SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-57997; File No. SR-CBOE-2008-30)

June 20, 2008

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change Relating to the Hybrid Opening System

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 June 5, 2008, 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 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 revise its Hybrid Opening System ("HOSS") procedures. The text of the proposed rule change is available at the Exchange, on the Exchange's Web site (http://www.cboe.org/Legal), and in 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, the Exchange 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 below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant aspects of such statements.

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1 15 U.S.C. 78s(b)(1).

2 17 CFR 240.19b-4.

A. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

1. Purpose

CBOE proposes to amend CBOE Rule 6.2B, Hybrid Opening System ("HOSS"), which pertains to trading rotations for series trading on the CBOE Hybrid Trading System ("Hybrid"), in order to allow the Exchange to permit Hybrid Agency Liaison ("HAL") functionality to be available on the openings in designated classes.[3]

The current HOSS method for opening chooses a single "market clearing" price that will leave bids and offers which cannot trade with each other.[4] However, one or more series of a class may not open if one of the following conditions is met:

- if no opening quote that complies with the legal width quote requirements of Rule 8.7(b)(iv) has been entered by at least one Market-Maker appointed to the class (or by the Designated Primary Market-Maker or Lead Market-Maker, if applicable for the particular class) (the "opening quote condition");
- the opening price is not within an acceptable range (as applicable for the particular class) compared to the lowest quote offer and the highest quote bid (the "acceptable opening range condition"); or
- the opening trade would leave a market order imbalance (i.e., there are more market orders to buy or to sell for the particular series than can be satisfied by the limit orders, quotes and market orders on the opposite side) (the "market order imbalance condition").

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3 See CBOE Rule 6.14, governing the operation of HAL.

4 In determining the priority of orders and quotes to be traded, HOSS gives priority to market orders first, then to limit orders and quotes whose price is better than the opening price, and then to resting orders and quotes at the opening price. See Rule 6.2B(c)(iv).

Under the current HOSS procedures, if the open quote condition or acceptable opening range condition is present, the senior official in the Exchange's control room may authorize the opening of the affected series where necessary to ensure a fair and orderly market. If the opening range condition is present, HOSS will not open the series but will send a notification to market participants indicating the reasons. If the market order imbalance condition is present, a notification will be sent to market participants indicating the size and direction (buy or sell) of the market order imbalance. HOSS will not open the series until the condition causing the delay is satisfied. HOSS will repeat the process until the series is open.

Under the proposed rule change, the Exchange could designate the classes in which HAL would be activated for HOSS openings. For such designated classes, additional steps would be automatically taken using HAL functionality to address the opening quote, acceptable opening range, and market order imbalance conditions discussed above, as well as to address instances where CBOE's opening trade would be at a price that is not the current national best bid or offer (the "NBBO condition"). In particular, in classes where HAL is activated for HOSS openings, the following procedures would apply if one of the following conditions is met:

- If the opening quote condition is present, HOSS would check to see if there is an NBBO quote on another market that falls within the acceptable opening range. If such an NBBO quote is present, the series would open and expose the marketable order(s) at the NBBO price. If such an NBBO quote is not present, HOSS would not open the series and would send a notification to market participants indicating the reason.[5]

[5] For example, if there is no Market-Maker quote present but an NBBO market is present that meets CBOE's acceptable opening range parameter (e.g., the NBBO is \$2.50 - \$2.80 25x25, while CBOE's pre-opening BBO is \$1.00 - \$5.00 25x25 and there is a market

- If the acceptable opening range condition is present, HOSS would match orders and quotes to the extent possible at a single clearing price[6] within the acceptable opening range and then expose the remaining marketable order(s) at the widest price point within the acceptable opening range or the NBBO price, whichever is better.[7]

- If the market order imbalance condition is present, HOSS would match orders and quotes to the extent possible at a single clearing price and then expose the remaining marketable order(s) at the widest price point within the acceptable opening range or the NBBO price, whichever is better.[8]

- If the NBBO condition is present, HOSS would match orders and quotes to the extent

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order to buy 10 contracts), HOSS will open without a trade and expose the market order to buy 10 contracts at $2.80.

6 In determining the priority of orders and quotes to be traded on the opening trade or through the subsequent exposure process, HOSS would give priority to public customer market orders first (with multiple orders ranked based on time priority), then to non-public customer market orders second (with multiple orders being ranked based on time priority), then to limit orders and quotes whose price is better than the opening price (with multiple orders and quotes being ranked in accordance with the allocation algorithm in effect for the option 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), and then to limit orders and quotes at the opening price (with multiple orders and quotes being ranked in accordance with the allocation algorithm in effect for the option class pursuant to Rule 6.45A or 6.45B). See proposed Interpretation and Policy .03(c)(i) to Rule 6.2B.

