SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66702; File No. SR-CBOE-2011-123)

March 30, 2012

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Order
Approving Proposed Rule Change to Establish an Automated Improvement Mechanism and a
Solicitation Auction Mechanism for FLEX Options

I.   Introduction

On December 20, 2011, the Chicago Board Options Exchange, Incorporated ("Exchange"

or "CBOE") filed with the Securities and Exchange Commission ("Commission"), pursuant to

Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")[1] and Rule 19b-4 thereunder,[2] a

proposed rule change to establish an Automated Improvement Mechanism ("AIM") and

Solicitation Auction Mechanism ("SAM") for FLEX Options. The proposed rule change was

published for comment in the Federal Register on January 4, 2012.[3] The Commission received

two comment letters regarding the proposal.[4] The Exchange submitted a response on March 20,

2012.[5] This order approves the proposed rule change.

II.   Description of the Proposal

The Exchange is proposing new Rules 24B.5A and 24B.5B to establish an AIM and

SAM for FLEX Options. Currently, the AIM and SAM are available for non-FLEX Options

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

2   17 CFR 240.19b-4.

3   See Securities Exchange Act Release No. 66052 (January 4, 2012), 77 FR 306.

4   See Letters to Elizabeth M. Murphy, Secretary, Commission from Todd Weingart, Spot
        On Brokerage Services, Division of Trading Block, William O'Keefe, Spot On
        Brokerage Services, Division of Trading Block, and Steve Stepanek, The SJS Group,
        Inc., dated January 20, 2012 ("Spot Letter") and from Jonathan Grodnick, Chicago
        Trading Company, dated February 7, 2012 ("CTC Letter").

5   See Letter to Elizabeth M. Murphy, Secretary, Commission from Jennifer M. Lamie,
        CBOE dated March 20, 2012 ("CBOE Response").

under Rules 6.74A and 6.74B. The FLEX versions of the AIM and SAM mechanisms are described below.

A.   Automated Improvement Mechanism

The Exchange is proposing to establish an AIM mechanism for FLEX Options. Under the AIM process, a FLEX Trader[6] ("Initiating TPH") that represents agency orders may submit an order it represents as agent (an "Agency Order") along with a second order (a principal order and/or solicited order(s) for the same amount as the Agency Order)[7] into the AIM mechanism where other FLEX Trader participants could compete with the Initiating TPH's second order to execute against the Agency Order.

To be eligible, the Agency Order must be in a FLEX class designated as eligible for AIM Auctions and within the designated AIM Auction order eligibility size parameters. The Exchange will announce such classes and size parameters via circular to FLEX Traders. In addition, an Initiating TPH must stop the entire Agency Order as principal and/or with a solicited order(s) at the better of the best bid or offer ("BBO") or the Agency Order's limit price.[8]

Only one AIM may be ongoing at any given time in a series and AIM auctions in the same series may not queue or overlap. In addition, unrelated FLEX Orders may not be submitted to the electronic book for the duration of an AIM auction.[9] To initiate an AIM auction, the Initiating TPH must mark the Agency Order for AIM processing and enter the second order in

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[6]   A "FLEX Trader" means a FLEX-participating Trading Permit Holder ("TPH") who has been approved by the Exchange to trade on the System. See Rule 24B.1(l).

[7]   Any solicited orders submitted by the Initiating TPH to trade against the Agency Order may not be for the account of a FLEX Market-Maker assigned to the option class. See proposed Rule 24B.5A.04.

[8]   See proposed Rule 24B.5A(a).

[9]   See proposed Rule 24B.5A(b).

one of two formats: (i) a specified single price at which it seeks to cross the Agency Order with

the second order (a "single-priced submission"), or (ii) a non-price specific commitment for the

second order to automatically match the price and size of all auction responses that are received

during the auction (an "auto-match"), in which case the Agency Order will be stopped at the

better of the BBO or the Agency Order's limit price. When using the auto-match feature, the

Initiating TPH would have no control over the ultimate match price. Once the Initiating TPH has

submitted an Agency Order for AIM processing, such submission cannot be cancelled by the

Initiating TPH.[10]

Upon receipt of an Agency Order (and second order), the Exchange will issue a request

for responses ("RFR"), detailing the side and size of the Agency Order.[11] The duration of the

