SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-60931; File No. SR-CBOE-2009-078)

November 4, 2009

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders

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 October 20, 2009, the Chicago Board Options Exchange, Incorporated (the "Exchange" or "CBOE") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. On November 3, 2009, the Exchange filed Amendment No. 1 to the proposal.[3] The Commission is publishing this notice to solicit comments on the proposed rule change, as modified by Amendment No. 1, from interested persons.

I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is proposing to amend its priority rules to give certain non-broker-dealer orders the same priority as broker-dealer orders. The text of the proposed rule change is available on the Exchange's website (http://www.cboe.org/Legal), at the Office of the Secretary, CBOE and at the Commission.

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

2 17 CFR 240.19b-4.

3 Amendment No. 1 proposed to revise a paragraph in the purpose section of the Form 19b-4 and in the Exhibit 1 thereto relating to the application of Section 11(a) of the Act.

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 Statutory Basis for, the Proposed Rule Change

1. Purpose

Under CBOE rules, a "public customer" or "customer" is a person or entity that is neither a member nor a broker/dealer. Each term is used in specific CBOE rules that provide certain marketplace advantages to public customer orders over non-customer orders (e.g., orders for the account of members or broker/dealers). In particular, under CBOE rules, subject to certain exceptions, (i) public customer orders are given priority over non-customer orders and Market-Maker quotes at the same price,[4] and (ii) members are generally not charged a transaction fee for the execution of public customer orders. The purpose of providing these marketplace advantages to public customer orders is to attract retail investor order flow to the Exchange by leveling the playing field for retail investors over market professionals[5] and providing competitive pricing.

[4] See, e.g., CBOE Rules 6.45, Priority of Bids and Offers – Allocation of Trades, 6.45A, Priority and Allocation of Equity Option Trades on the CBOE Hybrid System, and 6.45B, Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System.

[5] Market professionals have access to sophisticated trading systems that contain functionality not available to retail customers, including things such as continuously updated pricing models based upon real-time streaming data, access to multiple markets simultaneously, and order and risk management tools.

With respect to these CBOE marketplace advantages, the Exchange does not believe the definition of public customer versus a non-customer properly distinguishes between non-professional retail investors and certain professionals. According to the Exchange, providing marketplace advantages based upon whether the order is for the account of a participant that is a registered broker-dealer is no longer appropriate in today's marketplace because some non-broker-dealer individuals and entities have access to information and technology that enables them to professionally trade listed options in the same manner as a broker or dealer in securities.[6] These individual traders and entities (collectively, "Professionals") have the same technological and informational advantages over retail investors as broker-dealers trading for their own account, which enables them to compete effectively with broker-dealer orders and market maker quotes for execution opportunities in the CBOE marketplace.[7]

The Exchange therefore does not believe that it is consistent with fair competition for these professional account holders to continue to receive the same marketplace advantages as

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6 For example, some broker-dealers provide their professional customers with multi-screened trading stations equipped with trading technology that allows the trader to monitor and place orders on all six options exchanges simultaneously. These trading stations also provide compliance filters, order management tools, the ability to place orders in the underlying securities, and market data feeds. See Securities Exchange Act Releases 59287 (January 23, 2009), 74 FR 5694 (January 30, 2009)(SR-ISE-2006-26)(order approving International Securities Exchange ("ISE") proposal to introduce priority customer and professional orders) and 57254 (February 1, 2008), 73 FR 7345 (February 7, 2008)(SR-ISE-2006-26)(notice of ISE proposal to introduce priority customer and professional orders) at note 8.

7 Market-Makers enter quotes based upon the theoretical value of the option, which moves with various factors in their pricing models, such as the value of the underlying security. Professional customers place and cancel orders in relation to an option's theoretical value in much the same manner as a Market-Maker. This is evidenced by the entry of limit orders that join the best bid or offer and by a very high rate of orders that are cancelled. In contrast, retail customers who enter orders as part of an investment strategy (such as a covered write or directional trade) most frequently enter marketable orders or limit orders that they do not cancel and replace. See, e.g., Securities Exchange Act Release 57254 at note 9.

retail investors over broker-dealers trading on the CBOE. Moreover, because public customer orders at the same price are executed in time priority, retail investors are prevented from fully benefiting from the priority advantage when Professionals are afforded public customer order priority.

