

*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 change constitutes a stated policy, practice, or interpretation with respect to the meaning, administration, or enforcement of an existing rule, it has become effective pursuant to Section 19(b)(3)(A)(i) of the Act<sup>14</sup> and Rule 19b-4(f)(1) thereunder.<sup>15</sup> At any time within 60 days of the filing of the 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-2007-93 on the subject line.

*Paper Comments*

- 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-2007-93. 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 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-2007-93 and should be submitted on or before September 20, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>16</sup>

**Nancy M. Morris,**

*Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-56311; File No. SR-CBOE-2006-99]

**Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change and Amendment No. 1 Thereto Related to FLEX Options Trading**

August 23, 2007.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on November 27, 2006, the Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") 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. On August 17, 2007, CBOE filed Amendment No. 1 to the proposed rule change.<sup>3</sup> The Commission is publishing this notice to solicit

comments on the proposed rule change, as amended, from interested persons.

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

The Exchange proposes to adopt rules to provide for the trading of Flexible Exchange Options ("FLEX Options")<sup>4</sup> on the Exchange's new FLEX Hybrid Trading System platform and to make certain corresponding revisions to its existing open-outcry based FLEX RFQ System platform. The text of the proposed rule change is available on the Exchange's Web site (<http://www.cboe.org/legal>), at CBOE, and at the Commission's Public Reference Room.<sup>5</sup>

**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 the Statutory Basis for, the Proposed Rule Change*

1. Purpose

i. Description of the FLEX Hybrid Trading System

Currently, FLEX Options are traded on the Exchange through an open-outcry-based, Request for Quotes ("RFQ") process (referred to herein as the "FLEX RFQ System" platform). The purpose of the proposed rule change is to amend Exchange rules to provide for an alternate framework to trade FLEX

<sup>4</sup> FLEX Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices.

<sup>5</sup> The Exchange notes that unrelated changes are being proposed to the text of Rule 24A.7 in a separate rule filing. See Securities Exchange Act Release No. 56191 (August 2, 2007), 72 FR 44894 (August 9, 2007) (SR-CBOE-2007-79). If that rule filing becomes effective before this instant rule filing, the Exchange intends to submit an amendment to reflect conforming changes to the text to Rules 24A.7 and 24A.8, as well as proposed Rules 24B.7 and 24B.8. Telephone conversation between Jennifer Lamie, Assistant General Counsel, CBOE, and Terri Evans, Special Counsel, Division of Market Regulation ("Division"), Commission on August 20, 2007.

<sup>16</sup> 17 CFR 200.30-3(a)(12).

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

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

<sup>3</sup> In Amendment No. 1, the Exchange replaced the proposed rule change in its entirety.

<sup>14</sup> 15 U.S.C. 78s(b)(3)(A)(i).

<sup>15</sup> 17 CFR 240.19b-4(f)(1).

Options on the CBOE using a “hybrid” platform (referred to herein as the “FLEX Hybrid Trading System” platform or the “System”), which incorporates both open outcry and electronic trading functionality. Some key features of the new FLEX Hybrid Trading System platform are the following:

- *Method of Operation:* On the new hybrid platform, FLEX Option transactions could take place either through use of an open outcry RFQ process similar to the existing FLEX RFQ System process or through use of a new, Internet- and API-based, electronic RFQ platform. In addition, a new feature of the FLEX Hybrid Trading System will allow FLEX Orders to be entered and traded via an electronic book (the “Book”).

- *Access:* The new FLEX Hybrid Trading System platform will be available for the entry of RFQs, FLEX Quotes, and FLEX Orders, and the execution of trades resulting therefrom, of approved members. An approved member is any Exchange member that has been approved by the Exchange to use the FLEX Hybrid Trading System. This group of FLEX-eligible members are collectively referred to as “FLEX Traders.”<sup>6</sup>

- *Market-Maker Participation:* One category of FLEX Traders are FLEX Market-Makers, who will be appointed to one or more classes pursuant to proposed Rule 24B.9. As with the existing FLEX rules, there are two types of FLEX Market-Makers: A FLEX Appointed Market-Maker and a FLEX Qualified Market-Maker (unless specified, or unless the context requires otherwise, the term “FLEX Market-Maker” refers to both FLEX Appointed Market-Makers and FLEX Qualified Market-Makers). FLEX Market-Maker appointments and related market-making obligations, and changes proposed to the existing rule requirements, are discussed further below.

CBOE believes that enhancing its FLEX trading facilities to allow for a hybrid trading platform alternative is important to the Exchange’s efforts to create a market that provides members and investors interested in FLEX-type options with an improved but comparable alternative to the over-the-counter (“OTC”) market in customized options. By enhancing CBOE systems to allow for a FLEX Hybrid Trading System platform, market participants

will have greater flexibility in determining the means with which to execute their customized options in an exchange environment, thus making it a more attractive alternative to the OTC market. CBOE believes market participants benefit from being able to trade customized options in an exchange environment in several ways, including, but not limited to the following: (1) Enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of The Options Clearing Corporation (“OCC”) as issuer and guarantor of FLEX Options.

Given the design of FLEX Options to compete with the OTC market, the Exchange notes that the existing user base for trading FLEX Options includes both institutional investors and high net worth individuals. The Exchange also notes that, when the existing FLEX Rules were originally adopted in 1993, the Exchange put in place certain FLEX contract specification requirements that were designed to limit participation in FLEX Options to these types of sophisticated investors, rather than retail investors. These safeguards, which relate to minimum value size requirements, have been revised over time and will exist for FLEX Options traded on the proposed FLEX Hybrid Trading System. Thus, whether executed through the new electronic RFQ process or open outcry RFQ process (or through entering a FLEX Order to hit the new FLEX Book), the minimum value size requirements for a resulting FLEX transaction will be the same as currently exists today for trading on the existing FLEX RFQ System platform. Additionally, the minimum value size of FLEX Quotes that are entered by FLEX Traders in response to an underlying RFQ (and, correspondingly, the minimum value size of resting FLEX Orders (undecremented size) that are entered by FLEX Traders to provide liquidity for incoming FLEX Orders that hit the Book) will be the same as currently exists today for trading on the existing FLEX RFQ System platform. In maintaining these safeguards for trading on the proposed FLEX Hybrid Trading System, the Exchange is cognizant of the desire to continue to provide the requisite amount of investor protection that the safeguards were originally designed to achieve.

In addition, given the customized nature of FLEX Options, the sophistication of the target FLEX trading community, and the desire to effectively compete with the OTC market (which is

not subject to the same restrictions and requirements of exchange-based trading), CBOE has also designed its FLEX trading rules in a manner that is distinct from its trading rules for traditional options in order to create incentives for members and sophisticated investors to bring larger-sized orders to the Exchange, rather than the OTC market, and to provide deep liquid markets for investors in these customized products. As described below, these distinctions include: (i) Allowing for certain crossing participation entitlements and FLEX Appointed Market-Maker participation entitlements to be applied without yielding to other trading interest (including that of public customers, broker-dealers and FLEX Market-Makers) provided certain conditions are satisfied (including the requirements of Section 11(a)(1) of the Act<sup>7</sup> and the rules promulgated thereunder); (ii) allowing for certain modified market making obligations; and (iii) applying separate position limit and exercise limit requirements to FLEX Options. These principles will be maintained in the proposed FLEX Hybrid Trading System, though certain modifications are being proposed.

For the reasons noted herein, CBOE believes that the proposed structure of its FLEX Hybrid Trading System platform is appropriate and reasonable and that it will provide market participants with additional flexibility to determine choice of venue that best comport with investors’ particular needs.

#### ii. Detailed Summary of Proposed Rule Change

As indicated above, under the proposed rules structure, the Exchange will have the choice to allow trading to occur in a FLEX Option class on the existing FLEX RFQ System platform or the proposed FLEX Hybrid Trading System platform. The rules governing the trading of FLEX Options on the existing FLEX RFQ System platform are contained, and will continue to be maintained, in Chapter XXIVA of the Exchange Rules. The proposed rules governing the trading of FLEX Options on the FLEX Hybrid Trading System platform will be reflected in new Chapter XXIVB. The Exchange currently intends to maintain and operate both the existing FLEX RFQ System platform and the new FLEX Hybrid Trading System platform and will determine which trading platform will be utilized on a class-by-class basis. These

<sup>6</sup>In addition, as discussed further below, the Exchange will permit non-member users to be provided electronic access, through sponsoring members, to enter and execute orders on the FLEX Hybrid Trading System platform.

<sup>7</sup> 15 U.S.C. 78k(a).

determinations will be announced to the membership via Regulatory Circular.

The new platform rules are generally modeled after and correspond with the existing FLEX RFQ System rules contained in Chapter XXIVA. Discussion of each of the proposed new rules, as well as various corresponding changes to the existing FLEX rules, follows.

(1). Proposed FLEX Hybrid Trading System Rules (Chapter XXIVB)

An introductory section to proposed Chapter XXIVB provides that transactions in FLEX Options may be effected on the FLEX Hybrid Trading System in accordance with the procedures in Chapter XXIVB, or via the existing FLEX trading platform in accordance with the procedures in Chapter XXIVA. As described above, determinations as to which trading platform and rules set will be applicable will be made by the Exchange on a class-by-class basis and will be announced to the membership via Regulatory Circular. The introductory language further explains that the rules in Chapters I through XIX and XXIV are also applicable to the trading of FLEX Options on the System, except as indicated at the end of each rule. To the extent the rules in Chapter XXIVB are inconsistent with other Exchange rules, the rules in Chapter XXIVB take precedence in relation to the trading of FLEX Options on the System.

(A). FLEX Hybrid Trading System Definitions (Proposed Rule 24B.1)

Proposed Rule 24B.1, *Definitions*, corresponds with existing Rule 24A.1. It also contains several new definitions necessary to accommodate the introduction of the FLEX Hybrid Trading System. For example, the term "FLEX Hybrid Trading System" shall mean the Exchange's trading platform that allows FLEX Traders to submit both electronic and open outcry RFQs, FLEX Quotes in response to such RFQs, and FLEX Orders into an electronic FLEX Book. The term "FLEX Trader" shall mean a FLEX-participating Exchange member who has been approved by the Exchange to trade on the FLEX Hybrid Trading System. The term "FLEX Order" shall mean a FLEX bid or offer entered by a FLEX Market-Maker or an order to purchase or order to sell a FLEX Option entered by a FLEX Trader, in each case into the Book. With respect to the electronic RFQ process, various terms defining the "RFQ Market," the "RFQ Response Period," the "RFQ Reaction Period," and "RFQ Order" are

defined.<sup>8</sup> In addition, certain Trade Conditions that can be placed on an RFQ, an RFQ Order, or FLEX Order are identified.<sup>9</sup>

(B). Terms of FLEX Options (Proposed Rule 24B.4)

Proposed Rule 24B.4, *Terms of FLEX Options*, is similar to existing Rule 24A.4. Subparagraphs (a)(1) through (2) of Rule 24B.4, like subparagraphs (a)(1) through (2) of Rule 24A.4, provide that the variable terms of FLEX Options (such as the underlying security or index, put or call type, exercise-style, expiration date, and exercise price) will be established through the bidding and offering mechanics applicable to RFQs or the bidding and offer mechanics applicable to the Book. Other terms shall be the same as those that apply to Non-FLEX Options.

Subparagraph (a)(3) of Rule 24B.4, like subparagraph (a)(3) of Rule 24A.4, lists the additional categories of information that must be addressed by a member that initiates an RFQ (the "Submitting Member"), such as the type and form of quote sought and the length

<sup>8</sup> The term "RFQ Market" shall mean the FLEX Quote bids or offers, or both, as applicable, entered in response to an electronic Request for Quotes and FLEX Orders resting in the electronic book, if any. The term "RFQ Response Period" shall mean the period of time during which FLEX Traders may provide FLEX Quotes in response to a Request for Quotes. The term "RFQ Reaction Period" shall mean the period of time during which a Submitting Member determines whether to accept or reject FLEX Quotes submitted in response to an electronic Request for Quotes. The term "RFQ Order" shall mean an order to purchase or order to sell FLEX Options entered by the Submitting Member during the RFQ Reaction Period. See proposed Rule 24B.1(r)-(u).