RFR response period (i.e., the auction period) would be established by the Exchange on a class-

by-class basis and shall not be less than three (3) seconds. During that period, RFR responses

may be submitted by FLEX Traders. These responses must specify price and size and may not

cross the Exchange's BBO on the opposite side of the market. RFR responses are not visible to

any other participants and shall not be disseminated to the Options Price Reporting Authority

("OPRA"). RFR responses may be modified or cancelled so long as they are modified or

cancelled before the conclusion of the RFR response period. Lastly, the minimum price

increment for RFR responses and for an Initiating TPH's single price submission shall be set by

the Exchange at no less than one cent.[12]

Normally, an AIM Auction ends at the conclusion of the RFR response period (which

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[10]   See proposed Rule 24B.5A(b)(1)(i).

[11]   Each RFR will be sent to those FLEX Traders electing to receive RFRs (i.e., those FLEX
         Traders who have established the necessary systems connectivity to receive RFRs).
         Thus, such election to receive RFRs would not be on a case-by-case basis.

[12]   See proposed Rule 24B.5A(b)(1)(ii)-(ix).

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will be no less than three seconds). However, the proposal provides that the AIM Auction would end prior to the conclusion of the RFR response period any time an RFR response matches the BBO on the opposite side of the market from the RFR responses.[13] At the conclusion of the AIM Auction, the Agency Order would be allocated at the best price(s) and contra-side interest will be ranked and matched based on price-time priority, subject to the following:

- Such best prices may include non-AIM Auction FLEX Orders (to the extent the Exchange has determined to make available an electronic book).

- Public customers and non-TPH broker-dealers RFR responses and FLEX Orders would have priority.

- No FLEX Appointed Market-Maker participation entitlement would apply with respect to the AIM Auction.

- If the best price equals the Initiating TPH's single-price submission, the Initiating TPH's single-price submission shall be allocated the greater of one contract or a certain percentage of the order, which percentage would be determined by the Exchange and may not be larger than 40%. However, if only one other FLEX Trader matches the Initiating TPH's single price submission, then the Initiating TPH may be allocated up to 50% of the order.

- If the Initiating TPH selected the auto-match option of the AIM Auction, the Initiating TPH shall be allocated its full size at each price point until a price point is reached where the balance of the order can be fully executed. At such price point, the Initiating TPH shall be allocated the greater of one contract or a certain percentage of the remainder of the Agency Order, which percentage would be determined by the

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13   See proposed Rule 24B.5A(b)(2).

Exchange and may not be larger than 40%.

- Any remaining RFR responses and FLEX Orders will be allocated based on time priority. The Initiating TPH would not participate on any such balance unless the Agency Order would otherwise go unfilled.

- If the final AIM Auction price locks a public customer or non-TPH broker-dealer order in the electronic book on the same side of the market as the Agency Order, then, unless there is sufficient size in the AIM Auction responses to execute both the Agency Order and the booked public customer or non-TPH broker-dealer order (in which case they will both execute at the final AIM Auction price), the Agency Order will execute against RFR responses at one minimum RFR response increment worse than the final AIM Auction price against the AIM Auction participants that submitted the final AIM Auction price and any balance shall trade against the public customer or non-TPH broker-dealer order in the book at such order's limit price.[14]

The Exchange proposes that the AIM may only be used where there is a genuine intention to execute a bona fide transaction.[15] In addition, it would be deemed conduct inconsistent with just and equitable principles of trade and a violation of CBOE Rule 4.1 to engage in a pattern of conduct where the Initiating TPH breaks-up an Agency Order into separate orders for two (2) or few contracts for the purpose of gaining a higher allocation percentage than the Initiating TPH would have otherwise received in accordance with the allocation procedures.

The Exchange also may determine on a class-by-class basis to make the AIM Auction available for complex orders. In such classes, complex orders may be executed through the AIM

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[14]   See proposed Rule 24B.5A(b)(3).

[15]   See proposed Rule 24B.5A.01.