Accordingly, the Exchange is seeking to adopt a new term that will be used to more appropriately provide CBOE marketplace advantages to retail investors on the CBOE. Under the proposal, a "Professional" will be defined in proposed Rule 1.1 as a person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). Under the proposal, a Professional will be treated in the same manner as a broker or dealer in securities for purposes of CBOE Rules 6.2A (Rapid Opening System), 6.2B (Hybrid Opening System), 6.8C (Prohibition Against Members Functioning as Market-Makers), 6.9 (Solicited Transactions), 6.13A (Simple Auction Liaison), 6.45 (Priority of bids and Offers – Allocation of Trades), 6.13B (Penny Price Improvement), 6.45A (Priority and Allocation of Equity Option Trades on the CBOE Hybrid System) (except that Professional orders may be considered public customer orders, and therefore not be subject to the exposure requirements for solicited broker-dealer orders, under Interpretation and Policy .02), 6.45B (Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System) (except that Professional orders may be considered public customer orders, and therefore not be subject to the exposure requirements for solicited broker-dealer orders, under Interpretation and Policy .02), 6.53C(c)(ii) and (d)(v) and 6.53C.06(b) and (c) (Complex Orders on the Hybrid System), 6.74 (Crossing Orders) (except that Professional orders may be considered public customer orders subject to facilitation under paragraphs (b) and (d)), 6.74A (Automated Improvement Mechanism) (except Professional orders may be considered customer Agency Orders or solicited orders eligible for customer-to-customer immediate crosses under Interpretation and Policy .09), 6.74B (Solicitation Auction Mechanism), 8.13 (Preferred Market-Maker Program), 8.15B (Participation Entitlement of LMMs), 8.87 (Participation Entitlement of DPMs and e-DPMs), 24.19 (Multi-Class Broad-Based Index Option Spread Orders), 43.1 (Matching Algorithm/Priority), 44.4 (Obligations of SBT Market-Makers), and 44.14 (SBT DPM Obligations). In addition, the Professional designation is not available in Hybrid 3.0 classes.

The use of this new term for purposes of the above-referenced execution rules will result in Professional account holders participating in CBOE's allocation process on equal terms with broker-dealer orders. The proposal will not otherwise affect non-broker-dealer individuals or entities under CBOE rules, and in particular, all public customer orders will continue to be treated equally for purposes of the linkage-related rules. For example, CBOE will provide the same away-market protection for all public customer orders, including non-broker-dealer orders that are included in the definition of "Professional" orders.

In order to properly represent orders entered on the Exchange according to the new definitions, members will be required to indicate whether public customer orders are "Professional" orders.[8] To comply with this requirement, members will be required to review their customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should be represented as customer orders or Professional orders.[9]

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8 The Exchange intends to utilize a special order origin code for Professional orders.

9 Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional orders for the next calendar quarter. Members will be required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days

Lastly, the Exchange intends to establish, via a separate rule filing, transaction fees applicable to Professionals and the Exchange would not commence the Professional program until such fees are in place.

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Section 11(a) of the Act prohibits any 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 persons exercises discretion unless an exception applies.[10] Section 11(a)(1) contains a number of exceptions for principal transactions by members and their associated persons. One such exception, set forth in subparagraph (G) of Section 11(a)(1) and in Rule 11a1-1(T),[11] permits any transaction for a member's own account provided, among other things, that the transaction yields priority, parity, and precedence to orders for the account of persons who are not members or associated with members of the exchange. Exchange rules, therefore, may require members to yield priority to the orders of non-members, including public customers, to satisfy this exception to Section 11(a).[12] Another

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after the end of each calendar quarter. While members only will be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as public customer orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the member and the member will be required to change the manner in which it is representing the customer's orders within five days.

10 15 U.S.C. 78k(a).

11 17 CFR 240.11a1-1(T).