<sup>9</sup> The following Trade Conditions will be available in the FLEX Hybrid Trading System for a FLEX Trader to choose from for RFQs, RFQ Orders, or FLEX Orders: (a) Fill-or-Kill, which is a condition to execute an RFQ Order or FLEX Order in its entirety as soon as it is represented or cancel it; (b) All-or-None, which is a condition to execute an RFQ Order or FLEX Order in its entirety or not at all; (c) Minimum Fill, which is a condition to execute an RFQ Order or FLEX Order in a minimum quantity or not at all; (d) Lots Of, which is a condition to execute an RFQ Order or FLEX Order in minimum lot sizes or not at all; (e) Intent to Cross, which is an RFQ condition indicating that a Submitting Member intends to cross or act as principal and receive a crossing participation entitlement; and (f) Hedge, which is an RFQ or FLEX Order condition contingent on trade execution in Non-FLEX Options or other Non-FLEX components (e.g., stock, futures, or other related instruments or interests). Trade Conditions, other than Intent to Cross or Hedge, will be inputted but not disclosed on the System. In addition, other than Fill-or-Kill orders, FLEX Orders will be designated by the System as "day orders" and, if unexecuted, will be cancelled at the close of each trade day. See proposed Rule 24B.1(x). In the future, the Exchange may determine to enable "good-'til-cancelled" functionality. The introduction of such functionality would be the subject of a separate rule filing.

of the RFQ Response Period.<sup>10</sup> Additionally, the Submitting Member must indicate any Trade Condition placed on the RFQ (*i.e.*, an Intent to Cross or Hedge condition).<sup>11</sup> Given the proposed introduction of the new concept of the FLEX Book and the new concept of a FLEX Order that can be entered into the Book, proposed subparagraph (a)(4) lists the additional categories of information that must be included in a FLEX Order, such as the order type and form, and any Trade Condition, as applicable.

Subparagraph (a)(5) of Rule 24B.4 lists additional contract and transaction specifications that RFQs, FLEX Quotes responsive to RFQs, RFQ Orders, and FLEX Orders must satisfy. These additional specifications pertain first to maximum expiration terms and second to minimum value size requirements. The maximum expiration terms are the same as in the existing FLEX rules.<sup>12</sup> The minimum value size specifications are substantially similar to subparagraph (a)(4) of Rule 24A.4, though additional language has been added to clarify the applicability of the minimum value size requirements to FLEX Orders entered in the Book.<sup>13</sup> As with the existing FLEX rules, minimum value size requirements for transactions resulting from electronic and open outcry RFQs and for responsive FLEX Quotes will be as follows:

- *Opening Transactions in a New Series:* The minimum value size for an opening transaction resulting from an RFQ in any FLEX series in which there is no open interest at the time the RFQ is submitted shall be: (i) The lesser of 250 contracts or the number of contracts overlying \$1 million in the underlying securities in the case of FLEX Equity

<sup>10</sup> The length of the RFQ Response Period interval is defined by the Submitting Member, provided that the length of the interval must fall within the time ranges established by the appropriate Procedure Committee on a class-by-class basis for electronic RFQs or open outcry RFQs. Such time cannot be less than three seconds. See proposed Rule 24B.4(a)(3)(iii).

<sup>11</sup> At the conclusion of an RFQ, the Submitting Member may enter an RFQ Order to buy or sell a specified size. An RFQ Order shall contain the same transaction specifications as the related RFQ plus any additional Trade Condition(s), if applicable, that relate to the particular order and its size. See proposed Rule 24B.4(a)(3)(iv) and note 9, *supra*.

<sup>12</sup> Specifically, for FLEX Equity Options, the maximum term is three years; provided, however, that the Submitting Member may request a longer term to a maximum of five years. For FLEX Index Options, the maximum term is five years; provided, however, that a Submitting Member may request a longer term to a maximum of ten years. See existing Rule 24A.4(a)(4) and proposed Rule 24B.4(a)(5).

<sup>13</sup> As discussed above, the Exchange notes that the minimum value size requirements were put in place to limit participation in FLEX Options to sophisticated, high-net-worth investors, including institutional investors, rather than retail investors.

Options; and (ii) \$10 million Underlying Equivalent Value in the case of FLEX Index Options.

- *Transactions in Existing Series:* The minimum value size for a transaction in any currently-opened FLEX series resulting from an RFQ shall be: (i) 100 contracts in the case of opening transactions in FLEX Equity Options and 25 contracts in the case of closing transactions in FLEX Equity Options; and (ii) \$1 million Underlying Equivalent Value in the case of both opening and closing transactions in FLEX Index Options; or (iii) in either case, the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less.

- *FLEX Quote Sizes:* The minimum value size for FLEX Quotes responsive to an RFQ shall be: (i) 25 contracts in the case of FLEX Equity Options; and (ii) \$1 million Underlying Equivalent Value in the case of FLEX Index Options; or (iii) in either case, the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. However, FLEX Quotes of FLEX Index Appointed Market-Makers must be for at least \$10 million Underlying Equivalent Value or the dollar amount indicated in the RFQ, whichever is less.

There will be similar minimum value size requirements that apply to transactions that occur in the FLEX Book. Specifically, a transaction resulting from a FLEX Order that seeks liquidity by trading against (“hitting”) the Book must satisfy the same minimum value size requirements described above that are applicable to RFQ transactions. Conversely, a FLEX Order that provides liquidity by resting in the Book must satisfy the same minimum value size requirements described above that are applicable to FLEX Quotes. Thus, the minimum value size requirements for FLEX Orders entered into the Book will be as follows:

- *Opening Transactions in a New Series:* The minimum value size for an opening transaction resulting from a FLEX Order entered to hit the FLEX Book in any FLEX series in which there is no open interest at the time the FLEX Order is submitted shall be: (i) The lesser of 250 contracts or the number of contracts overlying \$1 million in the underlying securities in the case of FLEX Equity Options; and (ii) \$10 million Underlying Equivalent Value in the case of FLEX Index Options.

- *Transactions in Existing Series:* The minimum value size for a transaction in any currently-opened FLEX series resulting from a FLEX Order entered to hit the FLEX Book shall be: (i) 100 contracts in the case of opening

transactions in FLEX Equity Options and 25 contracts in the case of closing transactions in FLEX Equity Options; and (ii) \$1 million Underlying Equivalent Value in the case of both opening and closing transactions in FLEX Index Options; or (iii) in either case, the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less.

- *Resting FLEX Order Sizes:* The minimum value size for FLEX Orders (undecremented size) entered to rest in the FLEX Book shall be: (i) 25 contracts in the case of FLEX Equity Options; and (ii) \$1 million Underlying Equivalent Value in the case of FLEX Index Options; or (iii) in either case, the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. With respect to FLEX Index Appointed Market-Makers, FLEX Orders (undecremented size) must be for at least \$10 million Underlying Equivalent Value.

Subparagraph (a)(5)(iv) of the proposed rule also includes a new requirement that a FLEX Appointed Market-Maker<sup>14</sup> has an obligation to respond to a certain percentage of electronic RFQs. This percentage will be determined by the appropriate Procedure Committee on a class-by-class basis, but will not be less than 80%. As with the existing FLEX rules, a FLEX Appointed Market-Maker will continue to be required to respond to every open-outcry RFQ in a class of FLEX Options to which it is appointed and trading in open outcry.

Paragraph (b), pertaining to special terms for FLEX Index Options, and paragraph (c), pertaining to special terms for FLEX Equity Options, in proposed Rule 24B.4 are the same as the corresponding paragraphs in existing Rule 24A.4.

#### (C). FLEX Trading Procedures and Principles (Proposed Rule 24B.5)

Proposed Rule 24B.5, *FLEX Trading Procedures and Principles*, prescribes in some detail the trading procedures that apply to the FLEX Hybrid Trading System. It describes the RFQ processes for electronic and open-outcry trading, the FLEX Book, contract acceptance, priority of bids and offers, and applicable trading increments.

#### (a). Electronic and Open Outcry RFQ Processes

Paragraph (a) describes the RFQ process, which may be used at any time,

<sup>14</sup>FLEX Appointed Market-Makers and their related market-making obligations are described in proposed Rules 24B.4(a)(5)(iv) and 24B.9.

but is required to initiate a FLEX transaction when there are no FLEX Orders currently resting in the Book in the particular FLEX Options series to be traded. The RFQ process may be conducted electronically through the System or in open outcry as described below.

#### (aa). Electronic RFQ Process

Subparagraph (a)(1) of proposed Rule 24B.5 describes the electronic RFQ process. Upon receipt of an RFQ that satisfies the requirements of proposed Rule 24B.4, the System will cause the terms and specifications of the RFQ to be communicated to FLEX Traders. FLEX Traders, including FLEX Market-Makers and the Submitting Member, may then enter FLEX Quotes that are responsive to the RFQ during the RFQ Response Period.<sup>15</sup> FLEX Quotes may be entered, modified, or withdrawn at any point during the RFQ Response Period; provided, however, any FLEX Appointed Market-Makers must meet certain FLEX Quote maintenance obligations. During the RFQ Response Period, the System will intermittently calculate and disseminate to all FLEX Traders the aggregate depth of the market at each price level considering FLEX Quote responses and FLEX Orders resting in the Book (referred to as the expected “RFQ Market”).

At the end of the RFQ Response Period, the System will calculate and disseminate to all FLEX Traders the final RFQ Market. The Submitting Member will then have a brief interval of time to promptly accept or reject the RFQ Market, provided that such acceptance or rejection must occur during the “RFQ Reaction Period.”<sup>16</sup> During the RFQ Reaction Period, FLEX Quotes and FLEX Orders in the System cannot be modified or withdrawn.<sup>17</sup>

In the scenario where a Submitting Member has not indicated an “intent to cross” in the RFQ request, the Submitting Member can determine to do the following during the RFQ Reaction Period: (i) Trade against the bids and offers (but not both) by submitting an RFQ Order, in which case the resulting transaction will occur at a single “BBO

<sup>15</sup> However, FLEX Quotes may not be entered for the account of a options market maker from another options exchange. See proposed Rule 24B.5(a)(1)(ii)(A).

<sup>16</sup> The length of the RFQ Reaction Period interval will be established by the appropriate Procedure Committee on a class-by-class basis and will not be more than 30 seconds. Failure to promptly accept the bids or offers equates to a rejection. See proposed Rule 24B.5(a)(1)(iii)(A).

<sup>17</sup> FLEX Orders can be entered during the RFQ Reaction Period, but will not be included in the RFQ Market calculation. See proposed Rule 24B.5(a)(1)(iii)(B)(i).

clearing price" that does not violate the RFQ Order's limit price, if any;<sup>18</sup> or (ii) reject the RFQ or let it expire.<sup>19</sup>

If the Submitting Member rejects the RFQ Market or to the extent the RFQ Market size exceeds the Submitting Member's FLEX transaction size, the System will automatically execute any remaining FLEX Quotes and FLEX Orders that are marketable against each other at a single clearing price. Thereafter: (i) If there is a Book available, any further remaining balance of the FLEX Quotes will be automatically entered into the Book unless the FLEX Trader that entered the FLEX Quote has indicated that the FLEX Quote is to be automatically cancelled if not traded;<sup>20</sup> or (ii) if there is no Book

<sup>18</sup> If the Submitting Member chooses to trade, the RFQ Order it sends will be eligible to trade with the FLEX Quotes and FLEX Orders at a single price that will leave bids and offers which cannot trade with each other ("BBO clearing price"). In determining the priority of FLEX Quotes and FLEX Orders to be traded, the System gives priority to FLEX Quotes and FLEX Orders whose price is better than the BBO clearing price, then to FLEX Quotes and FLEX Orders at the BBO clearing price. The allocation among multiple FLEX Quotes and FLEX Orders that are priced at the BBO clearing price will be as follows: (i) Any FLEX Quotes that are subject to a FLEX Appointed Market-Maker participation entitlement will have priority to participate in the execution; (ii) then FLEX Orders resting in the electronic book based on the Book priority algorithm; (iii) then FLEX Quotes for the account of public customers and non-member broker-dealers based on time priority; and (iv) then all other FLEX Quotes based on time priority. In the event an RFQ Market is locked or crossed (e.g., the best bid is \$1.25 and the best offer is \$1.20), allocation at the BBO clearing price on the same side of the transaction as the RFQ Order shall be as follows: (i) FLEX Orders resting in the electronic book will have priority to participate in the execution based on time priority; (ii) then, if applicable, an RFQ Order for the account of a public customer or non-member broker-dealer, then any FLEX Quotes that are subject to a FLEX Appointed Market-Maker participation entitlement; (iii) then FLEX Quotes for the account of public customers and non-member broker-dealers based on time priority; (iv) then, if applicable, an RFQ Order for the account of a member, then any FLEX Quotes that are subject to a FLEX Appointed Market-Maker participation entitlement; and (v) then all other FLEX Quotes based on time priority. The System will then enter any remaining balance of the incoming RFQ Order in the Book (if available), unless the Submitting Member has indicated that the balance of the RFQ Order is to be automatically cancelled if it is not traded. An RFQ Order that has been decremented as part of an electronic RFQ is eligible to be entered into the Book (if available) even though the balance that remains may be below the minimum size requirements for FLEX Orders entered to rest in the Book. Once entered in the Book, an RFQ Order will be treated the same as other FLEX Orders. See proposed Rules 24B.4(a)(5)(iv) and 24B.5(a)(1)(iii)(C).

<sup>19</sup> Consistent with the existing FLEX rules, a Submitting Member has no obligation to accept any FLEX bid or offer. See proposed Rule 24B.5(a)(1)(iii)(E) and existing Rule 24A.5(c)(iv).