7 For example, if the opening price would be outside of CBOE's acceptable opening range parameter (e.g., CBOE's pre-opening BBO is $2.40 - $2.80 25x25, the next best CBOE pre-opening offer is $5.00 x25, and there is a market order to buy 50 contracts), HOSS will trade 25 contracts at $2.80 and then expose 25 contracts at $2.80 (assuming the $2.80 acceptable opening range price is better than the NBBO price).

8 For example, if there is an order imbalance and CBOE is at the NBBO (e.g., the NBBO is $1.00 - $1.25 25x25, CBOE's pre-opening BBO $1.00 – $1.20 25x25 and CBOE has a market order to buy 50 contracts), HOSS would open with a trade of 25 contracts at $1.20 and then expose 25 contracts at the NBBO price of $1.25 (assuming the $1.25 NBBO price is better than the acceptable opening range price).

possible at a single clearing price within the acceptable opening range or the NBBO price, whichever is better, and then expose the remaining marketable order(s) at the NBBO price.[9]

The order exposure process would be conducted pursuant to Rule 6.14, Hybrid Agency Liaison (HAL). Under the HAL process, marketable orders would be electronically exposed to all Market-Makers appointed to the relevant option class if not executed at a single clearing price.[10] For HOSS openings where HAL is used, this exposure period would afford Market-Makers appointed to the class an opportunity to match the widest price point within the opening range or the NBBO price, whichever is better. Assuming at least one Market-Maker committed to trade any portion of the exposed marketable order(s) during the exposure period, the exposure period would end and an allocation period would commence. The Exchange would determine on a class-by-class basis the applicable exposure period (which would not exceed 1.5 seconds) and allocation period (which, when combined with the designated exposure period time – as opposed

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9 For example, if an away exchange is open and posting an NBBO better than CBOE's anticipated opening price (e.g., the away exchange's BBO is $1.00 – $1.15 25x25, while CBOE's pre-opening BBO is $1.00 - $1.20 25x25, and CBOE also has a market order to buy 10 contracts), HOSS would open with no trade and expose 10 contracts at a price of $1.15.

10 On an intra-day basis, orders are normally exposed through HAL to Market-Makers appointed to the relevant option class as well as members acting as agent for orders at the top of CBOE's book ("Qualifying Members") in the relevant series. See Rule 6.14(b). For HOSS openings where HAL is used, the exposure to Qualifying Members would not be applicable because there would not be an established "top of CBOE's book" at the time. The Exchange notes that, as part of a separate rule filing, it recently modified Rule 6.14 to permit electronic exposure of HAL orders on a class-by-class basis to all members that elect to receive HAL messages (not just Market-Makers appointed to the relevant option class and Qualifying Members) and to permit such members to participate in the HAL process. See Securities Exchange Act Release No. 57837 (May 20, 2008), 73 FR 30431 (May 27, 2008) (SR-CBOE-2008-46). In classes where all members that elect to receive HAL messages are eligible to participate in the HAL process for a particular class on an intra-day basis, all such members would also be eligible to participate in any HAL process that occurs as part of the HOSS opening in that class.

to an exposure period that is terminated early[11] – would not exceed a total of 3 seconds) that would be applicable where HAL is activated for HOSS openings.

At the conclusion of the allocation period, the order(s) would 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. There is no participation entitlement applicable to exposed orders, and response sizes are limited to the size of the exposed order for allocation purposes. If no responses are received or if there remains an unexecuted marketable order (or portion thereof), then the balance of the order would be booked if it is a limit order that is not marketable or processed in one of the following ways:

- If the remaining order balance is for the account of a public customer and is marketable against another exchange that is a participant in the Intermarket Options Linkage, then HAL would 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 shall be allocated to that order.
- If the remaining order balance is marketable against another exchange that is a participant in the Intermarket Options Linkage but is not for the account of a public customer, then HAL would route a Principal Linkage Order ("P Order") on behalf of the Remaining Order through the Linkage and any resulting execution of the P Order shall be allocated to the remaining order.
- In either situation above, if the Linkage order cannot be transmitted from the

[11] In addition to the receipt of a response to trade any portion of the exposed order(s), the exposure period would also terminate early under the circumstances described in Rule 6.14(d).

Exchange because the price of the Linkage order (or a better price) is no longer available on any market, then HAL would, pursuant to normal order allocation processing, execute 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"),[12] against the Market-Makers that constituted the Exchange Initial BBO at a price equal to the Exchange Initial BBO.