Auction at a net debit or net credit price provided the AIM Auction eligibility requirements are satisfied and the Agency Order is eligible for the AIM Auction considering its complex order type, order origin code, class, and marketability as determined by the Exchange. Complex orders will only be eligible to trade with other complex orders through the AIM Auction.[16]

Initially, and for at least a pilot period expiring on July 18, 2012, there will be no minimum size requirement for orders to be eligible for the AIM Auction. During this Pilot Period, the Exchange will submit certain data, periodically as required by the Commission, to provide supporting evidence that, among other things, there is a meaningful competition for all size orders and that there is an active and liquid market functioning on the Exchange outside of the AIM Auction. Any data which is submitted to the Commission will be provided on a confidential basis.[17]

Any determinations made by the Exchange pursuant to the proposed rule, such as eligible classes, order size parameters and the minimum price increment, would be communicated in a circular.[18]

B.   Solicitation Auction Mechanism

The Exchange also proposes to establish a SAM mechanism for FLEX Options. The SAM permits a FLEX Trader to electronically execute larger-sized Agency Orders against

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[16]   See proposed Rule 24B.5A.05. To the extent the Exchange determines to make an electronic book available for resting FLEX Orders, there will be no "legging" of complex orders with FLEX Orders that may be represented in the individual series legs represented in the electronic book. Order allocation shall be the same as would be applicable for simple orders. In addition, the individual series legs of a complex order would not trade through equivalent bids (offers) in the individual series legs represented in the electronic book and at least one leg must better the corresponding bid (offer) of public customers and non-TPH broker-dealers in the electronic book.

[17]   See proposed Rule 24B.5A.03.

[18]   See proposed Rule 24B.5A.06.

solicited orders.[19] To be eligible, the Agency Order must be in a FLEX class designated as

eligible for SAM Auctions and within the designated SAM Auction order eligibility size

parameters determined by the Exchange (however, the eligible order size would not be less than

500 contracts). Such classes and size parameters will be determined by the Exchange and

announced via circular to FLEX Traders. Each order entered into the SAM would be designated

all-or-none (i.e., an order will be executed in its entirety or not at all).[20]

Once the Initiating TPH has submitted an Agency Order for SAM processing, such

submission cannot be cancelled by the Initiating TPH. To initiate the SAM, the Initiating TPH

must mark the Agency Order for SAM processing, and specify a single price at which it seeks to

cross the Agency Order with a solicited order. Upon receipt of an Agency Order (and second

order), an RFR message will be sent to all FLEX Traders that have elected to receive such

messages, detailing the price and size of the Agency Order. The duration of the RFR response

period (i.e., the auction period) would be established by the Exchange on a class-by-class basis

and shall not be less than three (3) seconds. During that period, RFR responses may be

submitted by FLEX Traders (specifying prices and sizes), except that responses may not be

entered for the account of an options Market-Maker from another options exchange. Responses

shall not be visible for other SAM participants and shall not be disseminated to OPRA. RFR

responses may be modified or cancelled so long as they are modified or cancelled before the

conclusion of the RFR response period.[21] Lastly, the minimum price increment for RFR

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[19]   Any solicited orders submitted by the Initiating TPH to trade against the Agency Order may not be for the account of a FLEX Market-Maker assigned to the option class. See proposed Rule 24B.5B.03.

[20]   See proposed Rule 24B.5B(a).

[21]   See proposed Rule 24B.5B(b)(1).

responses and for an Initiating TPH's single price submission shall be set by the Exchange at no less than one cent.[22]

Normally, a SAM ends at the conclusion of the RFR response period. However, as with AIM, the proposal provides that the SAM would end prior to the conclusion of the RFR response period any time an RFR response matches the BBO on the opposite side of the market from the RFR responses.[23] At the conclusion of the SAM auction, the Agency Order would be executed against the second/solicited order unless there is sufficient size to execute the entire Agency Order at a price (or prices) that improves the proposed crossing price. In the case where there are one or more public customers or non-TPH broker-dealers at the proposed execution price on the opposite side of the Agency Order, the second/solicited order would be cancelled and the Agency Order would be executed against other bids (offers) if there is sufficient size at the bid (offer) to execute the entire size of the Agency Order (size would be measured considering RFR responses and resting FLEX Orders, to the extent the Exchange has determined to make available an electronic book). If there is not sufficient size to execute the entire Agency Order, the proposed cross would not be executed and both the Agency Order and second/solicited order would be cancelled. Additionally, the proposed cross would not be executed and both the Agency Order and second/solicited order would be cancelled if the execution price would be inferior to the BBO.[24]

In the event the Agency Order is executed at an improved price(s) or at the proposed execution price against RFR responses and FLEX Orders, the allocation priority at a given price would be as follows: (i) RFR responses and FLEX Orders for the account of public customers

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22   See proposed Rule 24B.5B(a)(3) and (b)(1)(v).