<sup>20</sup> A FLEX Quote that has been decremented as part of an electronic RFQ is eligible to be entered into the Book (if available) even though the balance that remains may be below the minimum size

available, any remaining balance of the FLEX Quotes will be automatically cancelled.

Once the RFQ Reaction Period concludes and applicable allocations are completed, FLEX Traders can enter new FLEX Orders or cancel existing FLEX Orders in the Book at any time. If the Book is available, the Submitting Member and other FLEX Traders can also determine to enter FLEX Orders in the Book at the conclusion of the RFQ process.

The following examples illustrate the process:

- Assume the RFQ Market is bid 1000 contracts at \$1.00 and offered 1000 contracts at \$1.20, 1200 contracts at \$1.21, and 1500 contracts at \$1.23. Also assume that the FLEX Book is not activated in the particular class. If the Submitting Member submits an agency RFQ Order to buy 1500 contracts, the order will trade at a BBO clearing price of \$1.21. The priority among the interest represented on the offer-side of the RFQ Market will be first to the FLEX Quotes offered at \$1.20 and second to FLEX Quotes offered at \$1.21. Allocation among multiple FLEX Quotes represented at \$1.21 shall be first to any FLEX Appointed Market-Maker(s) with a participation entitlement, then to FLEX Quotes for the account of public customers and non-member broker-dealers based on time priority, then to all other FLEX Quotes based on time priority. The remaining balance of the FLEX Quotes entered in response to the RFQ will be automatically cancelled.

- Assume the RFQ Market is bid 1000 contracts at \$1.21 and offered 1000 contracts at \$1.20, 1200 contracts at \$1.21, and 1500 contracts at \$1.23. Thus, the bids and offers that make up the RFQ Market are "crossed." Also assume that each of the FLEX Traders that entered responses elected to have any remaining balance on their FLEX Quotes automatically booked. If the Submitting Member submits an agency RFQ Order to buy 1000 contracts, the order will trade at a BBO clearing price of \$1.21 and the 1000 contract bid will also trade against the offers at a BBO clearing price of \$1.21. (The particular allocation algorithm among the interest represented on the offer-side of the RFQ Market is as described in the first example, assuming there are no FLEX Orders in the Book.) Coming out of the RFQ auction, the Book will also display offers of 200 contracts at \$1.21 and 1500 contracts at \$1.23.

requirements for FLEX Orders entered to rest in the Book. Once entered in the Book, a FLEX Quote will be treated the same as other FLEX Orders. See proposed Rules 24B.4(a)(5)(iv) and 24B.5(a)(1)(iii)(F).

- Assume the RFQ Market is bid 1000 contracts at \$1.21 and offered 1000 contracts at \$1.20, 500 contracts at \$1.21, and 1500 contracts at \$1.23. Thus, the bids and offers that make up the RFQ Market are "crossed." Also assume that the bid consists in part of a 100-contract FLEX Order that was resting in the Book prior to the initiation of the RFQ and that each of the FLEX Traders that entered responses elected to have any remaining balance on its FLEX Quote automatically booked. If the Submitting Member submits a public customer RFQ Order to buy 1000 contracts at \$1.21, the 100 contract FLEX Order, the 1000 contract RFQ Order, and 400 contracts of the remaining 900 contract bid will trade against the offers at a BBO clearing price of \$1.21.<sup>21</sup> (The particular allocation algorithm among the interest represented on the offer-side of the RFQ Market is as described in the first example, assuming there are no FLEX Orders in the Book.) Coming out of the RFQ auction, the Book will also display a bid of 500 contracts at \$1.21 and an offer of 1500 contracts at \$1.23.

- Assume the RFQ Market is bid 1000 contracts at \$1.00 and offered 1000 contracts at \$1.20 and the Submitting Member wants to trade 200 contracts in a FLEX Equity series that has a minimum value size requirement of 100 contracts. Also assume the FLEX Book is activated in the particular class. During the RFQ Reaction Period, the Submitting Member enters an agency RFQ Order to buy 200 contracts at \$1.15. Because the best offer is \$1.20, no trade will occur. The RFQ Order and the FLEX Quotes entered in response to the RFQ will be booked (assuming the Submitting Member and each of the FLEX Traders that entered responses elected to have any remaining balance on their FLEX Quotes automatically booked). Coming out of the RFQ auction, the Book will display a market that is bid 200 contracts at \$1.15 and offered 1000 contracts at \$1.20.

In the scenario where the Submitting Member has indicated an "intent to cross" in its RFQ request, during the RFQ Reaction Period the Submitting Member can determine to: (i) Enter an RFQ Order to trade with the bids or offers and be automatically allocated a crossing participation entitlement to trade with the RFQ Order at the BBO

<sup>21</sup> If the RFQ Order is submitted for the account of a member, the RFQ Order will trade after the FLEX Order and any FLEX Quotes for the account of public customers and non-member broker-dealers. See note 18, *supra*

clearing price;<sup>22</sup> or (ii) reject the RFQ or let it expire.

If the Submitting Member enters an RFQ Order, the System will immediately execute the RFQ Order to the extent marketable at the BBO clearing price, with the Submitting Member executing an amount up to the applicable crossing participation entitlement at the BBO clearing price after yielding to certain trading interests.<sup>23</sup> Thereafter, any remaining balance of the RFQ Order will be exposed in the Book<sup>24</sup> for at least the minimum Crossing Exposure Period.<sup>25</sup> During this time, other FLEX Traders can trade against the order. At the end of the Crossing Exposure Period, the Submitting Member may enter a contra-side order to trade any remaining balance of the RFQ Order. The Submitting Member must, however, enter a contra-side order when necessary to satisfy the minimum value size requirements for the FLEX transaction.<sup>26</sup>

The following examples illustrate this process:

<sup>22</sup> The existing FLEX rules allow for the Submitting Member to execute a certain portion of a FLEX Order where the Submitting Member has indicated an intention to cross or act as principal (the "crossing participation entitlement"). See existing Rule 24A.5(e). The same concept will apply under the proposed FLEX Hybrid Rules, though changes to the applicable participation entitlement percentages are being proposed. In addition, the Exchange is proposing to extend the use of crossing participation entitlements to solicitations. See proposed Rule 24B.5(d). The particular participation entitlements are discussed further below.

<sup>23</sup> See note 18, *supra*, for description of the BBO clearing price. In determining the priority of FLEX Quotes and FLEX Orders to be traded when the Submitting Member has indicated an "intent to cross," the System gives priority to FLEX Quotes and FLEX Orders whose price is better than the BBO clearing price, then to FLEX Quotes and FLEX Orders at the BBO clearing price. The allocation among multiple FLEX Quotes and FLEX Orders that are priced at the BBO clearing price will be as follows: (i) FLEX Orders resting in the electronic book will have priority to participate in the execution; (ii) then FLEX Quotes for the account of public customers and non-member broker-dealers based on time priority; (iii) then the crossing participation entitlement; (iv) then any FLEX Quotes that are subject to a FLEX Appointed Market-Maker participation entitlement; and (v) then all other FLEX Quotes based on time priority. See proposed Rule 24B.5(a)(1)(iii)(D). The FLEX Appointed Market-Maker participation entitlement when combined with a crossing participation entitlement will collectively not exceed 40% of the incoming RFQ Order's original size. See proposed Rule 24B.5(d)(2).

<sup>24</sup> If there is no Book available, the System will expose the remaining balance of the incoming RFQ Order, if any, so other FLEX Traders can trade against the order. See proposed Rule 24B.5(a)(1)(iii)(D)(IV).

<sup>25</sup> The length of this Crossing Exposure Period shall be determined by the appropriate Procedure Committee on a class-by-class basis and shall not be less than three seconds. See *id.*

<sup>26</sup> See proposed Rule 24B.4(a)(5)(ii) and (iii), and proposed Rule 24B.5(a)(1)(iii)(D)(IV).

- Assume the RFQ Market is bid 1000 contracts at \$1.00 and offered 1000 contracts at \$1.20, 1200 contracts at \$1.21 and 1500 contracts at \$1.23. Also assume that the Submitting Member marked the RFQ with an "intent to cross" flag, that the applicable crossing entitlement is 40%, and that the FLEX Book is not activated in the particular class. If the Submitting Member submits an agency market RFQ Order to buy 200 contracts, the order will trade at a BBO clearing price of \$1.20, with the Submitting Member being automatically allocated 80 contracts (40% of 200) on the trade after yielding to any FLEX Quotes for the account of public customers and non-member broker-dealers. (The particular allocation algorithm applicable to any remaining contracts is as described in footnote 23.) The remaining balance of the FLEX Quotes entered in response to the RFQ will be automatically cancelled.

- Assume the RFQ Market is bid 1000 contracts at \$1.21 and offered 1000 contracts at \$1.20, 1200 contracts at \$1.21, and 1500 contracts at \$1.23. Thus, the bids and offers that make up the RFQ Market are "crossed." Also assume that the Submitting Member marked the RFQ with an "intent to cross" flag, that the applicable crossing entitlement is 40%, that the offer consists in part of a 100 contract FLEX Order at \$1.20 that was resting in the Book prior to the initiation of the RFQ, and that each of the FLEX Traders that entered responses were FLEX Market-Makers that elected to have any remaining balance on their FLEX Quotes automatically booked. If the Submitting Member submits an agency market RFQ Order to buy 200 contracts, the order will trade at a BBO clearing price of \$1.21, with the resting FLEX Order trading 100 contracts, the Submitting Member trading 80 contracts (40% of 200), and the remaining 20 trading against the other interest represented in the offer. The 1000 contract bid will also trade against the offers at the BBO clearing price of \$1.21. (The particular allocation algorithm among the remaining interest represented in the offer-side of the RFQ Market is as described in footnote 23.) Coming out of the RFQ auction, the Book will also display offers of 1000 contracts at \$1.21 and 1500 contracts at \$1.23.

- Assume a scenario where there is an RFQ Market of \$1.00–\$1.20, the Submitting Member wants to trade 200 contracts in a FLEX Equity series that has a minimum value size requirement of 100 contracts, and a crossing participation entitlement of 40%. Also assume the FLEX Book is activated in the particular class. During the RFQ

Reaction Period, the Submitting Member may enter an agency RFQ Order to buy 200 contracts at \$1.15. The Submitting Member will immediately cross 80 contracts (40% of 200) and the balance of the order will be entered in the Book. After waiting the required exposure time (say three seconds), the Submitting Member must enter a contra-side order for at least 20 contracts if no one else has traded against the remaining balance of the RFQ Order (in order to satisfy the minimum value size requirement of 100 contracts).

The Exchange notes that the Submitting Member must mark its RFQ with an "intent to cross" flag at the time the RFQ is originally submitted to be automatically allocated the applicable crossing participation entitlement for facilitation and solicitation transactions. If the RFQ is not flagged in this manner, the Submitting Member will not be automatically allocated the entitlement.

The Exchange notes that a Submitting Member also has the ability to enter an agency or proprietary FLEX Quote in response to the Submitting Member's own RFQ. Such a FLEX Quote will be treated the same as any other FLEX Quote and subject to the priority allocation algorithm described above.

Finally, the Exchange notes that all electronic RFQ transactions must be in compliance with Section 11(a)(1) of the Act<sup>27</sup> 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 discretion (collectively "proprietary" orders) unless an exception applies. In this regard, the Exchange is proposing that proprietary FLEX Quotes, RFQ Orders, and a crossing participation entitlements may rely on the exception found in paragraph (G) of Section 11(a)(1) of the Act<sup>28</sup> and Rule 11a1–1(T) thereunder (the "G" exemption"),<sup>29</sup> because within the System such trading interest would yield to same-priced FLEX Orders in the Book and same-priced FLEX Quotes for the account of public customers and non-member broker-dealers, in compliance with the "G" exception requirement to yield priority to any bid (offer) at the same price for the account of a person who is not, or is not associated with, a member (a "non-member"). A member that relies on the "G" exemption would also have

<sup>27</sup> 15 U.S.C. 78k(a).

<sup>28</sup> 15 U.S.C. 78k(a)(1)(G).

<sup>29</sup> 17 CFR 240.11a1–1(T).

to satisfy the other requirements of the "G" exemption.

