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SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66934; File No. SR-CBOE-2012-040)

May 7, 2012

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule Change Related to Permanent Approval of its Pilot on FLEX Minimum Value Sizes

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on April 25, 2012, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I and II below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The Exchange is proposing to make permanent its pilot program regarding minimum value sizes for Flexible Exchange Options (“FLEX Options”).³ The text of the rule proposal is available on the Exchange’s website (<http://www.cboe.org/legal>), at the Exchange’s Office of the Secretary and at the Commission.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ FLEX Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. FLEX Options can be FLEX Index Options or FLEX Equity Options. In addition, other products are permitted to be traded pursuant to the FLEX trading procedures. For example, credit options are eligible for trading as FLEX Options pursuant to the FLEX rules in Chapters XXIVA and XXIVB. See CBOE Rules 24A.1(e) and (f), 24A.4(b)(1) and (c)(1), 24B.1(f) and (g), 24B.4(b)(1) and (c)(1), and 28.17. The rules governing the trading of FLEX Options on the FLEX Request for Quote (“RFQ”) System platform are contained in Chapter XXIVA. The rules governing the trading of FLEX Options on the FLEX Hybrid Trading System platform are contained in Chapter XXIVB.

II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the self-regulatory organization included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of those statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts of such statements.

A. Self-Regulatory Organization's Statement of the Purpose of, and the Statutory Basis for, the Proposed Rule Change

1. Purpose

On January 28, 2010, the Exchange received approval of a rule change that, among other things, established a pilot program that eliminated minimum value sizes for FLEX Options. The pilot program is currently set to expire on the earlier of November 2, 2012 or the date on which the pilot program is approved on a permanent basis.⁴ The purpose of this rule change filing is to make the pilot program permanent.

⁴ At the same time the minimum value size pilot program was established, the Exchange also established a pilot program regarding permissible exercise settlement values for FLEX Index Options. Securities Exchange Act Release Nos. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010)(SR-CBOE-2009-087)(Approval Order); 61676 (March 9, 2010), 75 FR 13191 (March 18, 2010)(SR-CBOE-2010-026)(technical rule change to include original pilots' conclusion date of March 28, 2011 in the rule text); 64110 (March 24, 2011), 76 FR 17463 (March 29, 2011)(SR-CBOE-2011-024)(extending the pilots through March 30, 2012); and 66701 (March 30, 2012), 77 FR 20673 (April 5, 2012)(SR-CBOE-2012-027)(extending the pilots through the earlier of November 2, 2012 or the date on which the respective pilot program is approved on a permanent basis). The Exchange is not currently proposing permanent approval of the exercise settlement values pilot program for FLEX Index Options. Any such proposal would be the subject of a separate rule change filing.

Background on the Pilot

Prior to the initiation of the minimum value size pilot, the minimum value size requirements under CBOE Rules 24A.4 and 24B.4 were as follows:

- For opening transactions in any FLEX series in which there is no open interest at the time a FLEX RFQ or FLEX Order, as applicable, is submitted, the minimum value size was (i) for FLEX Equity Options, the lesser of 250 contracts or the number of contracts overlying \$1 million in the underlying securities; and (ii) for FLEX Index Options, \$10 million Underlying Equivalent Value. Under a prior pilot program (which was superseded by the minimum value size pilot program), the “250 contracts” component above had been reduced to “150 contracts.”⁵
- For a transaction in any currently-opened FLEX series resulting from an RFQ or from trading against the electronic book (other than FLEX Quotes responsive to a FLEX Request for Quotes and FLEX Orders submitted to rest in the electronic book), the minimum value size was (i) for FLEX Equity Options, the lesser of 100 contracts or the number of contracts overlying \$1 million in the underlying securities in the case of opening transactions, and 25 contracts in the case of closing transactions; and (ii) for FLEX Index Options, \$1 million Underlying Equivalent Value in the case of both opening and closing transactions; or (iii) in either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less.
- The minimum value size for FLEX Quotes responsive to an RFQ and FLEX Orders (undecrement size) submitted to rest in the electronic book was 25 contracts in the case of

⁵ See Securities Exchange Act Release No. 57249 [sic] (March 4, 2008), 73 FR 13058 (March 11, 2008)(SR-CBOE-2006-36)(approval of rule change that, among other things, established a pilot program that reduced the minimum number contracts required for a FLEX Equity Option opening transaction in a new series).

