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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65914; File No. SR-CBOE-2011-114)

December 8, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule Change Related to Complex Order Processing in Hybrid 3.0 Classes

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 November 29, 2011, the Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") filed with the Securities and Exchange Commission (the "Commission") the proposed rule change as described in Items I and II, which Items have been 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 is proposing to amend its electronic complex order rules. The text of the rule proposal is available on the Exchange's website (http://www.cboe.org/legal), at the Exchange's Office of the Secretary and at the Commission.

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.

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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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

Currently, complex orders that are submitted to the electronic complex order book ("COB") or the complex order RFR auction process ("COA") automatically execute against individual orders and quotes residing in the electronic book ("EBook") provided the complex order can be executed in full or in a permissible ratio, and against other complex orders represented in COB or COA (as applicable).

The Exchange is proposing to revise the operation of COB and COA as it relates to options classes trading on the Hybrid 3.0 Platform, which currently only includes options on the S&P 500 Index (option symbol SPX). The "Hybrid 3.0 Platform" is an electronic trading platform on the Hybrid Trading System[3] that allows one or more quoters to submit electronic quotes which represent the aggregate Market-Maker quoting interest in a series for the trading crowd. The quotes are represented, along with other orders, in the EBook. The function of generating the aggregate trading crowd quote is currently performed by certain designated Lead Market-Makers.

Under the proposed rule change, for each class trading on the Hybrid 3.0 Platform, the Exchange may determine to not allow marketable complex orders entered into COB and/or COA to automatically execute with the individual quotes residing in the EBook.[4] In such classes, the allocation of such marketable complex orders against orders residing in the EBook and other

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3 The "Hybrid Trading System" refers to the Exchange's trading platform that allows Market-Makers to submit electronic quotes in their appointed classes. See Rule 1.1(aaa).

4 Pursuant to Rule 6.53C.01, any determination by the Exchange to designate a class for complex order execution in this manner will be announced to the membership via Regulatory Circular.

complex orders shall be based on the best net price(s), as is currently the case under the existing rule. At the same net price, multiple orders will be allocated subject to the existing applicable COB or COA allocation algorithm,[5] subject to the following:

First, a complex order submitted to COB or COA, as applicable, that is marketable against the individual orders residing in the EBook will automatically execute against those individual orders residing in the EBook provided the complex order can be executed in full (or in a permissible ratio) by the orders in the EBook and provided the orders in the EBook are priced equal to or better than the individual quotes residing in the EBook.

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5 For COB, at the same net price, (i) individual orders and quotes in the EBook have first priority, provided the complex order can be executed in full (or in a permissible ratio), with multiple orders and quotes at the same price allocated based on the rules of trading priority otherwise applicable to incoming electronic orders in the individual component legs; and (ii) complex orders in COB have second priority, with multiple complex orders at the same price allocated based on the rules of trading priority otherwise applicable to incoming electronic orders in the individual series legs or such other algorithm as the Exchange may designate. For COA, at the same net price, (i) individual orders and quotes residing in the EBook have first priority, provided the complex order can be executed in full (or in a permissible ratio), with multiple orders allocated pursuant to the Ultimate Match Algorithm ("UMA") allocation described in Rule 6.45A or 6.45B, as applicable; (ii) public customer complex orders resting in COB before, or that are received during the COA auction, and public customer COA responses collectively have second priority, with multiple orders/responses allocated based on time priority; (iii) non-public customer orders resting in COB before the COA auction have third priority, with multiple orders allocated pursuant to the UMA allocation described in Rule 6.54A or 6.45B, as applicable; and (iv) non-public customer orders resting in COB that are received during the COA auction and non-public customer COA responses collectively have fourth priority, with multiple orders/responses allocated based on the capped UMA ("CUMA") allocation described in Rule 6.45A or 6.45B, as applicable. See Rule 6.53C(c)(ii) and (d) and Interpretation and Policy .09. The Exchange notes that the aforementioned electronic allocation algorithms for COB and COA are consistent with Rule 6.45A(b)(ii) and 6.45B(b)(ii) (which relate to the allocation of orders represented in open outcry and generally allow a Trading Permit Holder holding a complex order to trade at the same price as the trading crowd and public customer limit order book, provide at least one leg of the complex order betters the corresponding bid (offer) in the public customer limit order book by at least one minimum trading increment (i.e., $0.10, $0.05 or $0.01, as applicable) or a $0.01 increment, which increment will be determined by the Exchange on a class-by-class basis).