(bb). Open Outcry RFQ Process

Subparagraph (a)(2) of proposed Rule 24B.5 describes the open outcry RFQ process, which is similar to the process that exists today with a few primary distinctions.<sup>30</sup> To initiate a FLEX transaction using the open-outcry RFQ process, a Submitting Member shall submit an RFQ to the FLEX Official.<sup>31</sup> After providing an RFQ in proper form to the FLEX Official, the Submitting Member shall immediately announce the terms and specifications of the RFQ to the trading crowd for the FLEX Option by public outcry. FLEX Traders present in the trading crowd may provide the Submitting Member with responsive FLEX Quotes by public outcry during the RFQ Response Period.<sup>32</sup> These FLEX Quotes may be entered, modified, or withdrawn at any point during the RFQ Response Period; provided, however, FLEX Appointed Market-Makers must meet certain FLEX Quote maintenance obligations.<sup>33</sup> At the

<sup>30</sup> The primary distinctions between the trading mechanics applicable to the existing FLEX open-outcry RFQ process and the trading mechanics applicable to the proposed FLEX Hybrid Trading System open-outcry RFQ process are that, under the latter process, the Submitting Member will be responsible for announcing the terms and specifications of the RFQ to the trading crowd by public outcry, receiving FLEX Quotes responsive to the RFQ and, at the conclusion of the RFQ Response Period, announcing the BBO to the trading crowd (whereas under the existing process, the FLEX Post Official communicates the RFQ to FLEX-participating members over facilities maintained by the Exchange, FLEX Quotes responsive to the RFQ may be entered at the FLEX post, and the BBO is visibly displayed at the post and over the network). Compare proposed Rule 24B.5(a)(2)(i)(B), (ii)(A), and (ii)(B) to existing Rule 24A.5(a)(ii), (b)(i), and (b)(iii). There are also differences in the applicable priority provisions that will take into consideration the priority of the electronic book (which is not applicable under the existing process) and the priority of two bids submitted in open outcry at the same time and same price (which will be apportioned equally as compared to the existing practice of affording priority to the FLEX Appointed or Qualified Market-Makers) as well as modify the applicable crossing participation entitlements. Compare proposed Rule 24B.5(a)(2)(v) and (d) to existing Rule 24A.5(e) and (f); see also note 22, *supra*.

<sup>31</sup> Under the proposed rules, the Exchange may designate an employee or independent contractor to act as a FLEX Official and designate other qualified employees or independent contractors to assist the FLEX Official as the need arises. The FLEX Official shall perform the functions set out in proposed Rule 24B.14, which include reviewing the conformity of open-outcry RFQs to the terms and specifications contained in proposed Rule 24B.4.

<sup>32</sup> As with electronic RFQs, the length of the RFQ Response Period interval for open-outcry transactions is defined by the Submitting Member, provided that the length of the interval must fall within the time ranges established by the appropriate Procedure Committee on a class-by-class basis and such time cannot be less than three seconds. See proposed Rule 24B.4(a)(3)(iii).

<sup>33</sup> See proposed Rules 24B.4(a)(5)(iv) and 24B.9.

expiration of the RFQ Response Period, the Submitting Member will identify the BBO considering responsive FLEX Quotes and, if applicable, FLEX Orders resting in the Book. The Submitting Member will announce the BBO to the FLEX Traders in the trading crowd.

If the Submitting Member does not intend to cross or act as principal with respect to any part of the FLEX trade, the Submitting Member shall promptly accept or reject the BBO; provided, however, if a Submitting Member either rejects the BBO or is given a BBO for less than the entire size requested, all FLEX Traders in the trading crowd other than the Submitting Member will have an opportunity during the BBO Improvement Interval in which to match or improve, as applicable, the BBO.<sup>34</sup> At the expiration of any BBO Improvement Interval, the Submitting Member must promptly accept or reject the BBO(s).

If the Submitting Member indicates an intention to cross or act as principal with respect to any part of the FLEX trade, acceptance of the displayed BBO shall be automatically delayed until the expiration of the BBO Improvement Interval. Prior to the BBO Improvement Interval, the Submitting Member must announce to the trading crowd the price at which the Submitting Member expects to trade. In these circumstances, the Submitting Member may participate with all other FLEX Traders present in the trading crowd in attempting to improve or match the BBO during the BBO Improvement Interval. At the expiration of the BBO Improvement Interval, the Submitting Member must promptly accept or reject the BBO(s).

As with the existing rules, the Submitting Member has no obligation to accept any FLEX bid or offer. And, whenever following the completion of the RFQ Response Period or BBO Improvement Interval, as applicable, the Submitting Member rejects the BBO or the BBO size exceeds the FLEX transaction size indicated in the Request for Quotes, FLEX Traders present in the trading crowd may accept the unfilled balance of the BBO. Such acceptance must occur by public outcry promptly following the Submitting Member's determination whether to accept or reject the BBO or at the expiration of any applicable BBO Improvement Interval. Rejection of the open-outcry BBO(s) or failure to promptly to accept the BBO(s) by the Submitting Member or FLEX Traders, as applicable, results in expiration of the BBO(s) and the RFQ.

<sup>34</sup> The "BBO Improvement Interval" refers to a period of time during which FLEX Traders in the trading crowd may submit FLEX Quotes to meet or improve the BBO established during the RFQ Response Period. See proposed Rule 24B.1(b).

For open-outcry RFQs, the highest bid (lowest offer) will have priority. Subject to the requirements of Section 11(a)(1) discussed below, at the same price, the Submitting Member will allocate the RFQ Order in accordance with the following algorithm. First, to the extent the Submitting Member is entitled to a crossing participation entitlement, if any, the Submitting Member has priority to trade the applicable entitlement percentage. Next, to the extent a FLEX Appointed Market-Maker(s) is entitled to a participation entitlement, if any, the FLEX Appointed Market-Maker(s) has priority to trade the applicable entitlement amount. In any event, the FLEX Appointed Market-Maker participation entitlement when combined with a crossing participation entitlement will collectively not exceed 40% of the incoming order's original size.<sup>35</sup> Thereafter, FLEX Quotes submitted in open outcry in response to the open-outcry RFQ will trade based on time priority; provided, however, where two or more best bid (offer) FLEX Quotes are submitted in open outcry at the same time and same price or in the event the Submitting Member cannot reasonably determine the sequence in which the open-outcry bid (offer) FLEX Quotes were made, priority will be apportioned equally among the open-outcry bids (offers). Next, to the extent there is any remaining balance, same priced FLEX Orders resting in the Book will trade based on the Book priority algorithm.

If the RFQ Order being represented by the Submitting Member in open-outcry has an exemption from Section 11(a), the RFQ Order will have priority over all other same-priced bids (offers) on the same side of the market. After executing the RFQ Order (or if the Submitting Member determines not to trade), any unfilled balance of the BBO may be executed by FLEX Traders in the trading crowd based on the priority principles described above.

All open-outcry RFQ transactions must be in compliance with Section 11(a)(1) and the rules promulgated thereunder. In this regard, a bid (offer) submitted on behalf of the proprietary account of a member that is relying on the "G" exemption must yield priority to any bid (offer) at the same price that is represented in the Book (and all FLEX Quotes that have priority over the Book) in order to ensure that the proprietary order yields priority to non-member orders. A member that relies on the "G" exemption would also have to satisfy the other requirements of the "G" exemption. In the event a Submitting

<sup>35</sup> See proposed Rule 24B.5(d)(2).

Member is asserting a crossing participation entitlement on behalf of a proprietary order that must yield priority in reliance on the "G" exemption and a FLEX Appointed Market-Maker is asserting a participation entitlement, the Submitting Member's crossing participation entitlement to the remaining balance of the original order, when combined with the FLEX Appointed Market-Makers guaranteed participation, shall not exceed 40% of the original order.<sup>36</sup> However, provided the "G" exemption requirements are satisfied, nothing prohibits a Submitting Member or FLEX Appointed Market-Maker from trading more than its applicable entitlement if other FLEX Traders in the crowd do not choose to trade the remaining portion of the order.<sup>37</sup>

#### (b). The FLEX Book & FLEX Orders

As indicated above, the FLEX Book and FLEX Orders are new concepts being introduced through the FLEX Hybrid Trading System platform. Paragraph (b) of proposed Rule 24B.5 describes the FLEX Book. The determination of whether to make the FLEX Book functionality available will be made by the Exchange on a class-by-class basis.

Utilization of the new FLEX Order functionality is contingent upon the FLEX Book being made available. So, if the Book is not made available, the FLEX Order functionality will not apply and instead the FLEX Hybrid Trading System platform functionality will be limited to the electronic and open-outcry RFQ processes. If the Book is made available, FLEX Orders that satisfy the specification and minimum value size requirements described above are eligible to be entered in the Book, as well as the remaining balance of RFQ Orders and FLEX Quotes entered in response to an RFQ (both of which are treated the same as other FLEX Orders once entered in the Book).

The System will automatically execute incoming marketable FLEX Orders against FLEX Orders resting in the Book based on price-time priority,

provided that special procedures apply if a FLEX Appointed Market-Maker participation entitlement has been established for the option class and subject to the restriction discussed in the next paragraph. To the extent a FLEX Appointed Market-Maker(s) is entitled to a participation entitlement and is quoting at the best bid (offer), allocation among multiple bids (offers) at the same price shall be first to all FLEX Orders for the account of a public customer ranked ahead of the FLEX Appointed Market-Maker based on time priority, then the FLEX Appointed Market-Maker entitlement will be applied. Thereafter, all other FLEX Orders resting in the Book at the same price will trade based on time priority. To the extent there is any remaining balance of the incoming order, the balance will be entered in the Book or automatically cancelled, depending on any applicable Trade Conditions.<sup>38</sup>

Under the proposed procedures for the FLEX Book, a Submitting Member may not execute as principal against a FLEX Order it represents as agent unless: (i) The agency FLEX Order is first subject to an RFQ, or (ii) the Submitting Member has been bidding or offering for at least the Crossing Exposure Period<sup>39</sup> prior to receiving an agency FLEX Order that is executable against such bid or offer. With respect to solicitation orders, a Submitting Member may not execute a solicited order against a FLEX Order it represents as agent unless the agency order is first subject to an RFQ.

All Book transactions must also be in compliance with Section 11(a)(1) and the rules promulgated thereunder. In this regard:

- *"G" Exemption:* The Exchange is proposing that a member may rely on the "G" exemption only if the member is "hitting" the Book with a proprietary order. To the extent the proprietary order is not executed in whole or in part as soon as it hits the Book, the order must be immediately cancelled by the member. Such a member would also have to satisfy the other requirements of the "G" exemption, including the gross-revenue-related requirements of paragraph (b) of the "G" exemption rule. However, a member may not rely on the "G" exemption to rest a proprietary order in the Book. This limitation is necessary in order to ensure that the member yields priority to any bid (offer)

at the same price for the account of a non-member.

- *"Effect versus Execute" Exemption:* The Exchange is proposing that a member that submits a proprietary order to rest or "hit" the Book from off the floor may rely on the Exchange's automated System to satisfy the requirement of the "effect versus execute" exemption that the member's proprietary order be executed by an exchange member that is not affiliated with the member initiating the proprietary order. Such a member would also have to satisfy the other requirements of the "effect versus execute" exemption (which are discussed in more detail below).

#### (c). Creation of Binding Contracts

Paragraph (c) of proposed Rule 24B.5 provides that acceptance of any bid or offer creates a binding contract under Rule 6.48. This provision is the same as in existing Rule 24A.5(d) and will apply for both RFQ and Book transactions.

#### (d). FLEX Priority Algorithms and Section 11(a)(1) Requirements

Paragraph (d) of proposed Rule 24B.5 describes the general priority principles applicable to the FLEX Hybrid System. Subparagraph (d)(1) includes a cross-reference to the priority algorithms applicable to electronic RFQs, open-outcry RFQs, and Book transactions, each of which is discussed above. Subparagraph (d)(2) describes the optional crossing and FLEX Appointed Market-Maker participation entitlements that may be overlaid on the general priority principles.<sup>40</sup> The framework for these participation entitlements is modeled after the existing FLEX rules. However, the Exchange is proposing some modifications from the existing structure, which are discussed further below.

With respect to the crossing participation entitlement, a Submitting Member that has matched or improved the BBO or BBO clearing price, as applicable, will have priority after yielding to certain trading interests to execute the contra-side of the trade to the extent of the applicable crossing participation entitlement.<sup>41</sup> The crossing participation entitlement is intended to encourage members to bring FLEX Option orders to CBOE and to

<sup>36</sup> In this particular scenario, at the same price, priority is afforded first to any FLEX Appointed Market-Maker(s) with a participation entitlement, then to FLEX Quotes represented in the trading crowd that are not relying on the "G" exemption, then to FLEX Orders resting in the Book, then all other interest in the trading crowd relying on the "G" exemption. Among those latter interests, a Submitting Member seeking a crossing participation entitlement would then have priority to trade an amount that, when combined with allocated FLEX Appointed Market-Maker participation entitlement, does not exceed 40% of the original order size. See proposed Rule 24B.5(a)(2)(v)(B) and (d)(2)(ii).

<sup>37</sup> See proposed Rule 24B.5(a)(2)(v)(B).

<sup>38</sup> See note 9, *supra*.

<sup>39</sup> The length of this Crossing Exposure Period shall be determined by the appropriate Procedure Committee on a class-by-class basis and shall not be less than three seconds. See proposed Rule 24B.5(b)(3)(i).

<sup>40</sup> Additionally, Trade Conditions placed on a FLEX Order may prevent a match from occurring. See proposed Rules 24B.1(x) and 24B.5(d)(3).