23   See proposed Rule 24B.5B(b)(2).

24   See proposed Rule 24B.5B(b)(3).

and non-TPH broker-dealers, based on time priority; (ii) any RFR responses and FLEX Orders

that are subject to a FLEX Appointed Market-Maker participation entitlement, based on a

participation entitlement formula specified in Rule 24B.5(d)(2)(ii); then (iii) all other RFR

responses and FLEX Orders, based on time priority.[25]

The Exchange proposes to apply the SAM mechanism to complex orders, on a class-by-

class basis. In such classes, complex orders may be executed through the SAM at a net debit or

net credit price provided the SAM eligibility requirements are satisfied and the Agency Order is

eligible for the SAM considering its complex order type, order origin code, class, and

marketability as determined by the Exchange. Complex orders will only be eligible to trade with

other complex orders through the SAM.[26]

The proposed rule also requires TPHs to deliver to customers a written document, in a

form approved by the Exchange, describing the terms and conditions of the SAM mechanism

prior to executing Agency Orders using the SAM mechanism.[27] The proposed rule further

specifies that TPHs may not use the SAM mechanism to circumvent the Exchange's rules

limiting principal order transactions.[28] The Exchange also proposes that any determinations

made by the Exchange pursuant to the proposed SAM Auction rule, such as eligible classes,

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[25] See proposed Rule 24B.5B(b)(3)(i)(D).

[26] See proposed Rule 24B.5B.01. To the extent the Exchange determines to make an electronic book available for resting FLEX Orders, there will be no "legging" of complex orders with FLEX Orders that may be represented in the individual series legs represented in the electronic book. Order allocation shall be the same as would be applicable for simple orders. In addition, the individual series legs of a complex order would not trade through equivalent bids (offers) in the individual series legs represented in the electronic book, and at least one leg must better the corresponding bid (offer) of public customers and non-TPH broker-dealers in the electronic book.

[27] See proposed Rule 24B.5B.02.

[28] See proposed Rule 24B.5B.03

order size parameters and the minimum price increment, would be communicated in a circular.[29]

III.   Discussion and Commission Findings

After careful consideration, 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[30] and, in particular, the requirements of Section 6 of the Act.[31]

Specifically, the Commission finds that the proposed rule change is consistent with Section

6(b)(5) of the Act,[32] which requires, among other things, that the rules of a national securities

exchange be designed to promote just and equitable principles of trade, remove impediments to

and perfect the mechanism of a free and open market and a national market system, and, in

general, to protect investors and the public interest. The Commission believes that approving the

Exchange's proposal to establish the AIM and SAM for FLEX Options should confer benefits to

the public by increasing competition between and among the options exchanges, resulting in

better prices and executions for investors.[33] The Commission therefore finds that for the reasons

discussed below, the Exchange's proposal is consistent with the Act.

A.   Automated Improvement Mechanism

The Exchange proposes that the Initiating TPH must stop the Agency Order at the better

of the BBO or the Agency Order's limit price. The Commission believes that the proposed stop

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[29]   See proposed Rule 24B.5B.04.

[30]   In approving the proposed rule change, the Commission has considered the proposed
rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

[31]   15 U.S.C. 78f.

[32]   15 U.S.C. 78f(b)(5).