FLEX Equity Options, and \$1 million Underlying Equivalent Value in the case of FLEX Index Options, or in either case the remaining underlying size or Underlying Equivalent Value on a closing transaction, whichever is less. In addition, with respect to FLEX Index Appointed Market-Makers, FLEX Quotes and FLEX Orders (undecrement size) must have been for at least \$10 million Underlying Equivalent Value or the dollar amount indicated in the Request for Quote (if applicable), whichever is less.

Under the minimum value size pilot, these minimum value size requirements were eliminated.⁶ As mentioned above, the minimum value size pilot is currently set to expire on the earlier of November 2, 2012 or the date on which the pilot program is approved on a permanent basis.

Proposal

CBOE is proposing to make the minimum value size pilot program permanent. CBOE believes the pilot program has been successful and well received by its membership and the investing public for the period that it has been in operation as a pilot.

To accomplish this change, CBOE is proposing to eliminate the rule text describing the pilot program, which descriptions are contained in CBOE Rules 24A.4.01, FLEX Pilot Programs, and 24B.4.01, FLEX Pilot Programs; and to eliminate the rule text describing the minimum value size requirements, which descriptions are contained in CBOE Rules 24A.4(a)(4) and 24B.4(a)(5) and cross-referenced in paragraph (b) of CBOE Rule 24A.9, FLEX Market-

⁶ The provisions in CBOE Rules 24A.9(b) and 24B.9(c) that provide that every FLEX Quote entered by a FLEX Appointed Market-Maker or a FLEX Qualified Market-Maker shall meet or exceed the minimum value size parameters set forth in CBOE Rules 24A.4(a)(4)(iv) and 24B.4(a)(5)(iv), respectively, have not been/are not applicable during the duration of the pilot program. This is because all minimum value size requirements under CBOE Rules 24A.4(a)(4) and 24B.4(a)(5) have been eliminated under the pilot program.

Maker Appointments and Obligations, and paragraph (c) of CBOE 24B.9, FLEX Market-Maker Appointments and Obligations.

In conjunction with these changes, the Exchange is proposing certain non-substantive changes to reorganize the rule text. In particular, text from CBOE Rules 24A.4(a)(4)(i) and 24B.4(a)(5)(i) pertaining to the maximum fifteen (15) year term for a FLEX Option is proposed to be relocated and combined with the text of CBOE Rules 24A.4(a)(2)(iv) and 24B.4(a)(2)(iv), respectively, which describe FLEX Option expiration date requirements. As modified, Rules 24A.4(a)(2)(iv) and 24B.4(a)(2)(iv) will state that the expiration date may be any business day specified as to day, month, and year, not to exceed a maximum of fifteen (15) years, except that a FLEX Index Option that expires on any business day that falls on, or within two business days of, a third Friday-of-the-month expiration day for any Non-FLEX Option other than a QIX option) (“Expiration Friday”), may only have an exercise settlement value on the expiration date determined by reference to the reported level of the index as derived from the opening prices of the component securities (“a.m. settlement”).⁷ Finally, the minimum percentage requirements for FLEX Appointed Market-Maker responses to electronic Request for Quotes set forth in CBOE Rule 24B.4(a)(5)(iv) will be relocated to CBOE Rule 24B.9(c) (and replace an existing cross-reference in Rule 24B.9(c) to Rule 24B.4(a)(5)(iv)). These changes are proposed simply to reorganize the rule text in light of the other changes being proposed. As noted above, the changes are not substantive.

In support of approving the pilot program on a permanent basis, and as required by the pilot program’s approval order, the Exchange has submitted to the Commission a pilot program

⁷ The Exchange notes that the a.m. settlement limitation on permissible exercise settlement values for FLEX Index Options with an Expiration Friday expiration has been eliminated on a pilot basis. See CBOE Rules 24A.4.01 and 24B.4.01 and note 4, supra.

report regarding the pilot, which details the Exchange's experience with the program. Specifically, the Exchange provided the Commission an annual report containing data and analysis of underlying equivalent values, open interest and trading volume, and analysis of the types of investors that initiated opening FLEX Equity and Index Options transactions (i.e., institutional, high net worth, or retail). The report was provided to the Commission on a confidential basis.