<sup>41</sup> As discussed above, the mechanics for receiving a crossing participation entitlement and the related priority requirements are described in proposed Rule 24B.5(a)(1)(iii)(D) with respect to electronic RFQs and in proposed Rule 24B.5(a)(2)(iii)(B) and (v) with respect to open-outcry RFQs.



commit their capital to the FLEX Options market on CBOE, and thereby contribute to the liquidity of that market, by guaranteeing them a minimum right of participation in the other side of any trade they bring to the market if they are prepared to match or improve the BBO.

For FLEX Equity Options, the appropriate Procedure Committee will determine on a class-by-class basis whether to establish a crossing participation entitlement for facilitations and/or solicitations for electronic RFQs and/or open-outcry RFQs and the applicable entitlement percentage, which shall not exceed 40% of the trade.<sup>42</sup> For FLEX Index Options, the appropriate Procedure Committee will determine on a class-by-class basis whether to establish a crossing participation entitlement for facilitations and/or solicitations for electronic RFQs and/or open-outcry RFQs and the applicable entitlement, which shall be the greater of a crossing entitlement percentage (which shall not exceed 40%), a proportional share of the trade, \$1 million underlying equivalent value, or the remaining underlying equivalent value on a closing transaction valued at less than \$1 million.<sup>43</sup>

The proposed crossing entitlement requirements also provide that a Submitting Member that is seeking a crossing participation entitlement in conjunction with an open-outcry RFQ may not cross an order that it is holding

with a solicited order from a FLEX Market-Maker that is then in the trading crowd, except in accordance with CBOE Rule 6.55, *Multiple Representation Prohibited*. As such, if a FLEX Market-Maker is solicited and agrees to participate on a cross, the FLEX Market-Maker would not be permitted to be present in the trading crowd when such order is represented and executed unless an exception under Rule 6.55 applies. Similarly, the Exchange is proposing that a Submitting Member that is seeking a crossing participation entitlement in conjunction with an electronic RFQ transaction may not cross an order with (i) A solicited order for the individual or joint account of a FLEX Market-Maker or (ii) a solicited order initiated by the FLEX Market-Maker for an account in which the FLEX Market-Maker has an interest, unless the FLEX Market-Maker refrains from participating on the same trade. In such instances, it would be the responsibility of the FLEX Market-Maker to ascertain whether solicited orders for the FLEX Market-Maker's joint account are being represented by the Submitting Member.

With respect to the FLEX Appointed Market-Maker participation entitlement, the existing FLEX rule provides that the appropriate Procedure Committee may establish a participation entitlement from time to time. In the past, the establishment of these entitlements and changes thereto have been the subject of separate rule filings.<sup>44</sup> In lieu of continuing the practice of submitting separate rule filings, the Exchange is proposing to include specific parameters within the rule text, similar to its rules respecting crossing participation entitlements (discussed above) and to its rules respecting market-maker participation entitlements for Non-FLEX Options.<sup>45</sup> These parameters will provide that the appropriate Procedure Committee may establish a participation entitlement formula for FLEX Appointed Market-Makers on a class-by-class basis with respect to open-outcry RFQs, electronic RFQs, and/or Book transactions. Any such FLEX Appointed Market-Maker participation entitlement shall: (i) Be divided equally by the number of FLEX Appointed Market-Makers quoting at the BBO or BBO clearing price, as

applicable; (ii) collectively, be no more than: 50% of the remaining order when there is one other FLEX Market-Maker also quoting at the same price, 40% when there are two other FLEX Market-Makers also quoting at the same price; and 30% when there are three or more FLEX Market-Makers also quoting at the same price; and (iii) when combined with any Submitting Member's crossing participation entitlement, shall not exceed 40% of the original order.<sup>46</sup> Capping the total FLEX Appointed Market-Maker participation entitlement when combined with the crossing participation entitlement at 40% is consistent with the existing FLEX rules.<sup>47</sup>

The following is an example how the allocation will operate: Assume a FLEX Equity Option class has applied a 20% crossing participation entitlement and a 40% FLEX Appointed Market-Maker participation entitlement (when there are two other FLEX Market-Makers at the same price). At the end of an electronic RFQ, the interest representing the best offer of \$1.20 considering the responsive FLEX Quotes is composed of interest received in the following order: 75 contracts from FLEX Market-Maker A, 300 contracts from FLEX Appointed Market-Maker B, and 50 contracts from FLEX Market-Maker C. If the Submitting Member submits an order to buy 100 contracts at \$1.20 and intends to cross the order, the allocation among the contra-parties will be as follows: 20 contracts to the Submitting Member (20% of 100),<sup>48</sup> 20 contracts to FLEX Appointed Market-Maker B (greater of the participation entitlement of 20 contracts<sup>49</sup> or the price/time allocation of 5 contracts), and 60 contracts to FLEX Market-Maker A (based on time priority).

As with the existing FLEX rules, the proposed FLEX Hybrid Trading System rules also provide that all transactions must be in compliance with Section 11(a) of the Act<sup>50</sup> and the rules promulgated thereunder. Section 11(a)(1) prohibits a member of a national securities exchange from effecting transactions on that exchange

<sup>42</sup> The existing FLEX rules allow for a 25% crossing participation entitlement for FLEX Equity Options. This entitlement generally applies before any other trading interest represented at the execution price, which must be the better of the BBO or an improved price. See existing Rule 24A.5(e)(iii)(A). Providing for the flexibility to increase the entitlement percentage to 40% is similar to the percentage parameters that the Exchange may apply for crosses in Non-FLEX Options, which permit a crossing entitlement of up to 40% after all public customer orders in the limit order book are satisfied. See Rule 6.74(d). In addition, allowing for a 40% entitlement percentage is consistent with the American Stock Exchange's ("Amex") FLEX trading rules, which permit a FLEX Equity Option member firm guarantee of up to 40%. See Securities Exchange Act Release No. 54327 (August 16, 2006), 71 FR 49492 (August 23, 2006) (SR-Amex-2006-47).

<sup>43</sup> The existing FLEX rules have similar parameters for FLEX Index Options, except that the crossing entitlement percentage is set at 20%. See existing Rule 24A.5(e)(iii)(B). The proposed parameter allowing for up to 40% is similar to the parameter the Exchange applies for crosses in Non-FLEX Options. See CBOE Rule 6.74(d) and note 42, *supra*. The proposed rule also indicates that the proportional share, \$1 million underlying equivalent value, and remaining underlying equivalent value parameters will be made available only with respect to electronic RFQ transactions to the extent the Exchange determines to make this functionality available in the FLEX Hybrid Trading System. See proposed Rule 24B.5(d)(2)(i)(B).

<sup>44</sup> See existing Rule 24A.5(e)(iv) and Securities Exchange Act Release No. 45934 (May 15, 2002), 67 FR 36276 (May 23, 2002) (SR-CBOE-2002-09) (order approving a rule change relating to the allocation of orders for Appointed Market-Makers in FLEX Index Options).

<sup>45</sup> See, e.g., Rule 8.87, *Participation Entitlement of DPMs and e-DPMs*, which applies a DPM/e-DPM participation entitlement after all public customer orders in the limit order book are satisfied.

<sup>46</sup> See proposed Rule 24B.5(d)(2)(ii).

<sup>47</sup> See note 44, *supra*.

<sup>48</sup> In the event there were FLEX Orders resting in the Book at \$1.20 or FLEX Quotes for the account of public customers or non-member broker-dealers at \$1.20, such FLEX Orders and FLEX Quotes would have priority over the Submitting Member's participation entitlement. See proposed Rule 24B.5(a)(1)(iii)(D).

<sup>49</sup> The participation entitlement is the lesser of: (a) 40% of the remaining balance, which is 32 contracts (40% of 80) and (b) 40% of the original order minus the crossing entitlement, which is 20 contracts (40% of 100 minus 20).

<sup>50</sup> 15 U.S.C. 78k(a).

for its own account, the account of an associated person, or an account over which it or its associated person exercises investment discretion (collectively referred to herein as “proprietary” orders) unless an exception applies. First enacted as part of the Securities Acts Amendments of 1975,<sup>51</sup> Section 11(a) was intended by Congress to address trading advantages enjoyed by exchange members and conflicts of interest in money management.<sup>52</sup> In particular, as noted by the Commission, Congress was concerned about members benefiting in their proprietary transactions from special trading advantages—such as the ability to “execute decisions faster than public investors.”<sup>53</sup>

Where principal transactions contribute to the fairness and orderliness of exchange markets or do not reflect any time and place trading advantages, they are excepted from the prohibition. Among the transactions excepted under Section 11(a)(1) are those by a dealer acting in the capacity of a market maker,<sup>54</sup> bona fide arbitrage or hedge transactions,<sup>55</sup> and transactions made to offset errors.<sup>56</sup>

Rule 11a2–2(T) under the Act, commonly referred to as the “effect versus execute” exemption rule, provides an exception in addition to those delineated in the statute.<sup>57</sup> Rule 11a2–2(T) permits an exchange member, subject to certain conditions, to effect transactions for covered accounts by arranging for an unaffiliated member to execute the transactions on the exchange. To comply with the rule’s conditions, a member (i) Must transmit the order from off the exchange floor;

(ii) must not participate in the execution of the transaction once it has been transmitted to the member performing the execution;<sup>58</sup> (iii) must 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 excepted as provided in the rule.

As described by the Commission, these four requirements—off-floor transmission, non-participation in order execution, execution through an unaffiliated member, and non-retention of compensation for discretionary accounts—were “designed to put members and non-members on the same footing, to the extent practicable, in light of the purposes of Section 11(a).”<sup>59</sup> If a transaction meets the requirements of the “effect versus execute” rule, it will be deemed to be “consistent with the purpose of Section 11(a)(1) of the Act, the protection of investors, and the maintenance of fair and orderly markets.”<sup>60</sup>

The Exchange believes that proprietary FLEX Orders originating from off the Exchange’s trading floor and entered into the FLEX Book (whether to rest or the “hit” the Book) would qualify for Rule 11a2–2(T). The electronic platform component of the Book would place all of these users—both members and non-members—on the “same footing,” as intended by Rule 11a2–2(T). Given the Book’s automated matching and execution services, no Exchange member would enjoy any special control over the time of execution or special order handling advantages for orders executed electronically via the Book, because such orders would be centrally processed for execution by computer, as compared to being handled by a member through bids and offers on the trading floor. Because the electronic trading platform components are designed to prevent any Exchange members from gaining any time and place advantages, the Exchange believes that the electronic trading platform component of the Book satisfies the four requirements of the “effect versus execute” rule as well as the general policy objectives of Section 11(a).

Rule 11a2–2(T) requires proprietary orders to be transmitted from off the exchange floor. In considering the

application of this requirement to a number of automated trading and electronic order-handling facilities operated by national securities exchanges, the Commission has deemed the off-floor requirement to be met if the order is transmitted from off the floor directly to the exchange floor by electronic means.<sup>61</sup> Because the FLEX Hybrid Trading System permits remote entry of trading interests, the Exchange believes that members’ proprietary orders that are entered from off the Exchange’s trading floor and electronically received by the Book satisfy the off-floor transmission requirement for the purposes of the “effect versus execute” rule.

The “effect versus execute” rule further provides that the exchange member and its associated person may not participate in the execution of the transaction once the order has been transmitted. This requirement was included to prevent members with their own brokers on the exchange floor from using those persons to influence or guide their orders’ execution. This requirement does not preclude members from canceling or modifying orders, or from modifying the instructions for executing orders, after they have been transmitted to the floor. Such cancellations or modifications, however, also must be transmitted from off the exchange floor.<sup>62</sup> The Exchange believes that a proprietary FLEX Order entered in the Book meets the non-participation requirement. Upon submission to the Book, such a proprietary order would enter the queue and be executed against other orders in the Book based on an established matching algorithm. The execution depends not on the Exchange member, but rather, upon what other orders are resident in the Book and where the order is ranked based on the price-time priority ranking algorithm and FLEX Appointed Market-Maker participation overlay. Therefore, at no time following submission of an order is an Exchange member able to acquire control or influence over the result or timing of orders generated. That is, unlike a floor broker who currently may

<sup>51</sup> See Pub. L. No. 94–29, 89 Stat. 97 (June 4, 1975).

<sup>52</sup> See Securities Reform Act of 1975, Report of the House Comm. on Interstate and Foreign Commerce, H.R. Rep. No. 94–123, 94th Cong., 1st Sess. (1975) (“House Report”); Securities Acts Amendments of 1975, Report of the Senate Comm. on Banking, Housing and Urban Affairs, S. Rep. No. 94–75, 94th Cong., 1st Sess. (1975).

<sup>53</sup> See Securities Exchange Act Release Nos. 14563 (March 14, 1978), 43 FR 11542, 11543 (March 17, 1978); 14713 (April 27, 1978), 43 FR 18557, 18558 (May 1, 1978) (“1978 Release II”); 15533 (January 29, 1979), 44 FR 6084, 6092 (January 31, 1979) (“1979 Release”). Telephone conversation between Jennifer Lamie, Assistant General Counsel, CBOE, and Terri Evans, Special Counsel, Division, Commission, on August 22, 2007.