[33]   The Commission notes, that it previously found the non-FLEX AIM and SAM
mechanisms consistent with the Act. See, e.g., Securities Exchange Act Release Nos.
53222 (February 3, 2006), 71 FR 7089 (February 10, 2006) (SR-CBOE-2005-60) (Order
Approving AIM) and 57610 (April 3, 2008), 73 FR 19535 (April 10, 2008) (SR-CBOE-
2008-14) (Order Approving SAM).

price should provide customers with an opportunity for price improvement over the Exchange's BBO. The Commission believes that it is reasonable to stop the Agency Order at the better of the BBO or the Agency Order's limit price, versus the National Best Bid or Offer, because FLEX options are generally not multiply-listed and are not subject to a consolidated quotation reporting program. In addition, the FLEX AIM will only process Agency Orders with limit prices, not market orders. The Commission also believes that the proposal should provide FLEX Traders with incentives to compete in AIM auctions. The Commission notes that once an Agency Order is submitted into the AIM, the submission may not be modified or cancelled. Therefore, the Agency Order submitted to the AIM will be guaranteed an execution price of at least the BBO and, moreover, will be given an opportunity for execution at a price better than the BBO.

The Exchange also proposes to send an RFR to all FLEX Traders that have elected to receive RFRs, and RFR responses may be submitted by FLEX Traders. The Commission believes that permitting access to the AIM auction for all FLEX Traders who may wish to compete for an Agency Order should be sufficient to provide opportunities for a meaningful, competitive auction.

With respect to the RFR period, the Exchange proposes that the duration of the RFR response period will be established by the Exchange on a class-by-class basis and shall not be less than three seconds. One commenter argued that the proposed three second RFR period for a new FLEX strike and cross would present an exceptional technological challenge to market making firms attempting to provide liquidity in FLEX Options. The commenter suggested that the response time in the AIM and SAM for newly added flex strikes be increased from three

seconds to one minute.[34] CBOE disagreed, stating that in today's market, a one-minute timer far

exceeds the standards that have been set for any other exchange timer. CBOE notes that while

the FLEX market may be thinly traded or a bit more complex given its customized nature;

however, this does not mean that the AIM or SAM should be subject to unnecessarily lengthy

timers. According to CBOE, FLEX AIM and SAM are intended to be automated and FLEX

Traders desiring to participate in the FLEX AIM and SAM need to dedicate resources to

program to the auctions. Assuming a FLEX Trader develops the technology to electronically

trade, CBOE believes the three second interval is sufficient to electronically process and respond

to an auction in today's markets.[35]

The Commission agrees that the three-second electronic auction proposed by the

Exchange should provide sufficient time for an electronic crowd to compete for an Agency

Order. The Commission notes that the RFR response period of three seconds is consistent with

the existing minimum exposure period for FLEX Option crossing pursuant to the existing FLEX

crossing procedures.[36]

Under the proposal, allocation will be based on price-time priority, subject to public

customer and non-TPH broker-dealer priority. No FLEX Appointed Market-Maker participation

entitlement shall apply. If the best price equals the Initiating TPH's single-price submission, the

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[34]   See CTC Letter, supra note 4, at 1. The Commission also received another comment
        letter regarding the proposed rule change. See Spot Letter, supra note 4. The Spot Letter
        suggested that there be an additional phase, the Decision Phase, in the RFQ process.
        During this Decision Phase, the initiator of an RFQ would have a brief period of time,
        during which no changes of any type to market quotes would be permitted, in order to
        decide to trade or cancel their RFQ. The Commission notes that the subject of the
        comment letter (the RFQ process for FLEX Options) is not related to the CBOE's
        proposal to establish a separate AIM and SAM for FLEX Options.

[35]   See CBOE Response, supra note 5, at 3.

[36]   See Rule 24B.5(b)(3)(iii).

Initiating TPH's single-price submission shall be allocated the greater of one contract or up to

40% of the order.[37] If the Initiating TPH selected the auto-match option of the AIM Auction, the

Initiating TPH shall be allocated its full size at each price point until a price point is reached

where the balance of the order can be fully executed. At such price point, the Initiating TPH

shall be allocated the greater of one contract or up to 40% of the remainder of the Agency Order.

Any remaining RFR responses and FLEX Orders will be allocated based on time priority. In

addition, it will be deemed conduct inconsistent with just and equitable principles of trade and a

violation of Rule 4.1 to engage in a pattern of conduct where the Initiating TPH breaks-up an

Agency Order into separate orders for 2 or fewer contracts for the purpose of gaining a higher

allocation percentage than the Initiating TPH would have otherwise received in the AIM.

