

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-57837; File No. SR-CBOE-2008-46)

May 20, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to the Hybrid Agency Liaison

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on May 15, 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 Exchange filed the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder,<sup>4</sup> which renders the proposal effective upon filing with the Commission. 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 modify Rule 6.14, Hybrid Agency Liaison (“HAL”), so that the Exchange may determine on a class-by-class basis to permit electronic exposure of HAL orders to all CBOE members to give additional opportunities to provide the orders with the best price. The text of the proposed rule change is available on the Exchange’s Web site

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

(<http://www.cboe.org/Legal>), at the Exchange's Office of the Secretary, 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 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

In classes where HAL is activated, HAL automatically upon receipt processes market and limit orders if: (i) the market orders or limit orders are marketable against the Exchange's disseminated quotation while that quotation is not at the national best bid or offer ("NBBO"); (ii) the limit orders would improve the Exchange's disseminated quotation and are marketable against quotations disseminated by other exchanges participating in the Intermarket Options Linkage ("Linkage"); and (iii) for Hybrid 3.0 classes, the limit orders would improve the Exchange's disseminated quotation, except when the disseminated quotation is represented by a manual quote, in which case the limit order will automatically route to the electronic book instead of being processed by HAL, and the manual quote will be cancelled.<sup>5</sup>

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<sup>5</sup> See Rule 6.14(a).

When these circumstances occur, orders that are received by HAL are immediately upon receipt electronically exposed to all Market-Makers appointed to the relevant option class, as well as all members acting as agent for orders at the top of the Exchange's book ("Qualifying Members") in the relevant series.<sup>6</sup> At the conclusion of the HAL process:

- the order will be filled in accordance with the allocation algorithm in effect for the class pursuant to Rule 6.45A, Priority and Allocation of Equity Option Trades on the CBOE Hybrid System, or 6.45B, Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System, subject to certain requirements. In particular, there is no participation entitlement applicable to exposed orders, and response sizes are limited to the size of the exposed order for allocation purposes; or
- if no responses are received or if there remains an unexecuted portion of a marketable order, then the remaining balance of the order will be routed through Linkage.<sup>7</sup>

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<sup>6</sup> The orders are exposed for a period determined by the Exchange on a class-by-class basis, which period shall not exceed 1.5 seconds. If a Market-Maker or Qualifying Member (on behalf of the order it is representing) commits to trade with any portion of the order during the exposure period, then the exposure period will end, and an allocation period will begin. The allocation period is determined by the Exchange on a class-by-class basis and, when combined with the designated exposure period (as opposed to an exposure period that is terminated early), shall not exceed a total of 3 seconds. See Rule 6.14(b).

<sup>7</sup> If the remaining order balance is for the account of a public customer and is marketable against another exchange that is a participant in Linkage, then HAL will route a Principal Acting as Agent Linkage Order ("P/A Order") on behalf of the remaining order balance through the Linkage, and any resulting execution of the P/A Order will be allocated to that order. If the remaining order balance is marketable against another exchange that is a participant in Linkage but is not for the account of a public customer, then HAL will route a Principal Linkage Order ("P Order") on behalf of the Remaining Order through the Linkage, and any resulting execution of the P Order will be allocated to the remaining order. In either situation above, if the Linkage order cannot be transmitted from the Exchange because the price of the Linkage order (or a better price) is no longer available on any market, then HAL will, pursuant to normal order allocation processing, execute

If a marketable order is not executed via HAL, it is routed through Linkage to a competing exchange(s) even though there may be other CBOE members who would be willing to execute the order at the better price. Additionally, when an order is sent through Linkage, the other exchange charges an execution fee. The cost of sending the order through Linkage can be substantial, particularly with respect to other options exchanges that have adopted a maker-taker fee schedule.<sup>8</sup> To retain as much order flow as possible on CBOE and to help reduce costs associated with the number of orders sent through Linkage,<sup>9</sup> CBOE proposes to allow itself the

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the remaining order balance against the Exchange's existing quote (provided such execution would not cause a trade-through) or, if the Exchange's quote is inferior to the Exchange's best bid or offer at the time the order was received by HAL ("Exchange Initial BBO"), against the Market-Makers that constituted the Exchange Initial BBO at a price equal to the Exchange Initial BBO. If the remaining order is not marketable (either on CBOE or another exchange), it will be entered into the Hybrid book for dissemination. See Rule 6.14(b)(i) – (iii).

