SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-56951; File No. SR-CBOE-2007-74)

December 12, 2007

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order Granting
Approval of Proposed Rule Change, as Modified by Amendment No. 1 Thereto, to Amend
CBOE Rule 6.13A to Modify the Simple Auction Liaison Auction Process and Incorporate
Specific Provisions for Hybrid 3.0 Classes

I.   Introduction

On July 2, 2007, the Chicago Board Options Exchange, Incorporated ("CBOE" or

"Exchange"), filed with the Securities and Exchange Commission ("Commission") pursuant to

Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a

proposed rule change to amend CBOE Rule 6.13A to modify the Simple Auction Liason

("SAL") auction process. On October 16, 2007, CBOE filed Amendment No. 1 to the proposed

rule change. The proposed rule change, as amended, was published for comment in the Federal

Register on November 7, 2007.[3] The Commission received no comments on the proposal. This

order approves the proposed rule change, as amended.

II.   Description of the Proposal

CBOE Rule 6.13A governs the operation of the Exchange's SAL system. SAL is a

feature on CBOE's Hybrid system that auctions certain marketable orders for price improvement

over the National Best Bid and Offer ("NBBO"). The SAL rules provide for an auction, for a

period of time not to exceed two seconds as determined by the Exchange on a class-by-class

basis, for any qualifying order ("Agency Order") that is eligible for automatic execution by

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[1]   15 U.S.C. 78s(b)(l).

[2]   17 CFR 240.19b-4.

[3]   See Securities Exchange Act Release No. 56730 (November 1, 2007), 72 FR 62883
        (November 7, 2007) (the "Notice").

CBOE's Hybrid System.[4] CBOE Rule 6.13A(b) outlines the procedures regarding how a response shall be submitted during the auction and provides that the response may be submitted in one-cent increments. CBOE proposes to modify this rule to allow the auction response in all option classes in which SAL is activated to be submitted in one-cent increments or standard increments, as determined by the Exchange.[5] CBOE believes that this modification may encourage market makers and other market participants to quote more aggressively overall.

The Exchange believes that applying SAL to Hybrid 3.0 classes will provide a more automated order handling process in those classes. CBOE proposes to modify the operation of SAL, however, with respect to Hybrid 3.0 classes. The existing SAL rules provide that Agency Orders are to be allocated in two rounds.[6] For Hybrid 3.0 Classes, CBOE proposes to conduct only one round of allocations, because the Designated Primary Market Maker or Lead Market Maker ("DPM" or "LMM") is the only "quoter" on the Hybrid 3.0 Platform.[7] Specifically, the first round allocation specified in Rule 6.13A(c)(i) will not apply; rather, in Hybrid 3.0 Classes, the single allocation round will be conducted pursuant to the criteria in Rule 6.13A(c)(ii) for Hybrid and Hybrid 2.0 classes, with a few differences.

The current SAL rule allocates the Agency Order pursuant to the matching algorithm that is in effect for the class pursuant to Rule 6.45A or Rule 6.45B.[8] CBOE's proposal will allow the matching algorithm as applied to SAL to be different from the matching algorithm that is

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4   See CBOE Rule 6.13(b)(C)(i).

5   See proposed changes to CBOE Rule 6.13A(b)(ii).

6   See CBOE Rule 6.13A(c).

7   Pursuant to CBOE Rule 1.1(aaa), the Hybrid 3.0 Platform is an electronic trading platform on the Hybrid trading system that allows a single quoter to submit an electronic quote which represents the aggregate Market-Maker quoting interest in a series for the trading crowd.

8   See CBOE Rule 6.13A(c)(1).

currently in effect for the Hybrid 3.0 Class. Therefore, for Hybrid 3.0 Classes, the Exchange

proposes to allow the appropriate Exchange Procedure Committee to determine, on a class-by-

class basis, which electronic matching algorithm will apply to SAL executions. The matching

algorithm applied to SAL in Hybrid 3.0 Classes will continue to be pursuant to Rule 6.45B.