The Commission believes that the priority and allocation rules are reasonable and

consistent with the Act.[38] The Commission believes that the matching algorithm set forth in the

FLEX AIM rule is sufficiently clear regarding how orders are allocated in the AIM auction.

The Commission notes that the proposal to provide both public customers and non-TPH

broker-dealers with first priority in the FLEX AIM auction is consistent with how other FLEX

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[37]   However, if only one other FLEX Trader matches the Initiating TPH's single price
        submission, then the Initiating TPH may be allocated up to 50% of the order.

[38]   The Commission also believes that the proposed priority and allocation rules for
        electronic FLEX trading in the AIM are consistent with Section 11(a) of the Act. 15
        U.S.C. 78k(a) 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 discretion unless an
        exception applies. FLEX Market-Makers qualify for the market-maker exception. With
        respect to non-market-maker members, the auction appears reasonably designed to cause
        RFR Quotes constituting the RFR Market and the RFR Order that trades against the RFR
        Market to yield to non-member interest, consistent with the "G" exception. See 15
        U.S.C. 78k(a)(1)(G) (setting forth all requirements for the "G" exception).

allocation algorithms currently operate.[39] In addition, the Commission notes that public

customer priority/non-TPH broker-dealer priority and price-time priority have previously been

found consistent with the Act.[40]

Like the Exchange's AIM for non-FLEX options, the FLEX AIM auction would be

available for orders of fewer than 50 contracts. Under the Exchange's proposal, there would be

no minimum size requirement for orders entered into the AIM, for a pilot period expiring on July

18, 2012. The Commission believes that the Exchange's proposal should provide small

customer orders with the opportunity for price improvement, and is consistent with the Act. In

particular, any Agency Order for less than 50 contracts that is entered into the AIM is guaranteed

an execution at the end of the auction at a price at least the BBO. The Commission will evaluate

the AIM auction during the Pilot Period to determine whether it would be beneficial to customers

and to the options market as a whole to approve any proposal requesting permanent approval to

permit orders of fewer than 50 contracts to be submitted to the AIM auction. In addition, the

Commission will examine the data submitted by the Exchange with respect to situations in which

the AIM auction is terminated prematurely by an RFR response. To aid the Commission in its

evaluation, the CBOE represents that it will provide the following information each month:

(1)   The number of orders of fewer than 50 contracts entered into the FLEX AIM

auction;

(2)   The percentage of all orders of fewer than 50 contracts sent to CBOE that are

entered into CBOE's FLEX AIM auction;

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[39]   See, e.g., Rule 24B.5(a)(1)(iii)(C) and (D).

[40]   See, e.g., Securities Exchange Act Release Nos. 51822 (June 10, 2005), 70 FR 35321
(June 17, 2005) (SR-CBOE-2004-87) (Adopting rules pertaining to priority and
allocation of trades for index options) and 56792 (November 15, 2007), 72 FR 65776

(3)   The percentage of all CBOE FLEX trades represented by orders of fewer than 50
        contracts;

(4)   The percentage of all CBOE FLEX trades effected through the FLEX AIM
        auction represented by orders of fewer than 50 contracts;

(5)   The percentage of all FLEX contracts traded on CBOE represented by orders of
        fewer than 50 contracts;

(6)   The percentage of all FLEX contracts effected through the FLEX AIM auction
        represented by orders of fewer than 50 contracts;

(7)   The spread in the option, at the time an order of fewer than 50 contracts is
        submitted to the FLEX AIM auction;

(8)   The number of orders of 50 contracts or greater entered into the FLEX AIM
        auction;

(9)   The percentage of all FLEX orders of 50 contracts or greater sent to CBOE that
        are entered into CBOE's FLEX AIM auction;

(10)   The spread in the option, at the time an order of 50 contracts or greater is
        submitted to the FLEX AIM auction;

(11)   Of FLEX AIM trades for orders of fewer than 50 contracts, the percentage done at
        the BBO, BBO plus $.01, BBO plus $.02, BBO plus $.03, etc.;

(12)   Of FLEX AIM trades for orders of 50 contracts or greater, the percentage done at
        the BBO, BBO plus $.01, BBO plus $.02, BBO plus $.03, etc.;

(13)   The number of orders submitted by FLEX Traders when the spread was $.05,

$.10, $.15, etc. For each spread, specify the percentage of contracts in orders of

fewer than 50 contracts submitted to CBOE's FLEX AIM that were traded by:

(a)   the Initiating TPH that submitted the order to the FLEX AIM;

(b)   CBOE Market Makers assigned to the class;

(c)   other FLEX Traders;

(d)   Public Customer Orders;

(e)   non-TPH broker-dealers; and

(f)   other non-AIM FLEX Orders.