- For all classes, any remaining balance of opening contingency orders not executed via HAL on the opening would be automatically cancelled.
- For single list classes, any remaining balance of marketable orders (other than opening contingency orders) not executed via HAL on the opening would route as determined by the Exchange on a class-by-class basis to PAR, BART, or at the order entry firm's discretion to the order entry firm's booth printer.

Last, the Exchange notes that all transactions executed via HOSS, including through the new proposed HAL exposure period, must be in compliance with Section 11(a) of the Act[13] and the rules promulgated thereunder. Section 11(a)(1) prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises investment

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[12] With respect to new proposed HAL exposure period, "Exchange Initial BBO" means the best bid (or offer) that exists in the system at the time the auction begins. This takes into account orders and quotes on the relevant side of the market that exist in the system at that time (including orders and quotes that may have been entered up until the beginning of the HAL auction). See email from Jennifer Lamie, Assistant General Counsel, CBOE, to Sara Gillis, Special Counsel, Commission, dated June 19, 2008.

[13] 15 U.S.C. 78k(a).

discretion (collectively referred to herein as "proprietary accounts") unless an exception applies. In this regard, the Exchange notes its belief that orders for proprietary accounts submitted into HOSS, including any such orders submitted as a response through the proposed HAL exposure period, would qualify for an exception under Rule 11a2-2(T),[14] commonly referred to as the "effect versus execute" exception, provided the member: (i) must transmit the order from off the exchange floor;[15] (ii) must not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[16] (iii) must not be affiliated with the executing member;[17] and (iv) with respect to an account over which the member has investment

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14 17 CFR 240.11a2-2(T).

15 In the context of other automated trading systems, the Commission has found that the off-floor transmission requirement is met if an order for a proprietary account is transmitted from a remote location directly to an exchange's floor by electronic means. See, e.g., Securities Exchange Act Release No. 57478 (March 12, 2008), 73 FR 14521, 14538 (March 18, 2008) (SR-NASDAQ-2007-004 and SR-NASDAQ-2007-080) ("NASDAQ Options Market Approval Order"). The Exchange believes this requirement is met if an order for a proprietary account is transmitted from a remote location directly into the HOSS system by electronic means.

16 The Exchange states that given HOSS's existing and proposed automated matching and execution services, no Exchange member enjoys any special control or influence over the timing of execution or special order handling advantages for orders executed via HOSS (including as proposed to be amended), as all orders will be centrally processed for execution by computer, rather than being handled by a member through bids or offers made on the trading floor. The member may, however, participate in clearing and settling the transaction.

17 The Commission has recognized in the past that this requirement is not applicable where automated exchange facilities are used, as long as the design of these systems ensures that members do not possess any special or unique trading advantages in handling their orders after transmitting them to the exchange. See, e.g., NASDAQ Options Market Approval Order, 73 FR at 14539, and Securities Exchange Act Release No. 15533 (January 29, 1979), 44 FR 6084 (January 31, 1979). The Exchange believes that this principle is directly applicable to HOSS, including through the proposed new exposure period, due to HOSS's open, electronic structure that is designed to prevent any Exchange members from gaining any time and place advantages. Therefore, the Exchange believes that an Exchange member effecting a transaction through HOSS (including as proposed to be amended) satisfies the requirement for execution through an unaffiliated member.

discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the rule. To the extent a member submits an order for a proprietary account into HOSS from on the floor (including an order for a proprietary account initiated from off the floor and routed to the member or an affiliated member on the floor for submission into HOSS), such an order would not qualify for the effect versus execute exception.

The Exchange believes the proposed rule change should serve to further enhance the efficiency of HOSS opening rotations because it will further automate the process for addressing opening quote, acceptable opening range, and market order imbalance conditions that may occur on the openings, as well as address NBBO condition scenarios where the Exchange's opening trade might occur at a price when there is a better away market.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act,[18] in general, and furthers the objectives of Section 6(b)(5) of the Act,[19] 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 should serve to enhance the efficiency of HOSS opening rotations.

B. Self-Regulatory Organization's Statement on Burden on Competition

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18 15 U.S.C. 78f(b).

19 15 U.S.C. 78f(b)(5).

CBOE does not believe that the proposed rule change will impose any burden on competition that is 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 Exchange 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-2008-30 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2008-30. 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 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-2008-30 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.[20]

Florence E. Harmon
Acting Secretary

[20] 17 CFR 200.30-3(a)(12).