

In addition, the appropriate FPC would determine, on a class-by-class basis, the maximum size of orders entitled to receive automatic execution through Hybrid. If the appropriate FPC determines to allow market makers and specialists to access the automatic execution feature of Hybrid, proposed CBOE Rule 6.13(b)(i)(C) would permit the FPC to establish the maximum order size eligibility for such orders at a level lower than the maximum order size eligibility for non-broker-dealer public customers and non-market-maker broker-dealers.

Under proposed CBOE Rule 6.13(b)(iii), eligible orders for a size greater than the disseminated size would be automatically executed up to the disseminated size. The balance of the order, if marketable, would be executed automatically at the revised disseminated price up to the revised disseminated size. If not marketable, the balance of the order would book electronically, if the order were eligible for book entry. Otherwise, the balance would route either to PAR or BART, or, at the order entry firm's discretion, to the order entry firm's booth printer.<sup>17</sup>

Pursuant to proposed CBOE Rule 6.13(b)(iv), when the CBOE quotation is inferior to the NBBO, eligible orders would not automatically execute and instead, would route to the DPM's PAR terminal or, at the order entry firm's discretion, to BART, for non-automated handling.<sup>18</sup> Eligible orders received while the CBOE market is locked would be eligible for automatic execution on CBOE at the disseminated quote, provided that CBOE's disseminated quote is not inferior to the NBBO, in which case the order would route to the DPM's PAR terminal or, at the order entry firm's discretion, to BART, for non-automated handling.

In its comment letter, the ISE questions why "an FPC would establish a size limit for orders eligible for automatic execution under proposed Rule 6.13 when the size of market maker quotes is displayed and firm for certain

incoming orders."<sup>19</sup> The ISE's comment suggested that, in its view, the requirements of the Quote Rule<sup>20</sup> and an exchange's automatic execution system parameters must necessarily be the same. The Quote Rule, however, does not require an automatic execution. For this reason, the Commission has previously approved exchange rules that establish automatic execution sizes that are different from the sizes for which responsible brokers or dealers are obligated under the Quote Rule.<sup>21</sup>

The ISE also argues that the size restrictions on orders eligible for automatic execution, together with "the requirement that broker-dealer orders and/or competing market maker orders must be represented in the trading crowd \* \* \* raise best execution concerns not only for the orders represented in the trading crowd, but also for incoming electronic orders and orders on the electronic limit order book that may receive automatic executions at inferior prices."<sup>22</sup> In response to this comment, CBOE notes that proposed CBOE Rule 6.13(b)(iv) expressly prohibits the automatic execution of orders at prices inferior to the NBBO and that orders do not lose this protection merely because they are executed manually instead of electronically.<sup>23</sup> The CBOE also notes that orders executed in open outcry actually have the potential opportunity to be executed at better prices than they would receive if executed electronically.<sup>24</sup> The Commission believes that the proposed rules are consistent with the Act. Brokers continue to have best execution obligations to their customers and must consider all facts and circumstances in determining where to route customers' orders.

Finally, CBOE notes that the ISE is incorrect in its statement that orders for competing market makers that are not eligible for automatic execution must be routed to a floor broker in the firm's

booth.<sup>25</sup> Pursuant to Proposed CBOE Rule 6.13(b)(i)(B), absent specific instructions by the order entry firm to the contrary, orders that are not eligible for automatic execution may route only to PAR or BART.

## B. Priority and Allocation

### 1. Allocation of Incoming Electronic Orders

Under proposed CBOE Rule 6.45A, incoming electronic orders would be allocated to a market participant who is quoting or representing an order at the CBOE BBO using UMA for up to the size of its quote.<sup>26</sup> Public customer orders in the electronic book and at the BBO would always have priority. Multiple public customer orders in the electronic book at the same price would be ranked based on time priority.<sup>27</sup>

A market participant quoting alone at the BBO would have priority and would be entitled to receive incoming electronic order(s) up to the size of its quote. When more than one market participant is quoting at the BBO, inbound electronic orders would be allocated pursuant to UMA. UMA allocates orders based on two separate components: parity (*i.e.*, multiple participants quoting at the best price) and depth of liquidity (*i.e.*, relative size of each market participant's quote).<sup>28</sup> Component A of the UMA is the parity component, which would treat as equal all market participants quoting at the relevant best bid or best offer. Accordingly, the percentage used for Component A is an equal percentage, derived by dividing 100 by the number of market participants quoting at the best price. Component B of the UMA is the size pro-rata component designed to reward and incent market participants to quote with size. The percentage used

<sup>25</sup> *Id.*

<sup>26</sup> If, pursuant to CBOE Rule 7.4(a), the appropriate FPC determines to allow broker-dealer orders to be placed in the electronic book, then, for purposes of this rule, the cumulative number of broker-dealer orders in the electronic book at the best price would be deemed one "market participant," regardless of the number of broker-dealer orders in the book. The allocation due the broker-dealer orders in the electronic book by virtue of their being deemed a "market participant" would be distributed among each broker-dealer order comprising the "market participant" based on UMA. See proposed CBOE Rule 6.45A(a)(i)(A)(2).

<sup>27</sup> If a public customer order in the electronic book matches, or is matched by, a market participant's quote, the public customer order would have priority and, the balance of the electronic order, if any, would be allocated based on UMA.

<sup>28</sup> UMA operates electronically and, as such, only market participants that are represented in the disseminated quote would participate in the allocation of incoming electronic orders. Multiple incoming orders would execute in accordance with CBOE Rule 8.51, Firm Disseminated Market Quotes.

BART. If market maker orders are not eligible for automatic execution, they would all route to PAR or they would all route to BART. The FPC could not determine to route, for example, orders for CBOE market makers that are not in the crowd to PAR, and competing market maker orders to BART. The CBOE represents that routing decisions would be changed infrequently. See Amendment No. 6, *supra* note 7.

<sup>17</sup> See Amendment No. 5, *supra* note 6.

<sup>18</sup> In these instances, the order would route to PAR, unless the order entry firm decides that these orders should route to BART, because routing to PAR would allow the DPM either to send an order through the options intermarket linkage or to execute the order at the better price. See Amendment No. 6, *supra* note 7.

<sup>19</sup> See ISE Letter, *supra* note.

<sup>20</sup> 11Ac1-1 under the Act ("Quote Rule"), 17 CFR 240.11Ac1-1.

<sup>21</sup> See, e.g., CBOE Rule 6.8(c)(v), which states that "[t]he appropriate FPC shall determine the size of orders eligible for entry into RAES." See also PCX Rule 6.76, which states that "[t]he maximum size of an inbound order that may be eligible for execution on PCX Plus . . . will initially be established by the LMM in the issue, subject to the approval of the Options Floor Trading Committee. Any request by the LMM for changes to the Maximum Order Size . . . must be approved by two Floor Officials, whose approval must be further ratified by the Options Floor Trading Committee."

<sup>22</sup> See ISE Letter, *supra* note 6.

<sup>23</sup> See CBOE Response Letter, *supra* note.

<sup>24</sup> *Id.*