For each spread, also specify the percentage of contracts in orders of 50 contracts

or greater submitted to CBOE's FLEX AIM that were traded by:

(a)   the Initiating TPH that submitted the order to the FLEX AIM;

(b)   CBOE Market Makers assigned to the class;

(c)   other FLEX Traders;

(d)   Public Customer Orders;

(e)   non-Trading Permit Holder broker-dealers; and

(f)   other non-AIM FLEX Orders.

(14)   The number of times that an RFR response matching the BBO on the opposite

side of the market from the RFR responses prematurely ended the FLEX AIM

auction, and the number of times such orders were entered by the same (or

affiliated) firm that initiated the FLEX AIM auction that was terminated;

(15)   The percentage of FLEX AIM early terminations due to the receipt of an RFR

response matching the BBO on the opposite side of the market from the RFR

responses that occurred within a ½ second of the start of the AIM auction; the percentage that occurred within one second of the start of the AIM auction; the percentage that occurred within one and ½ second of the start of the AIM auction; the percentage that occurred within 2 seconds of the start of the AIM auction; the percentage that occurred within 2 and ½ seconds of the AIM auction; and the average amount of price improvement provided to the Agency Order where the AIM auction is terminated early at each of these time periods;

(16)   The average amount of price improvement provided to the Agency Order when the FLEX AIM auction is not terminated early (i.e., runs the full three seconds);

(17)   The percentage of all CBOE FLEX trades effected through the FLEX AIM auction in which the Initiating TPH has chosen the Auto-Match feature, and the average amount of price improvement provided to the Agency Order when the Initiating TPH has chosen the Auto-Match feature vs. the average amount of price improvement provided to the Agency Order when the Initiating TPH has chosen a single-price submission;

(18)   For the first Wednesday of each month:

(a)   the total number of FLEX AIM auctions on that date;

(b)   the number of FLEX AIM auctions where the order submitted to the AIM was fewer than 50 contracts;

(c)   the number of FLEX AIM auctions where the order submitted to the AIM was 50 contracts or greater;

(d)   the number of FLEX AIM auctions (for orders of fewer than 50 contracts) with 0 participants (excluding the initiating participant), 1 participant

(excluding the initiating participant), 2 participants (excluding the initiating participant), 3 participants (excluding the initiating participant), 4 participants (excluding the initiating participant), etc., and

(e)   the number of FLEX AIM auctions (for orders of 50 contracts or greater) with 0 participants (excluding the initiating participant), 1 participant (excluding the initiating participant), 2 participants (excluding the initiating participant), 3 participants (excluding the initiating participant), 4 participants (excluding the initiating participant), etc.; and

(19)   For the third Wednesday of each month:

(a)   the total number of FLEX AIM auctions on that date;

(b)   the number of FLEX AIM auctions where the order submitted to the AIM was fewer than 50 contracts;

(c)   the number of FLEX AIM auctions where the order submitted to the AIM was 50 contracts or greater;

(d)   the number of FLEX AIM auctions (for orders of fewer than 50 contracts) with 0 participants (excluding the initiating participant), 1 participant (excluding the initiating participant), 2 participants (excluding the initiating participant), 3 participants (excluding the initiating participant), 4 participants (excluding the initiating participant), etc., and

(e)   the number of FLEX AIM auctions (for orders of 50 contracts or greater) with 0 participants (excluding the initiating participant), 1 participant (excluding the initiating participant), 2 participants (excluding the

initiating participant), 3 participants (excluding the initiating participant),

4 participants (excluding the initiating participant), etc.

