically executed. Under the proposal, the exposure period for the SAM Auction would be reduced to one second.

The Exchange notes that in adopting the various three-second order handling and exposure periods, it recognized that three seconds would not be long enough to allow human interaction with the orders (or RFQs, as applicable). Rather, market participants had become sufficiently automated that they could react to these orders electronically. In this context, CBOE believes it would be in all market participants’ best interest to minimize the exposure period to a

³ For Hybrid 3.0 classes, the exposure period is established on a class-by-class basis, provided the minimum exposure time must be at least three seconds and shall not exceed 30 seconds. See CBOE Rule 6.45B .03. The Exchange is proposing to reduce the minimum time from three seconds to one second. The 30-second parameter will remain unchanged.

time frame that continues to allow adequate time for market participants to electronically respond, as both the order being exposed and the participants responding are subject to market risk during the exposure period. In this respect, the Exchange states that its experience with the three-second exposure time period indicates that one second would provide an adequate response time.⁴ Most members wait until the end of the last second of the three second period before responding to exposed orders in order to minimize market risk. Accordingly, the Exchange does

⁴ The Exchange has numerous market participants that have the capability and do opt to respond within a one-second exposure period on its Hybrid trading platform. In this regard, the Exchange notes that it has other Hybrid electronic exposure mechanisms for which timers set at or below one second provide for an adequate response time. For example, the exposure and allocation timers for the Exchange’s Hybrid Agency Liaison (“HAL”) mechanism are currently both set at 0.300 seconds, and numerous market participants can and do opt to respond to HAL exposure messages within this time frame. See CBOE Rule 6.14.

HAL is a feature that provides automated order handling in designated classes for qualifying electronic orders that are not automatically executed. Qualifying orders that are received by HAL are electronically exposed immediately upon receipt for an exposure period of 0.300 seconds. If during the exposure period a Market-Maker or Qualifying Member commits to trade any portion of the order, the exposure period ends and the allocation period of 0.300 seconds will begin. At the conclusion of the allocation period the order is executed or, if no responses are received, processed in accordance with the procedures set forth in Rule 6.14.

The Exchange believes that its experience with the HAL mechanism supports its view that one second is sufficient time for market participants to respond to CBOE’s AIM and SAM Auction mechanisms, which operate on the Hybrid trading system and employ the same type of mechanical messaging as the HAL mechanism. The Exchange also believes its experience with the HAL mechanism supports its view that one second is sufficient time for market participants to have an opportunity to enter orders to trade against an order exposed in the book before the order entry firm is permitted to enter a contra-side facilitation or solicited order. This is because market participants receive mechanically messaged information about book updates, and are able and do opt to automatically submit orders and quotes in response to those book updates on the Hybrid trading system in substantially the same manner as they would respond to a HAL message. The Exchange also notes that any delay or latency associated with submitting responses to an AIM or SAM Auction, or responding to a book update, would be the same as responding to HAL because all such responses are processed over the same network.

not believe it is necessary or beneficial to the orders being exposed to continue to subject them to market risk for a full three seconds.

When approving the existing three-second order handling and exposure periods, the Commission concluded that, in the electronic environment of Hybrid, reducing the exposure period to three seconds could facilitate the prompt execution of orders while providing participants in Hybrid with an adequate opportunity to compete for exposed bids and offers.⁵ Continuing on that same logic, CBOE believes that reducing its order handling and exposure periods from three seconds to one second will benefit market participants. Since members react to these orders electronically, and generally only opt to respond at the tail end of the three-second period in order to minimize market risk, CBOE believes that reducing the time periods to one second will continue to provide CBOE members with sufficient time to ensure effective interaction with orders.⁶ At the same time, CBOE believes that reducing the time periods to one second will allow it to provide investors and other market participants with more timely executions, thereby reducing market risk.

This shortened exposure period is fully consistent with the electronic nature of Hybrid. CBOE members have electronic systems available that would allow them to respond in a meaningful way within the proposed timeframe. It will continue to provide market participants with sufficient time to respond, compete, and provide price improvement for orders.

⁵ See, e.g., Securities Exchange Act Release No. 53567 (March 29, 2006), 71 FR 17529 (April 6, 2006) (SR-CBOE-2006-09) (order approving the reduction of the exposure period for crossing orders in Hybrid under Rules 6.45A and 6.45B from ten seconds to three seconds).

⁶ The Exchange believes that the proposed timeframe would give market participants sufficient time to respond, compete, and provide price improvement for orders. The Exchange also notes that electronic systems are readily available to, if not already in place for, CBOE members that allow them to respond in a meaningful way within the proposed timeframe.

2. Statutory Basis

The Exchange 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. In particular, the exchange believes that the proposed rule change will provide investors with more timely execution of their options orders, while ensuring that there is an adequate exposure of all crossing orders in the CBOE marketplace.

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

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

such longer period to be appropriate and publishes its reasons for so finding, or (ii) as to which CBOE consents, the Commission will:

- (A) by order approve such proposed rule change, or
- (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 Number SR-CBOE-2008-16 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2008-16. 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 a.m. and 3:00 p.m. 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-2008-16 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).