The existing SAL rule also provides for a Market-Maker to receive a participation

entitlement only if the applicable matching algorithm (from Rule 6.45A or 6.45B) that is in

effect for the class includes a participation entitlement.[9] Currently, Hybrid 3.0 does not permit

an LMM or DPM to receive a participation entitlement as it pertains to the allocation of

incoming electronic orders.[10] Since the LMM or DPM does not receive a participation

entitlement with regard to incoming electronic orders, CBOE proposes to permit the appropriate

Exchange Market Performance Committee to establish, on a class-by-class basis, an LMM or

DPM participation entitlement applicable only to SAL executions in Hybrid 3.0 Classes.

Incorporating SAL on the Hybrid 3.0 Platform will provide Market-Makers with electronic

access to the Agency Order since Market-Makers will be able to electronically respond to the

Agency Order through SAL. The Exchange stated in its Notice that with Market-Makers having

access to electronically respond to the Agency Order, incorporating a LMM/DPM participation

entitlement to SAL executions may provide for more aggressive quoting. The participation

entitlement, if any, will be in compliance with the provisions of Rule 6.45B(a)(i)(2).

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[9]   See CBOE Rule 6.13A(c)(3).

[10]   In Hybrid 3.0 Classes, pursuant to existing rules, all eligible orders pursuant to Rule 6.13 can receive automatic execution against public customer orders in the electronic book. The remaining balance of the eligible order, if any, may be represented in the electronic book, provided such order is eligible for book entry pursuant to Rule 7.4; if not book eligible, the remaining balance of the eligible order will route to PAR, BART, or the order entry firm's booth printer. See CBOE Rule 6.13(b)(i)(A)(2). Orders not eligible for automatic execution will route on a class-by-class basis to PAR, BART, or the order entry firm's booth printer. See CBOE Rule 6.13(b)(i)(B).

When the SAL system is enabled, the Exchange will conduct a SAL auction in Hybrid 3.0 classes only when the Exchange's quote is represented by the DPM/LMM quote. The Exchange will not conduct a SAL auction when the Exchange's quote is represented by a manual quote.[11] All other aspects of SAL pursuant to CBOE Rule 6.13A will apply to Hybrid 3.0 Classes.

III.   Discussion and Commission Findings

The Commission has carefully reviewed the proposed rule change and finds that it is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.[12] In particular, the Commission finds that the proposed rule change is consistent with Section 6(b)(5) of the Act,[13] which, among other things, requires that the rules of a national securities exchange be designed to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating 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.

The Commission notes that SAL is a feature which auctions certain orders for price improvement over the NBBO. The Commission believes that it is reasonable and consistent with the Act to allow the Exchange flexibility to determine the minimum trading increment in which responses in the auction - responses to provide price improvement - can be submitted. The Commission notes that orders that participate in a SAL auction will, at a minimum, receive executions at the NBBO.

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[11]   See proposed CBOE Rule 6.13A.04(iii).

[12]   In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

[13]   15 U.S.C. 78f(b)(5).

Applying the SAL functionality to Hybrid 3.0 classes should serve to further automate the order handling process for certain orders in those classes. Automation may increase efficiency in the marketplace, which would be in the interest of the Exchange, its members, and the investing public. Further, the Commission believes the differences in the application of SAL to Hybrid 3.0 classes are reasonable and consistent with the Act, in part because of the differences in the operation of Hybrid 3.0. The Commission notes, however, that the Exchange has the duty to surveil for compliance with its own rules and Rule 602 of Regulation NMS[14] in all instances, including when an order is received when the Exchange's quote is represented by a manual quote.

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[14]   17 CFR 242.602.

IV.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[15] that the

proposed rule change (SR-CBOE-2007-74), as modified by Amendment No. 1, be, and hereby is,

approved.

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

authority.[16]

                                    Florence E. Harmon
                                    Deputy Secretary

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[15]   15 U.S.C. 78s(b)(2).

[16]   17 CFR 200.30-3(a)(12).