B.   Solicitation Auction Mechanism

The Exchange is also proposing a SAM Auction for FLEX Options. The Commission

believes that the proposal should allow for greater flexibility in pricing large-sized orders. The

Commission further believes that the proposal includes appropriate terms and conditions to

assure that the Agency Order is first exposed to FLEX Traders by RFR for the possibility of

price improvement and that public customer orders on the Exchange are protected. The

Commission also notes that the proposal is similar to requirements set forth in the CBOE SAM

for non-FLEX Options.[41]

The Exchange proposes that the duration of the RFR response period would be

established by the Exchange on a class-by-class basis and shall not be less than three seconds.

As with the AIM, one commenter suggested that the response time in the SAM for newly added

flex strikes be increased from three seconds to one minute.[42] The Commission believes that the

three-second electronic auction proposed by the Exchange should provide sufficient time for an

electronic crowd to compete for an Agency Order. The Commission notes that the RFR response

period of three seconds is consistent with the existing minimum exposure period for FLEX

Option crossing pursuant to the existing FLEX crossing procedures.[43] The Commission believes

that using the same period of time to respond to RFRs in SAM auctions should be appropriate for

FLEX Traders.

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[41]   See Rule 6.74B.

[42]   See CTC Letter, supra note 4, at 1. See also discussion at Section III.A regarding the
        three-second RFR period for the AIM.

[43]   See Rule 24B.5(b)(3)(iii).

Under the proposal, at the conclusion of the SAM, the Agency Order would be executed against the second/solicited order unless there is sufficient size to execute the entire Agency Order at a price(s) that improves the proposed crossing price. In the case where there are one or more public customers or non-TPH broker-dealers at the proposed execution price on the opposite side of the Agency Order, the second/solicited order would be cancelled and the Agency Order would be executed against other bids (offers) if there is sufficient size at the bid (offer) to execute the Agency Order entirely. If there is not sufficient size to execute the entire Agency Order, or if the execution price would be inferior to the BBO, then the proposed cross would not be executed, and both the Agency Order and second/solicited order would be cancelled. In the event the Agency Order is executed at an improved price(s) or at the proposed execution price against RFR responses and FLEX Orders, priority would first go to RFR responses and FLEX Orders for the account of public customers and non-TPH broker-dealers based on time priority, then any RFR responses and FLEX Orders that are subject to a FLEX Appointed Market-Maker participation entitlement, and finally all other RFR responses and FLEX Orders. The Commission believes that the priority and allocation rules are reasonable and consistent with the Act.[44]

The Commission also notes that the Exchange has included a provision stating that FLEX Traders may not use the SAM auction to circumvent Rule 24B.5 limiting principal transactions. The Exchange will also require written notification to customers prior to entering Agency Orders into the SAM on behalf of the customer and will require that determinations made by the Exchange regarding eligible classes, order size parameters, and the minimum price increment

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[44] The Commission also believes, for the same reasons described above for the AIM, that the proposed priority and allocation rules for electronic FLEX trading in the SAM are consistent with Section 11(a) of the Act. See supra note 38.

shall be communicated in a Regulatory Circular. The Exchange also proposes to permit the

processing of complex orders. The Commission believes that the provisions help to clarify

application of the SAM rule and may encourage further use of FLEX Options.

One commenter asserted that the current FLEX auction mechanism should not be allowed

to migrate to the CBOE Hybrid platform, arguing that participants that submit RFQs can receive

quote responses that lock and/or cross markets.[45] In response, CBOE stated that the comments

have no relevance to the instant proposed rule change, which simply seeks to implement the two

new FLEX AIM and SAM auctions and which does not propose any changes to the existing

electronic RFQ auction mechanism.[46]

IV.   Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act,[47] that the

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[45]   See CTC Letter, supra note 4, at 2.

[46]   See CBOE Response, supra note 5, at 4. CBOE, however, notes that with respect to the
FLEX SAM auction, the mechanism uses an all-or-none type allocation methodology
and, by design it is possible for an agency order to receive an execution at a price that is
through a response price. This is consistent with how the existing SAM auction for non-
FLEX Options currently operates. Id.

[47]   15 U.S.C. 78s(b)(2).

proposed rule change (File No. SR-CBOE-2011-123), be, and hereby is, approved.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[48]

Kevin M. O'Neill
Deputy Secretary

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[48]   17 CFR 200.30-3(a)(12).