12 See, e.g., CBOE Rule 6.45A(b)(i)(D), which pertains to the allocation of orders in open outcry and provides that members relying on the Section 11(a)(1)(G) and Rule 11a1-1(T) thereunder as an exemption must yield priority to any bid (offer) at the same price of public customer orders and broker-dealer orders resting in the electronic book, as well as any other bids and offers that have priority over such broker-dealer orders under that rule.

exception permits market makers to effect transactions on exchanges in which they are members.[13]

In addition to the exceptions noted above, Rule 11a2-2(T) under the Act[14] provides exchange members with an exception from the prohibitions in Section 11(a). Rule 11a2-2(T), known as the "effect versus execute" rule, permits an exchange member, subject to certain conditions, to effect transactions for its own account, the account of an associated person, or an account with respect to which it or an associated person thereof exercises investment discretion (collectively "covered accounts") by arranging for an unaffiliated member to execute the transaction on the exchange.

To comply with the "effect versus execute" rule's conditions, a member: (i) must transmit the order from off the exchange floor; (ii) may not participate in the execution of the transaction once it has been transmitted to the member performing the execution;[15] (iii) may not be affiliated with the executing member; and (iv) with respect to an account over which the member has investment discretion, neither the member nor its associated person may retain any compensation in connection with effecting the transaction except as provided in the rule.[16]

The Exchange does not believe that its proposal relating to Professional orders would affect the availability of the exceptions to Section 11(a) of the Act, including the exceptions in

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13 Section 11(a)(1)(A).

14 17 CFR 240.11a2-2(T).

15 The member, however, may participate in clearing and settling the transaction. See Securities Exchange Act Release No. 14563 (March 14, 1978), 43 FR 11542 (March 17, 1978).

16 17 CFR 240.11a2-2(T).

subparagraph (G) of Section 11(a) and in Rules 11a1-1(T) and 11a2-2(T), as are currently available.[17]

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The Exchange believes that identifying Professional account holders based upon the average number of orders entered for a beneficial account is an appropriately objective approach that will reasonably distinguish such persons and entities from retail investors. The Exchange proposes the threshold of 390 orders per day on average over a calendar month because it believes it far exceeds the number of orders that are entered by retail investors in a single day,[18] while being a sufficiently low number of orders to cover the Professional account holders that are competing with broker-dealers in the CBOE marketplace. In addition, basing the standard on the number of orders that are entered in listed options for a beneficial account(s) assures that Professional account holders cannot inappropriately avoid the purpose of the rule by spreading their trading activity over multiple exchanges, and using an average number over a calendar month will prevent gaming of the 390 order threshold.

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17 See Securities Exchange Act Release No. 59546 (March 10, 2009), 74 FR 11144 (March 16, 2009)(SR-CBOE-2009-016) and related regulatory circular, RG09-35.

18 Three hundred ninety orders is equal to the total number of orders that a person would place in a day if that person entered one order every minute from market open to close. Many of the largest retail-oriented electronic brokers offer lower commission rates to customers they define as "active traders." Publicly available information from the websites for Charles Schwab, Fidelity, TD Ameritrade and optionsXpress all define an "active trader" as someone who executes only a few options trades per month. The highest required trading activity to qualify as an active trader among these four firms was 35 trades per quarter. See Securities Exchange Act Release 57254 at note 11 (which also notes that a study of one of the largest retail-oriented options brokerage firms indicated that on a typical trading day, options orders were entered with respect to 5922 different customer accounts. There was only one order entered with respect to 3765 of the 5922 different customer accounts on this day, and there were only 17 customer accounts with respect to which more than 10 orders were entered. The highest number of orders entered with respect to any one account over the course of an entire week was 27).

2. Statutory Basis

The basis under the Act for this proposed rule change is the requirement under Section 6(b)(5)[19] that an exchange have rules that are designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and 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, the proposal will assure that retail investors continue to receive the appropriate marketplace advantages in the CBOE marketplace, while furthering fair competition among marketplace professionals by treating them equally within 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 such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization 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.

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

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-2009-078 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-2009-078. 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 a.m. and 3 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-2009-078 and should be submitted on or before [insert date 21 days from the date of publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

Florence E. Harmon
Deputy Secretary

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