<sup>54</sup> See Section 11(a)(1)(A) of the Act, 15 U.S.C. 78k(a)(1)(A).

<sup>55</sup> See Section 11(a)(1)(D) of the Act, 15 U.S.C. 78k(a)(1)(D).

<sup>56</sup> See Section 11(a)(1)(F) of the Act, 15 U.S.C. 78k(a)(1)(F).

<sup>57</sup> 17 CFR 240.11a2–2(T). In addition to the application of Rule 11a2–2(T), members of the Exchange who are registered as market makers may also take advantage of the market-maker exemption from Section 11(a), at least for securities in which they make a market. See note 54, *supra*.

<sup>58</sup> The member may, however, participate in clearing and settling the transaction.

<sup>59</sup> See 1978 Release II, 43 FR at 18560.

<sup>60</sup> Rule 11a2–2(T)(e) under the Act, 17 CFR 240.11a2–2(T)(e).

<sup>61</sup> Among the systems considered by the Commission are (1) the Philadelphia Stock Exchange’s VWAP Trading System; (2) the Pacific Exchange’s (“PCX”) Application of OptiMark; (3) Chicago Match; (4) the Amex’s Post Execution Reporting System and the Amex Switching System (see 1979 Release, 44 FR at n.25); (5) the Intermarket Trading System; (6) the Multiple Dealer Trading Facility of the Cincinnati Stock Exchange; (7) the PCX’s Communications and Execution System (“COMEX”); and (8) the Phlx’s Automated Communications and Execution System (“PACE”) (see 1979 Release, 44 FR at nn. 19–35).

<sup>62</sup> See Securities Exchange Act Release No. 14563 (March 14, 1978).

enjoy a trading advantage inherent to being present on an exchange floor for transactions being executed on that floor, no Exchange member would be permitted to take advantage of any non-member through use of the Book. As a result, the Exchange believes the non-participation requirement is met where these types of Exchange member orders are matched and executed automatically through the Book.

Although Rule 11a2-2(T) contemplates having an order executed by an exchange member who is unaffiliated with the member initiating the order, the Commission has recognized in the past that this requirement is not applicable where automated exchange facilities are used. For example, in considering the operation of COMEX and PACE, among other systems, the Commission noted that, while there is no independent executing exchange member, the execution of the order is automatic once it has been transmitted into the systems.<sup>63</sup> Because the design of these systems ensures that a member does not possess any special or unique trading advantages in handling its order after transmitting it to the exchange floor, the Commission has stated that executions obtained through these systems satisfy the independent execution requirement of Rule 11a2-2(T).<sup>64</sup> The Exchange believes that this principle is directly applicable to the Book; the design of the Book ensures that an Exchange member does not have any special or unique trading advantages in handling its FLEX Orders after transmission. Accordingly, the Exchange believes that an Exchange member effecting a transaction by utilizing the System to enter a FLEX Order into the Book satisfies the requirement for execution through an unaffiliated member.

The exemption in Rule 11a2-2(T) states that, in the case of a transaction effected for any account for which the initiating member exercises investment discretion, in general, the member may not retain compensation for effecting the transaction. As a prerequisite to the use of the Book, if an Exchange member is to rely on Rule 11a2-2(T) for a managed account transaction, the Exchange member must comply with the limitations on compensation as set forth in paragraph (a)(2)(iv) of the "effect versus execute" rule.

The Exchange believes that these types of proprietary orders, when entered into the Book, satisfy the four requirements of the "effect versus execute" rule as well as the general

policy objectives of Section 11(a) of the Act. The proposed rule change is beneficial because it will facilitate transactions in securities and will remove impediments to and perfect the mechanism of a free and open market. The proposed rule change will place FLEX users, members, and non-members, on the "same footing," as intended by Rule 11a2-2(T). In light of the aforementioned, CBOE believes, under its proposal, no member that submits a FLEX Order will be able to engage in proprietary trading in a manner inconsistent with Section 11(a) of the Act.

Lastly, the Exchange notes that the text of proposed Rule 24B.5(b)(2) would provide that a proprietary order that is entered on behalf of a member relying on the "G" exemption<sup>65</sup> may not be submitted as a FLEX Order to rest in the Book. Instead, a priority order of a member relying on the "G" exemption may be executed only as a FLEX Order entered to "hit" the Book (or as part of an electronic or open-outcry RFQ).<sup>66</sup> To the extent the proprietary order is not executed in whole or in part as soon as it hits the Book, the order must be immediately cancelled by the member. A member relying on the "G" exemption would also have to satisfy the other requirements of that exemption.

The Exchange believes that members relying on the "G" exemption as an exemption to the Section 11(a)(1) requirements must comply with the requirements of that exemption before executing a proprietary order, including the requirement to yield priority to any bid or offer at the same price for the account of a person who is not, or is not associated with, a member (a "non-member"), irrespective of the size of any such bid or offer or the time when entered. Because the FLEX Hybrid Trading System will not always distinguish between member and non-member broker-dealer orders, the proposed restrictions of allowing the "G" exemption to be utilized only in open outcry on the physical floor of the Exchange (where the Member can manually yield priority), electronically as part of an electronic RFQ (where the System is programmed to yield to the Book and FLEX Quotes for the account of public customers and non-member broker-dealers), or electronically as a FLEX Ordered entered to "hit" the Book

provided the order is immediately cancelled to the extent it is not executed in whole or in part (where the Member would be the only contra-party on that side of the transaction) are intended to enforce the requirement that a member relying on the "G" exemption yield priority to non-members.

(e). FLEX Standard Minimum Increments

Subparagraph (e) of proposed Rule 24B.5 describes the proposed standard minimum increments applicable to FLEX bids and offers as follows.

- *FLEX Index Options*: The applicable increments for FLEX Index Options will be identical to the increments in the existing FLEX rules, which permit decimal bids and offers in the designated currency that meet or exceed certain minimum parameters.<sup>67</sup> For example, the minimum increment for U.S. dollars is \$0.01 (or such other minimum as the appropriate Procedure Committee may set from time to time to ensure fair and orderly markets). By comparison, the standard minimum increment applicable to Non-FLEX Index Options is generally \$0.10 for simple bids and offers in series quoted at or above \$3 a contract and \$0.05 for simple bids and offers in series quotes below \$3 a contract.<sup>68</sup>

- *FLEX Equity Options*: The applicable increments for FLEX Equity Options will be determined by the appropriate Procedure Committee on a class-by-class basis, but may not be smaller than \$0.01. This represents a change from the existing FLEX rules, under which the trading increments applicable to FLEX Equity Options are the same as those that are applicable to Non-FLEX Equity Options (*i.e.*, \$0.10 for simple bids and offers in series quoted at or above \$3 a contract, \$0.05 for simple bids and offers in series quoted below \$3 a contract, and \$0.01 for series quoted in the penny pilot program).<sup>69</sup> Thus, similar to the existing practice for FLEX Index Options, FLEX Equity Options bids and offers would now be permitted in \$0.01 increments for simple bids and offers.

<sup>67</sup> See existing Rule 24A.5(g), which is proposed to be renumbered to Rule 24A.5(f), and proposed Rule 24B.5(e).

<sup>68</sup> See Rule 6.42, *Minimum Increments for Bids and Offers*. The \$0.10 and \$0.05 increments are applicable to simple orders. Under Rule 6.42(4), a smaller increment applies with respect to multi-part complex orders. In addition, under other CBOE rules, a smaller increment may be applicable to simple orders. See, e.g., Rule 6.74A, *Automated Improvement Mechanism ("AIM")*, which is an automated auction process that permits price improvement in increments as small as \$0.01.

<sup>69</sup> See CBOE Rule 6.42(3).

<sup>65</sup> 17 CFR 240.11a1-1(T).

<sup>66</sup> Any member relying on the "G" exemption as part of the open-outcry RFQ mechanics must yield priority to any bid (offer) at the same price that is represented in the Book and all FLEX Quotes that have priority over the Book. See note 36, *supra* and related discussion.

<sup>63</sup> See 1979 Release.

<sup>64</sup> See *id.*

The Exchange believes this change in the standard minimum increment applicable to FLEX Equity Options is consistent with the existing policy and procedure for FLEX Index Options. The Exchange notes that, given the unique nature of FLEX trading occurring primarily through the RFQ auction process and limited amount of secondary trading that occurs and is anticipated to occur in FLEX Options,<sup>70</sup> it is not expected that this change in increment will have any detrimental impact on system capacity or on trading in Non-FLEX Equity Options overlying the same classes. The Exchange also believes that utilizing a \$0.01 increment is reasonable and appropriate and will better accommodate trading in FLEX Equity Options which are subject to certain minimum value size requirements and which, if otherwise traded over-the-counter, would not be subject to such restrictions on trading increment and size. CBOE believes market participants benefit from being able to trade these customized options in an exchange environment in several ways, including, but not limited to the following: (1) Enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of FLEX Options.

(D). FLEX Market-Maker Appointments & Obligations (Proposed Rule 24B.9)

Proposed Rules 24B.9, *FLEX Market-Maker Appointments and Obligations*, prescribes the types of FLEX Market-Makers that may be appointed and applicable quoting obligations with respect to the FLEX Hybrid Trading System platform. This proposed rule differs from Rule 24A.9, which pertains to appointments and quoting obligations with respect to the FLEX RFQ System platform, in various respects including that the applicable Market-Maker categories and the number appointed within each class are being revised.

As with the existing FLEX rules, the Exchange is proposing to limit FLEX Market-Maker appointments to CBOE members that are registered with the Exchange as Market-Makers. Under the proposed appointment provisions, FLEX Qualified Market-Makers would also be required to maintain an appointment in at least one Non-FLEX option class listed on the Exchange. FLEX Market-Makers are currently, and under the

<sup>70</sup>The Exchange also notes that, in Non-FLEX Equity Option class, certain bids and offers are already permitted in \$0.01 increments. See notes 68 and 69, *supra*.

proposed new Rules would continue to be, designated as specialists on the CBOE for all purposes under the Act. In addition, with respect to the categories of FLEX Market-Makers, there will continue to be two categories: FLEX Appointed Market-Makers and FLEX Qualified Market-Makers.

Under the existing FLEX Rules, the categories and number of FLEX Market-Makers appointed to a given class depends on whether it is for a FLEX Equity Option class or FLEX Index Option class:

- For FLEX Equity Options, the existing rules generally call for five or more FLEX Qualified Market-Makers to be appointed to each class; provided, however, that the appropriate Exchange Market Performance Committee can determine to appoint two or more FLEX Appointed Market-Makers to such classes in lieu of appointing FLEX Qualified Market-Makers.

- For FLEX Index Options, the existing rules call for two or more FLEX Appointed Market-Makers to be appointed to each class and for settlement in one or more currencies.

The proposed rule for the FLEX Hybrid Trading System platform, as well as corresponding changes to the existing rule for the FLEX RFQ System platform, would eliminate these distinctions between equity and index products, and will instead provide that the Exchange will appoint two or more FLEX Qualified Market-Makers to each FLEX Index Option of a given class and currency and to each FLEX Equity Option class.<sup>71</sup>

Under the proposed appointment procedures, a registered Market-Maker may apply on a form prescribed by the Exchange to be a "FLEX Qualified Market-Maker" in one or more classes of FLEX Options. From among the applicants, the Exchange would appoint two or more FLEX Qualified Market-Makers to each FLEX Index Option of a given class and settlement currency, and two or more FLEX Qualified Market-Makers to each FLEX Equity Option of a given class. In making such appointments and in taking other action with respect to FLEX Qualified Market-Makers, the Exchange shall take into account the factors enumerated in, and shall refer to the requirements of, Rule 8.3, *Appointment of Market-Makers*. In addition, as discussed above, a

<sup>71</sup>As compared to the existing FLEX rules, the proposal would replace various references to "appropriate Market Performance Committee" with the "Exchange." Certain of these changes make the rule consistent with current practice and procedures. Additionally, CBOE can continue to delegate to the appropriate Market Performance Committee various duties and responsibilities.

proposed new requirement would be that, as a condition to receiving and maintaining a FLEX Qualified Market-Maker appointment in a FLEX Index Option class (or a FLEX Equity Option class, as applicable,) the FLEX Qualified Market-Maker must maintain an appointment in one or more Non-FLEX Index Option classes (or one or more Non-FLEX Equity Option classes, as applicable).<sup>72</sup> Such Non-FLEX Option class appointment(s) need not be in a class(es) that has the same underlying index (or security) as the appointed FLEX Option class.