Second, complex orders that are marketable against each other will automatically execute provided the execution is at a net price that has priority over the individual orders and quotes residing in the EBook. As noted above, the allocation of a complex order will otherwise be consistent with the existing rules of trading priority otherwise applicable to COB or COA.[6]

Third, to the extent that a marketable complex order cannot automatically execute when it is routed to COB or after being subject to COA because there are individual quotes residing in the EBook that have priority, any part of the order that may be executed will be executed automatically and the part of the order that cannot automatically execute will be routed on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth. If an order is not eligible to route to PAR, then the remaining balance will be cancelled.

Finally, fourth, to the extent that a complex order resting in COB becomes marketable and cannot automatically execute in full (or in a permissible ratio), the full order will be subject to COA (and the process for COA described above). Having the system automatically initiate a COA once such a complex order resting in COB becomes marketable provides an opportunity for other market participants to match or improve the net price and allows for an opportunity for an automatic execution before a marketable complex order is routed for manual handling to PAR or a booth.[7] As noted above, after being subject to COA, any part of the order that may be

6 See note 5, supra.

7 The Exchange notes that, in these circumstances when a resting complex order becomes marketable, COA will automatically initiate regardless of whether a Trading Permit Holder has requested that the complex order be COA'd pursuant to Rule 6.53C.04. In this regard, the Exchange notes that, currently, all of its Trading Permit Holders have elected to have their COA-eligible orders COA'd. In addition, the Exchange notes that other markets have programs in place that provide for the automatic auctioning of complex orders. See, e.g., NASDAQ OMX PHLX LLC ("Phlx") Rule 1080(e)(i)(A) which, among other things, provides that a complex order live auction ("COLA") will initiate if the Phlx system receives a complex order that improves the Phlx complex order best debit or credit price respecting the specific complex order strategy that is the subject

executed will be executed automatically and the part of the order that cannot automatically execute will be routed on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth. If an order is not eligible to route to PAR, then the remaining balance will be cancelled.

The following examples illustrate the operation of the proposed system functionality:

Example 1: Assume an incoming market complex order for 75 units is submitted to COA, where the strategy involves the purchase of SPX Dec 1250 calls and sale of SPX Dec 1255 calls. At the conclusion of COA, assume the best offer in the individual SPX Dec 1250 call series is $27.90 for a size of 50 contracts made up only of orders resting in the EBook, and the next best offer is $28.20 for 100 contracts made up only of Lead Market-Maker quotes. Also assume the best bid in the individual SPX Dec 1255 call series is $22.90 with a size of 50 contracts made up only of orders resting in the EBook, and the next best bid is $22.50 made up only of Lead Market-Maker quotes. The best derived net leg market price would therefore be $5.00 ($27.90 - $22.90). Also assume that there is a COA response for 10 units at a net price of $4.90. The incoming market order to purchase 75 units of the call/put strategy would receive a partial execution of 60 units: 10 units would execute at a net debit price of $4.90 against the COA response (which has priority over the individual orders net priced at $5.00), and 50 units at a net debit price of $5.00 against the orders resting in each of the individual series legs (the execution is in a permissible ratio and the orders in the EBook are priced equal to or better than the individual quotes residing in the EBook). Because the remaining 15 units are only marketable against the quotes in the individual series legs at a net price of $5.70 ($28.20 - $22.50), the 15 units would be routed to PAR or, at the order entry firm's discretion, to the order entry firm's booth, for manual handling. If the order would otherwise route to PAR but is not eligible to route to PAR, then the remaining 15 units will be cancelled.

Example 2: Assume a complex order for 75 units with a net debit price of $5.00 is resting in COB, where the strategy involves the purchase of SPX Dec 1250 calls and sale of SPX Dec 1255 calls. By virtue of the fact that it is resting the COB, the complex order is not marketable – meaning there are no orders or quotes within the derived net leg market price or other complex orders within COB against which the resting complex order may trade. Assume there are no other complex orders representing in the COB for the strategy and also assume the best offer in the individual SPX Dec 1250 call series is $27.90, with a size of 100 contracts (50 contracts are orders and 50 contracts represent the Lead Market-Maker quote) and

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of the complex order. During a COLA, Phlx market participants may bid and offer against the COLA-eligible order pursuant to the Phlx Rule.