<sup>8</sup> Several options exchanges have adopted a fee structure in which firms receive a rebate for the execution of orders resting in the limit order book (i.e., posting liquidity) and pay a fee for the execution of orders that trade against liquidity resting on the limit order book (i.e., taking liquidity). Taker fees currently range up to \$0.45 per contract and are charged without consideration of the order origin category, including public customer orders. In contrast, CBOE does not generally charge a fee for the execution of public customer orders that are routed directly to our market. The effective price paid by a customer purchasing an option can be considerably higher on an exchange that charges a taker fee. For example, a customer that enters a marketable limit order to buy 10 contracts for \$0.10 would pay \$100 on CBOE and \$104.50 if executed on an exchange that charges a \$0.45 taker fee (an effective 4.5% increase). Because orders cannot be executed at prices inferior to the NBBO, members are effectively forced to pay taker fees when an exchange with a taker fee structure is at the NBBO and the members' orders are directly routed to such an exchange or indirectly routed to such an exchange through Linkage (where the fees are passed through).

<sup>9</sup> Outbound Linkage costs are incurred by CBOE and its members. CBOE currently rebates DPM transaction fees generated from transactions against customer orders that underlie outbound P/A and P Orders ("CBOE Transactions"). In addition, when DPMs incur fees to execute P/A or P Orders at other exchanges ("Away Transactions"), those DPMs are credited an additional amount per contract to offset such fees. CBOE also credits DPMs an additional amount per contract on both CBOE Transactions and Away Transactions to offset the Sales Value Fee (which offsets fees payable to the Commission

flexibility to determine on a class-by-class basis to expose orders received by HAL to all members that have elected to receive HAL messages (not just Market-Makers appointed to the relevant option class and Qualifying Members), and to permit such members to respond to HAL on a proprietary or agency basis. This would provide for additional opportunities to provide orders with the best price on CBOE.

For such classes, each member that submits a response to trade with an order during the exposure or allocation periods would be entitled to receive an allocation of the order in accordance with the allocation algorithm in effect for the option class pursuant to Rule 6.45A or 6.45B, subject to certain requirements. As with the existing HAL allocation process, there would be no participation entitlement applicable to exposed orders, and response sizes would be limited to the size of the exposed order for allocation purposes. In addition, if the applicable allocation algorithm in effect for the option class is price-time or pro-rata, then any public customer priority overlay in effect for a class would not be applicable. The Exchange believes this condition is a reasonable modification designed to give market participants a more balanced opportunity to participate in an allocation. The Exchange also notes that, in accordance with the existing provisions of Rules 6.45A and 6.45B, there is no requirement that a public customer priority overlay be in effect if there is no participation entitlement.

Lastly, because all members would be permitted to respond on a proprietary or agency basis, the HAL provision that normally prohibits the dissemination of information regarding

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under Section 31 of the Act), the Options Clearing Corporation (“OCC”) per contract fee applicable to market-makers and specialists set forth on the OCC Schedule of Fees, and an estimated average clearing firm per contract fee. In the case of a P Order, the Exchange also passes through the total amount of the credits above to the member that originated the order underlying the P Order. See Section 21 of the CBOE Fees Schedule.

exposed orders to third parties would not apply.<sup>10</sup> The Exchange believes that permitting the dissemination of this information by members to third parties will assist in its efforts to provide additional opportunities for orders to receive executions at the NBBO on CBOE and reduce costs by reducing the number of Linkage orders sent to other exchanges.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>11</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> 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 change would give additional opportunities to provide orders executions at the NBBO on CBOE and reduce costs by reducing the number of Linkage orders sent to other exchanges.

### 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.

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<sup>10</sup> This prohibition only deals with disseminating information to third parties after an order is exposed in HAL. See Rule 6.14.02. The Exchange notes that members remain subject to the requirements of Rule 4.18, Prevention of the Misuse of Material, Nonpublic Information, and Rule 8.91, Limitations on Dealings of DPMs and Affiliated Persons of DPMs.

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

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, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

Normally, a proposed rule change filed under 19b-4(f)(6) may not become operative prior to 30 days after the date of filing. However, Rule 19b-4(f)(6)(iii)<sup>15</sup> permits the Commission 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. The Exchange believes that the expansion of HAL to permit all members to respond in the manner proposed will provide additional opportunities for orders to receive executions at the NBBO on CBOE and reduce costs by reducing the number of Linkage orders sent to other exchanges. The Exchange believes that the proposed rule change is non-controversial, does not raise any new, unique or substantive issues, and is essential for competitive purposes and to

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6)(iii) requires that a self-regulatory organization submit to the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of 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 notes that the Exchange has satisfied the five-day pre-filing notice requirement.

<sup>15</sup> 17 CFR 240.19b-4(f)(6)(iii).

promote a free and open market for the benefit of investors. For these reasons, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. Accordingly, the Commission designates the proposed rule change to be operative upon filing with the Commission.<sup>16</sup>

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:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2008-46 on the subject line.

##### Paper Comments:

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



- 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-2008-46. 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 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-2008-46 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.<sup>17</sup>

Florence E. Harmon  
Deputy Secretary

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<sup>17</sup> 17 CFR 200.30-3(a)(12).