Notwithstanding the above, under the proposed appointment procedures, the appropriate Market Performance Committee may determine to solicit applications and appoint (i) One or more FLEX Appointed Market-Makers in addition to appointing FLEX Qualified Market-Makers to such classes or (ii) two or more FLEX Appointed Market-Makers in lieu of appointed FLEX Qualified Market-Makers. Thus, under this revised structure that will be applicable to both trading platforms, a FLEX Option class could be structured as a FLEX Qualified Market-Maker-only crowd with at least two participants, a mixed FLEX Qualified/Appointed Market-Maker crowd with at least three participants, or a FLEX Appointed Market-Maker-only crowd with at least two participants. Providing for the flexibility to determine the eligible categories of market-maker participants is similar to the existing rules regarding FLEX Equity Option appointments and other Exchange Rule regarding the appointment of market-makers in Non-FLEX Options.<sup>73</sup>

The applicable market-making restrictions and obligations of FLEX Market-Makers will continue to be applied in a similar manner, except that new obligations respecting electronic RFQs and the Book will be specified. Specifically: (i) A FLEX Appointed Market-Maker will have an obligation to respond to any open-outcry RFQ and to a percentage of electronic RFQs<sup>74</sup> in the Appointed Market-Maker's appointed classes in the prescribed minimum

<sup>72</sup>Market-Makers that are registered and appointed to trade Non-FLEX Options are subject to certain market-making obligations, including obligations respecting quote widths, continuous electronic quoting obligations, and continuous open-outcry quoting obligations. See CBOE Rule 8.7, *Obligations of Market-Makers*.

<sup>73</sup>See, e.g., CBOE Rules 8.14, *Index Hybrid Trading System Classes: Market-Maker Participants*, and 8.95, *Allocation of Securities and Location of Trading Crowds and DPMs*.

<sup>74</sup>The applicable electronic RFQ response percentage will be determined by the appropriate Procedure Committee and will not be less than 80%. See proposed Rules 24B.4(a)(5)(iv) and 24B.9(c).

response size; and (ii) a FLEX Qualified Market-Maker will be permitted, but not obligated, to respond to RFQs but, when responding, must respond in the prescribed minimum response size. In addition, similar to the existing FLEX rules, under the FLEX Hybrid Trading System rules a FLEX Official may call upon FLEX Market-Makers appointed in a class of FLEX Options to submit FLEX Quotes in response to a specific Request for Quotes in that class of FLEX Options whenever in the opinion of the FLEX Official the interests of a fair, orderly, and competitive market are best served by such action. Similar to the existing FLEX rules, the FLEX Official shall also make such a call upon FLEX Market-Makers whenever no FLEX Quotes are made in response to a specific Request for Quotes. The ability of a FLEX Official to call on FLEX Market-Makers applies to both electronic and open-outcry RFQs. Also, as with the existing FLEX rules, under the FLEX Hybrid Trading System rules FLEX Appointed Market-Makers and FLEX Qualified Market-Makers need not provide continuous FLEX Quotes or quote a minimum bid-offer spread in FLEX Options, except that certain maximum bid-offer spread requirements do apply for FLEX Market-Makers quoting in FLEX Options with a European-style exercise, an underlying of the S&P 100 Index or the S&P 500 Index, and two weeks or more to expiration and two years or less to expiration.<sup>75</sup> FLEX Market-Makers also need not enter FLEX Orders into the electronic book, but to the extent they do so, such orders must satisfy the applicable minimum size requirements.

These market-making restrictions and obligations are tailored to reflect the particular nature of FLEX Options, which are customized to fit particular investor needs, and the particular nature of FLEX trading, which is anticipated to continue to have limited secondary trading in any series due to the diversity inherent in FLEX Options. The restrictions and obligations are designed to assure that each FLEX Market-Maker's course of dealings as a FLEX Market-Maker will contribute significantly and positively toward the maintenance of fair and orderly markets in FLEX Options on the Exchange and will, therefore, be consistent with the protection of investors and the purposes of the Act and Section 11(a) thereof. As proposed, FLEX Market-Makers will be required to engage generally in a course of dealings which will enhance the Exchange market and positively

contribute to depth and liquidity. These objectives are basic to the major purposes of the Act and, thus, are consistent with the purposes of Section 11(a) and the protection of investors. Therefore, the Exchange believes that a FLEX Market-Maker who initiates the purchase or sale of securities as provided in the proposed Rules will be "acting in the capacity of market maker" within the meaning of Section 11(a)(1)(A) of the Act.<sup>76</sup>

(E). FLEX Officials (Proposed Rule 24B.14)

Existing FLEX Rule 24A.12 currently provides that a FLEX Post Official is responsible for (i) Reviewing the conformity of FLEX Requests for Quotes and FLEX Quotes to the terms and specifications contained in Rule 24A.4, (ii) posting FLEX Requests for Quotes for dissemination, (iii) determining the BBO, (iv) ensuring that FLEX contracts are executed in conformance with the priority principles set forth in Rule 24A.5(e), (v) calling for Indicative FLEX Quotes in accordance with the requirements of Rule 24A.12(c), and (vi) calling upon FLEX Qualified Market-Makers to make FLEX Quotes in specific classes of FLEX Equity Options as provided in Rule 24A.9(c).

Proposed Rule 24B.14, *FLEX Official*, corresponds with existing Rule 24A.12 and describes the functions of an Exchange FLEX Post Official (referred to in the proposed new rules as simply a "FLEX Official") for the new FLEX Hybrid Trading System. Under proposed Rule 24B.14, a FLEX Official will continue to be responsible for reviewing the conformity of *open-outcry* FLEX Requests for Quotes to the applicable terms and specifications in proposed Rule 24B.4. However, because open-outcry FLEX Quotes will now be provided to the Submitting Member, the FLEX Official will no longer be responsible for reviewing such FLEX Quotes for conformity to the applicable terms and specifications or determining the BBO.<sup>77</sup> In addition, the proposed

<sup>76</sup> The term "market maker" is defined in Section 3(a)(38) of the Act, 15 U.S.C. 78c(a)(38), to include "any dealer who, with respect to a security, holds himself out (by entering quotations in an interdealer communications system or otherwise) as being willing to buy and sell such security for his own account on a regular or continuous basis."

<sup>77</sup> See existing Rule 24A.12(b)(i)–(iv) (providing that a FLEX Post Official is responsible for reviewing the conformity of FLEX RFQs and FLEX Quotes to the terms and specifications contained in existing Rule 24A.4, posting FLEX RFQs for dissemination, determining the BBO, and ensuring that FLEX contracts are executed in conformance with the priority principles set forth in Rule 24A.5(e)). By comparison, to initiate the open-outcry RFQ process under the proposed FLEX Hybrid System, a Submitting Member must submit

rule provides that a FLEX Official may nullify a FLEX transaction, whether executed in open outcry or electronically, if the transaction is determined by the FLEX Official to not conform to the terms and specifications contained in Rule 24B.4 or to the priority principles set forth in Rule 24B.5. However, a trade subject to adjustment or nullification pursuant to Rule 6.25, *Nullification and Adjustment of Equity Options Transactions*, or Rule 24.16, *Nullification and Adjustment of Transactions in Index Options, Options on ETFs and Options on HOLDRS*, shall be subject to the procedures set forth in Rule 6.25 or 24.16.

Similar to the existing FLEX rules, a FLEX Official will also be responsible for calling upon FLEX Market-Makers, whether Qualified or Appointed to a given class, to make FLEX Quotes in specific classes, as provided in proposed Rule 24B.9.<sup>78</sup>

(F). Other FLEX Hybrid Trading System Rules

The remaining rules that are proposed to be included in Chapter XXIVB are the same as, or closely modeled after, the existing FLEX rules. For example, proposed Rules 24B.2, *Hours of Trading*; 24B.3, *Trading Rotations*; 24B.10, *Related Securities*; 24B.15, *Nonavailability of RAES*; and 24B.16, *Inapplicability of Split Price and Accommodation Liquidation Rules*, are identical to Rules 24A.2, 24A.3, 24A.11, 24A.16, and 24A.17, respectively. Proposed Rules 24B.6, *Discretionary Transactions*, and 24B.13, *Letter of Guarantee or Authorization* are virtually identical to Rules 24A.6 and 24A.15, respectively, except for non-substantive grammatical changes.

Proposed Rules 24B.11, *FLEX Index Appointed Market-Maker Account Equity*, and 24B.12, *FLEX Index Appointed Market-Maker Financial Requirements*, are virtually identical to Rules 24A.13 and 24A.14, respectively, except that revisions are being made to clarify that these rules apply only to

a Request for Quotes to the FLEX Official. After providing a Request for Quotes in proper form to the FLEX Official, the Submitting Member must immediately announce the terms and specifications of the Request for Quotes to the trading crowd for the FLEX Option by public outcry. See proposed Rule 24B.5(a)(2)(i). To initiate a FLEX transaction using the electronic RFQ process, a Submitting Member submits a Request for Quotes to the System, not the FLEX Official. On receipt of a Request for Quotes in the proper form, the System causes the terms and specifications to be communicated to FLEX Traders. See proposed Rule 24B.5(a)(1)(i).

<sup>78</sup> By comparison, the existing FLEX Rule 24A.12 provides for only the FLEX Official to call upon FLEX Qualified Market-Makers. See existing Rule 24A.12(b)(vi).

<sup>75</sup> See existing Rule 24A.9(e) and proposed Rule 24B.9(e).

FLEX Index Appointed Market-Makers.<sup>79</sup>

Proposed Rules 24B.7, *Position Limits and Reporting Requirements*, and 24B.8, *Exercise Limits*, are modeled after existing Rules 24A.7 and 24A.8. However, the Exchange is proposing to make certain revisions to existing Rules 24A.7 and 24A.8, and to include the same language in proposed Rules 24B.7 and 24B.8, relating to the applicable position and exercise limits for FLEX Index Options and the aggregation of certain FLEX and non-FLEX positions.

Specifically, the current text indicates that there are no position limits for any broad-based FLEX Index Options. The proposed text provides that, while there are no position limits for FLEX DJX, NDX, OEX, or SPX options contracts,<sup>80</sup> all other FLEX Index Options (whether broad-based or not) will be subject to position limits fixed by the Exchange within prescribed parameters set forth in existing Rule 24A.7 and proposed Rule 24B.7. Specifically, the rules would provide that:

- *Other Broad-Based FLEX Index Option Classes*: The Exchange-established position limits with respect to a broad-based FLEX Index Option class (other than the four identified above) shall not exceed 200,000 contracts on the same side of the market.

- *Industry-Based FLEX Index Option Classes*: The Exchange-established position limits for an industry-based FLEX Index Option class shall not exceed one times the applicable number of Non-FLEX Index Option Contracts

<sup>79</sup> The special account equity and financial requirements under existing Rules 24A.13 and 24A.14 only apply to "FLEX Appointed Market-Makers," who currently are appointed only to FLEX Index Option classes and currently are subject to certain heightened FLEX Quote minimum value size requirements under Rule 24A.4(a)(4)(iv). Given the proposed changes to the FLEX Market-Maker appointments discussed above, which would allow for the appointment of a FLEX Equity Appointed Market-Maker, proposed Rules 24B.11 and 24B.12 make clear that these special account equity and financial requirements would apply only to FLEX Index Appointed Market-Makers (who would continue to be subject to the heightened FLEX Quote, as well as FLEX Order, minimum value size requirements under proposed Rule 24B.4(a)(5)(iv)) and not FLEX Equity Appointed Market-Makers (who would not be subject to heightened minimum value size requirements). Corresponding changes are also being proposed to existing Rules 24A.13 and 24A.14.

<sup>80</sup> The Exchange notes that these four broad-based FLEX Index Options classes correspond with the Non-FLEX DJX, NDX, OEX, and SPX options classes, which currently have no position limits under Rule 24.4, *Position Limits for Broad-Based Index Options*. The Exchange also notes that FLEX DJX, NDX, OEX, and SPX options contracts are, however, subject to special reporting requirements in accordance with existing Rule 24A.7(b). This same reporting requirements are included in proposed Rule 24B.7(b).

(whether long or short) of the put class and the call class on the same side of the market, as determined on the basis of the position limits established pursuant to Rule 24.4A, *Position Limits for Industry Index Options*; provided, however, the position limits for an industry-based FLEX Index Option class shall not exceed four times the applicable position limits established pursuant to Rule 24.4A, instead of one times as provided above, for: (i) The Dow Jones Transportation Average or the Dow Jones Utility Average; or (ii) an underlying industry-based index that is not a "narrow-based security index," as defined under Section 3(a)(55)(B) of the Act.<sup>81</sup>

- *Micro Narrow-Based FLEX Index Option Classes*: The Exchange-established position limits for a micro narrow-based FLEX Index Option class shall not exceed one times the applicable number of Non-FLEX Index Option Contracts (whether long or short) of the put class and the call class on the same side of the market, as determined on the basis of the position limits established pursuant to Rule 24.4B, *Position Limits for Options on Micro Narrow-Based Indexes As Defined Under Rule 24.2(d)*.