the best bid in the individual SPX Dec 1255 call series is $22.75, with a size of 100 contracts (50 contracts are orders and 50 contracts represent the Lead Market-Maker quote). The best derived net leg market price would therefore be $5.15 ($27.90 - $22.75). If the Lead Market-Maker bid in the SPX Dec 1255 call series is thereafter updated to $22.90 (with a size of 100 contracts), the derived net leg market price would become $5.00 ($27.90 - $22.90) and the full size of the resting complex order will become marketable but cannot automatically execute. As a result, the full size (75 units) of the resting complex order would be subject to COA. At the conclusion of COA, any part of the complex order that may be executed against orders in the EBook and other complex orders will be automatically executed. Any part of the order that is marketable and cannot automatically execute (because of Lead Market-Maker quotes in an individual series leg(s)) will be routed on a class-by-class basis to PAR or, at the order entry firm's discretion, to the order entry firm's booth. If an order is not eligible to route to PAR, then the remaining balance will be cancelled. To the extent any part of the complex order is not marketable, it will continue resting in COB.

Over time, the Exchange has introduced various enhancements to the operation of COB and COA, which enhancements the Exchange believes are generally designed to make the processes operate more efficiently and effectively, as well as to avoid executions at extreme and potentially erroneous prices. The Exchange believes the instant proposed rule change is another example of such an enhancement. The Exchange believes the proposed system functionality will permit more efficient and effective execution of complex orders in our electronic trading environment. In addition, the Exchange believes the change will assist in preventing complex orders from automatically executing against the individual quotes residing in the individual series legs at potentially erroneous prices, particularly when there are momentary or inadvertent discrepancies that occur between the pricing of an individual series leg that is a component of a complex order strategy. The Exchange recognizes that Market-Makers could encounter difficulties maintaining quotations in the individual series legs if the quotes are allowed to execute against complex orders in COB or COA. In particular, Market-Maker pricing systems automatically update the price of a Market-Maker's quotations when there is a move in the price of the underlying stock, index, component securities or related futures. When such a change occurs, a Market-Maker will need to send updates for its quotes all [sic] the individual series legs it is quoting in each of the Market-Maker's appointed classes. In the SPX options class alone this can include thousands of series, and when considering all series across a Market-Makers [sic] various appointed classes, this can include millions of series. Accordingly, it is possible that the Market-Maker could unintentionally trade with another Market-Maker or market participant via COB or COA before a quote update(s) in the individual series leg is processed.[8] The result is executions at price(s) that were not intended and, at times, that may also be at extreme or potentially erroneous prices.

The proposed rule change is designed to protect the Lead Market-Maker that generate [sic] quotes in SPX, as well as other Market-Makers and other market participants that may trade against these quotes with complex orders at extreme or potentially erroneous prices. The Exchange believes the proposed system functionality is fair and reasonable with respect to classes trading on the Hybrid 3.0 Platform in particular, where the quotes represent the aggregate Market-Maker quoting interest in a series for the trading crowd but the responsibility for generating the quotes and satisfying trades against those quotes in relation to executions occurring through COB or COA rests with the designated Lead Market-Maker(s) that generates the quote. The functionality will mitigate the risk borne only by the Lead Market-Makers that a complex order may execute against a quote in an individual series leg at an extreme or potentially erroneous price. The Exchange believes that the proposed system functionality is a reasonable limitation on Hybrid 3.0 Market-Maker quotations that will appropriately address an operational issue that would discourage Market-Makers, particularly Lead Market-Makers, from

8 Indeed, the Exchange has long recognized the need to ameliorate small timing differences in processing Market-Maker quotations updates by delaying Market-Maker quotations from executing against each other for up to one second. See, e.g., Exchange Rule 6.45B(d).

offering additional liquidity in the individual series legs. It also will prevent other Market-Makers and other market participants from receiving executions at extreme or potentially erroneous prices.[9]

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act[10] in general and furthers the objectives of Section 6(b)(5) of the Act[11] in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. The Exchange believes that the proposed rule change will facilitate the orderly execution of complex orders in our Hybrid 3.0 electronic trading environment.

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

The Exchange neither solicited nor received comments on the proposal.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days of such date (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which

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9 The Exchange has determined to limit the application of this proposed rule change to Hybrid 3.0 classes. In the future, the Exchange may determine to expand the alternate process of not permitting complex orders to trade against Market-Maker quotes to other option classes. Any such expansion would be the subject of a separate rule change filing.

10 15 U.S.C. 78f(b).

11 15 U.S.C. 78f(b)(5).

the self-regulatory organization consents, the Commission will:

(A) by order approve or disapprove 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-2011-114 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-2011-114. 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 website (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 am and 3:00 pm. 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-2011-114 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.[12]

Kevin M. O'Neill
Deputy Secretary

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12 17 CFR 200.30-3(a)(12).