The rules would also provide that FLEX Option positions shall not be aggregated with positions in Non-FLEX Options other than as described below, and positions in FLEX Index Options on a given index shall not be aggregated with options on any stocks included in the index or with FLEX Index Option positions on another index.

- *Comparable QIX Options*: Commencing at the close of trading two business days prior to the last trading day of the calendar, positions in P.M. Settled FLEX Index Options (*i.e.*, FLEX Index Options having an exercise settlement value determined by the level of the index at the close of trading on the last trading day before expiration) shall be aggregated with positions in Quarterly Index Options on the same index with the same expiration ("comparable QIX options") and shall be subject to the position limits set forth in Rule 24.4, 24.4A, or 24.4B, as applicable.

- *Comparable Weekly Options*: Commencing at the close of trading two business days prior to the last trading day of the week, positions in FLEX Options that are cash-settled<sup>82</sup> shall be aggregated with positions in Short Term

<sup>81</sup> 15 U.S.C. 78c(a)(55)(B).

<sup>82</sup> FLEX Index Options and FLEX Credit Default Options are cash-settled. FLEX Equity Options are settled by physical delivery. See existing Rules 24A.4(b)(4) and (c)(3) and 29.19; see also proposed Rules 24B.4(b)(4) and (c)(3).

Option Series on the same underlying (*e.g.* same underlying index) with the same means for determining exercise settlement value (*e.g.*, opening or closing prices of the underlying index) and same expiration ("comparable Weekly options") and shall be subject to the position limits set forth in Rule 24.4, 24.4A, 24.4B, or 29.5, as applicable.

With respect to exercise limits, the proposed rule text clarifies that the exercise limits for FLEX Index Options shall be equivalent to the FLEX position limits and that FLEX DJX, NDX, OEX, and SPX options shall not be subject to exercise limits.

Because the maximum FLEX Index Option position and exercise limits will now be specifically set out in Rules 24A.7, 24A.8, 24B.7, and 24B.8 (before the rules simply provided that the limits would be "fixed by the Exchange"), the Exchange is also proposing to eliminate the requirement that, when CBOE files to trade a new Non-FLEX Index Option, it also propose the position and exercise limits that will apply for the related FLEX Index Option.<sup>83</sup>

\* \* \* \* \*

The Exchange believes that, while retaining the existing advantages of exchange-traded FLEX Options, the FLEX Hybrid Trading System will streamline and automate the FLEX trading process and establish increased price transparency. The Exchange believes that the FLEX Hybrid Trading System will offer a legitimate alternative for institutional sell-side firms and potentially buy-side customers to taking their order flow to the OTC market. Additionally, the FLEX Hybrid Trading System will offer the CBOE market-making community a channel to the FLEX Options market.

(2). Proposed Changes to Existing FLEX Rules (Chapter XXIVA) & Related Cross-References

The Exchange is also proposing certain changes to the existing FLEX rules that correspond to the proposed rules discussed above in order that there be consistency between the two sets of rules. These changes include revising provisions pertaining to the various categories of FLEX Market-Makers and related obligations in Rules 24A.4,

<sup>83</sup> See Securities Exchange Act Release No. 43108 (August 2, 2000), 65 FR 48770 (August 9, 2000) (SR-CBOE-00-26) (immediately effective proposal providing for the listing and trading of FLEX Options on all of the indices on which the Exchange lists and trades Non-FLEX Options). As part of that rule change, CBOE represented that, when it files a proposed rule change to list and trade a new Non-FLEX Index Option, it will also propose to list and trade the FLEX Index Options in the same file and include proposed position and exercise limits.

24A.5, 24A.9, 24A.13, 24A.14, and 24A.15; the applicable crossing and Appointed Market-Maker participation entitlements and crossing procedures in Rule 24A.5;<sup>84</sup> the increments applicable to FLEX Equity Options in Rule 24A.5;<sup>85</sup> the position limits applicable to FLEX Index Options in Rule 24A.7; and the FLEX Post Official description and responsibilities in Rules 24A.1(g) and 24A.12. The term "FLEX Post Official," as described in Rules 24A.1(g) and 24A.12 is being revised to reflect that, in addition to Exchange employees, such individuals can include independent contractors designated by the Exchange to perform the FLEX post functions set out in the rules.<sup>86</sup> In addition, the term "Indicative

<sup>84</sup> In addition, at the end of existing Rule 24A.5, the cross-references to other Exchange rules are proposed to be updated to clarify that paragraph (d) of CBOE Rule 6.9, *Solicited Transactions*, is superceded in those situations where a Submitting Member representing an eligible order and a contra-side order determines to take advantage of the crossing participation entitlement provisions of Rule 24A.5. The addition of this cross-reference is simply a clarification of the current application of Rule 24A.5(e)(iii). Specifically, while Rule 6.9(d) provides that non-solicited Market-Makers and Floor Brokers holding non-solicited discretionary orders in the trading crowd will have priority over the solicited person or the solicited order to trade with an original order at the best bid or offered price, Rule 24A.5(e)(iii) provides the solicited person or order with priority over all other parties for an applicable crossing participation entitlement, which is proposed to be determined by the appropriate Exchange Procedure Committee on a class-by-class basis. The cross-references to other Exchange rules at the end of proposed Rule 24B.5 will have a similar reference to paragraph (d) of Rule 6.9. See also note 22, *supra*.

<sup>85</sup> In addition, at the end of existing Rule 24A.5, the cross-references to other Exchange rules are proposed to be updated to reflect that the provisions of paragraphs (1)–(3) of CBOE Rule 6.42, as well as those in paragraph (4) of Rule 6.42 pertaining to SPX and OEX complex orders that are not box/spread rolls, are superceded by Rule 24A.5(g). Rule 24A.5(g), which is proposed to be renumbered to Rule 24A.5(f), sets out the minimum incremental changes for FLEX Index Options and proposed minimum incremental changes for FLEX Equity Options. The addition of the cross-reference to the various provisions of Rule 6.42 is intended to clarify that the minimum increment for a simple order in a FLEX Index or Equity Option class is as specified in Rule 24A.5, but the minimum increment for a multi-part, complex order in a FLEX Index or Equity Option class may be expressed in any increment, as provided in Rule 6.42(4). The cross-references to other Exchange rules at the end of proposed Rule 24B.5 will have a similar reference to Rule 6.42.

<sup>86</sup> Inclusion of independent contractors within the category of persons eligible to be appointed to perform the function of FLEX Post Officials is consistent with CBOE rules pertaining to the appointment of Exchange PAR Officials. See CBOE Rule 7.12, *PAR Official*. In addition, as with the existing PAR Official requirements, the proposed requirements for FLEX Post Officials provide that the FLEX Post Official and any designated assistants may not be affiliated with any member that is approved to act as a Market-Maker, including a FLEX Market-Maker. The proposed requirements also provide that the FLEX Post Official and any

FLEX Quote" in Rule 24A.1 and a related reference in Rule 24A.12 are being removed. Indicative FLEX Quotes were non-binding indications of the market for particular series of FLEX Options that were periodically supplied by Market-Makers and displayed on the FLEX communication network. This functionality is no longer utilized, so the obsolete references in Rules 24A.1 and 24A.12 are being deleted.

Finally, cross-references in the Exchange rules are being updated to include a corresponding reference to the proposed FLEX Hybrid Trading System rules, and various non-substantive grammatical and formatting changes are being made throughout.

### (3). Sponsored Users (Proposed Rule 6.20A)

In conjunction with the introduction of the new FLEX Hybrid Trading System, CBOE is proposing to add the concepts of Sponsored Users and Sponsoring Members to its rules. Sponsored Users would be provided electronic access to directly enter and execute orders through a Sponsoring Member onto the Exchange's FLEX Hybrid Trading System.

CBOE is proposing to adopt Rule 6.20A, which will govern electronic access for the entry and execution of orders by Sponsored Users with authorized access to the System and outline the requirements that Sponsored Users and Sponsoring Members would be required to meet prior to engaging in a Sponsoring Member/Sponsored User relationship. A "Sponsored User" would be a person, such as an institutional investor, who has entered into a sponsorship arrangement with a Sponsoring Member for purposes of entering orders on the System. This would include entering and responding to electronic RFQs and entering FLEX Orders into the Book. A Sponsored User may obtain and maintain authorized access to the System only if such access is authorized in advance by one or more Sponsoring Members in accordance with the provisions of proposed Rule 6.20A, which are substantially similar to NYSE Arca Inc. ("NYSEArca") Rules 7.29 and 7.30.<sup>87</sup>

designated assistants shall be compensated exclusively by the Exchange, which shall determine the amount and form of compensation, and that no Market-Maker, including a FLEX Market-Maker, shall directly or indirectly compensate or provide any other form of consideration to a FLEX Post Official or any designated assistants.

<sup>87</sup> In comparison to the NYSEArca rules, proposed Rule 6.20A differs in that it will be limited to only the FLEX Hybrid Trading System and will also provide that, to the extent the Sponsoring Member is not a clearing firm, the Sponsoring Member's clearing firm, who must be a

## 2. Statutory Basis

The Exchange believes that the proposed rule change is consistent with the provisions of Section 6(b) of the Act<sup>88</sup> and the rules and regulations thereunder, in general, and Section 6(b)(5)<sup>89</sup> in particular, in that it is designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

### 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 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 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.

## 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:

CBOE member organization, would have to provide CBOE with a Letter of Authorization, accepting responsibility for the clearance of the Sponsored User's transactions.

<sup>88</sup> 15 U.S.C. 78f(b).

<sup>89</sup> 15 U.S.C. 78f(b)(5).

*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–2006–99 on the subject line.

*Paper Comments*

- 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–2006–99. 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 Exchange. 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–2006–99 and should be submitted on or before September 20, 2007.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>90</sup>

**Nancy M. Morris,**  
Secretary.

[FR Doc. E7–17165 Filed 8–29–07; 8:45 am]

**BILLING CODE 8010–01–P**

**SECURITIES AND EXCHANGE COMMISSION**

**[Release No. 34–56315; File No. SR–ISE–2007–58]**

**Self-Regulatory Organizations; International Securities Exchange, LLC; Order Approving a Proposed Rule Change Relating to ISEE Select Market Data Fees**

August 24, 2007.

On July 6, 2007, the International Securities Exchange, LLC (“ISE” or “Exchange”) filed with the Securities and Exchange Commission (“Commission”), 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> a proposed rule change to amend its Schedule of Fees to adopt a

subscription fee for an enhanced sentiment market data offering. The proposed rule change was published for comment in the **Federal Register** on July 25, 2007.<sup>3</sup> The Commission received no comments on the proposal. This order approves the proposed rule change.

**I. Description of the Proposal**

The Exchange proposes to offer, to both member and non-member subscribers, a data feed that will provide a bulk delivery of ISEE Select™ (“ISEE Select”) values.<sup>4</sup> The existing ISEE Select browser application allows a subscriber to access ISEE Select values for up to five securities simultaneously; this proposal will allow subscribers to access numerous ISEE Select values simultaneously. The actual potential number of ISEE Select values accessible by this proposed data feed offering can range from one to more than 1,700.

The ISEE Select data feed will have a flat rate subscription fee based on a fixed number of end users that each subscriber allows to view the data, as follows: \$0.10 Per end user, per month, for a minimum of 10,000 end users; \$0.10 for each additional end user, per month, up to 74,999 end users, in increments of 5,000 end users; \$0.084 per end user, per month, for redistribution from 75,000 to 199,999 end users, in increments of 5,000 end users; and \$0.0825 per end user, per month, for redistribution to 200,000 or more end users, in minimum increments of 5,000 end users. An example of the monthly subscription fee for a subscriber with 100,000 end users is as follows:

Number of users per increment	Monthly fee per user	Monthly sub-total
10,000 .....	\$ .10	\$1,000
10,001–74,999 .....	.10	6,500
75,000–100,000 .....	.084	2,100
Monthly Total .....	.....	9,600
Average Fee per User .....	.....	.096

**II. Discussion**

The Commission finds that the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange.<sup>5</sup> Specifically, the Commission finds that the proposal is

consistent with Section 6(b)(4) of the Act, which requires that an exchange have an equitable allocation of reasonable dues, fees, and other charges among its members and other persons using its facilities. This proposed rule change will diversify ISEE Select offerings by allowing members and non-

members to subscribe to a data feed of ISEE Select values at a flat rate subscription fee for redistribution to their customers. Further, we note that the fees are identical for members and non-members. As with other ISEE Select

<sup>90</sup> 17 CFR 200.30–3(a)(12).

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

<sup>2</sup> 17 CFR 240.19b–4.

<sup>3</sup> See Securities Exchange Act Release No. 56093 (July 18, 2007), 72 FR 40912.

<sup>4</sup> ISEE Select allows subscribers to identify bullish and bearish investor sentiment for nearly any issue traded on the Exchange by providing sentiment values for particular indices, industry sectors or individual stocks. These values are calculated three times per hour.

<sup>5</sup> In approving this proposed rule change, the Commission has considered the proposed rule’s impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).