The Exchange believes there is sufficient investor interest and demand in the pilot program to warrant its permanent approval. The Exchange believes that, for the period that the pilot has been in operation, the program has provided investors with additional means of managing their risk exposures and carrying out their investment objectives. Furthermore, as discussed in more detail below, the Exchange has not experienced any adverse market effects with respect to the pilot program.

CBOE believes that eliminating the minimum value size requirements for all FLEX Options on a permanent basis is important and necessary to the Exchange's efforts to create a product and market that provides its membership and investors interested in FLEX-type options with an improved but comparable alternative to the over-the-counter ("OTC") market in customized options, which can take on contract characteristics similar to FLEX Options but are not subject to the same restrictions. By making the pilot permanent, market participants will continue to have greater flexibility in determining whether to execute their customized options in an exchange environment or in the OTC market. 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: (i) enhanced efficiency in initiating and closing out positions; (ii) increased market transparency; and (iii) heightened contra-party creditworthiness

due to the role of The Options Clearing Corporation (“OCC”) as issuer and guarantor of FLEX Options. The Exchange also believes the pilot programs are wholly consistent with comments by Timothy F. Geithner, Secretary of the Treasury, to the U.S. Senate. In particular, Secretary Geithner has stated that:

“Market efficiency and price transparency should be improved in derivatives markets by requiring the clearing of standardized contracts through regulated [central counterparties] and by moving the standardized part of these markets onto regulated exchanges and regulated transparent electronic trade execution systems for OTC derivatives and by requiring development of a system for timely reporting of trades and prompt dissemination of prices and other trade information. Furthermore, regulated financial institutions should be encouraged to make greater use of regulated exchange-traded derivatives. Competition between appropriately regulated OTC derivatives markets and regulated exchanges will make both sets of markets more efficient and thereby better serve end-users of derivatives.”⁸

The Exchange believes that the elimination of the minimum value size requirements on a permanent basis would provide FLEX-participating Trading Permit Holders with greater flexibility in structuring the terms of FLEX Options that best comports with their and their customers’ particular needs. In this regard, the Exchange notes that the minimum value size requirements were originally put in place over nineteen years ago to limit participation in FLEX Options to sophisticated, high net worth investors rather than retail investors.⁹ However, the

⁸ See letter from Secretary Geithner to the Honorable Harry Reid, United States Senate (May 13, 2009), located at <http://www.financialstability.gov/docs/OTCletter.pdf>.

⁹ See Securities Exchange Act Release Nos. 31361 (October 27, 1992) 57 FR 52655

Exchange believes the restriction is no longer necessary and is overly restrictive. The Exchange has also not experienced any adverse market effects with respect to the pilot program eliminating the minimum value size requirements. Again, based on the Exchange's experience to date and over the pilot period, the minimum value size requirements are too large to accommodate the needs of Trading Permit Holders and their customers – who may be institutional, high net worth or retail - that currently participate in the OTC market. In this regard, the Exchange notes that, prior to establishing the minimum value size pilot, it received numerous requests from broker-dealers representing institutional, high net worth and retail investors indicating that the minimum value size requirements prevented them from bringing transactions that are already taking place in the OTC market to an exchange environment. The Exchange believes that eliminating the minimum value size requirements on a permanent basis would further broaden the base of investors that use FLEX Options to manage their trading and investment risk, including investors that currently trade in the OTC market for customized options, where similar size restrictions do not apply. The Exchange also believes that this may open up FLEX Options to more retail investors. The Exchange does not believe this raises any unique regulatory concerns because existing safeguards – such as certain position limit, aggregation and exercise limit requirements, reporting requirements, and margin requirements – continue to apply.¹⁰ In addition, the

(November 4, 1992)(SR-CBOE-92-17)(notice of filing of proposed rule change relating to Flexible Exchange Options) and 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993)(order approving SR-CBOE-92-17).

¹⁰ The Exchange also notes that certain position limit, aggregation and exercise limit requirements continue to apply to FLEX Options in accordance with CBOE Rules 24A.7, Position Limits and Reporting Requirements, 24A.8, Exercise Limits, 24B.7, Position Limits and Reporting Requirements, and 24B.8, Exercise Limits. Additionally, all FLEX options remain subject to the position reporting requirements in paragraph (a) of CBOE Rule 4.13, Reports Related to Position Limits. CBOE Rule 4.13(a) provides that “[i]n a manner and form prescribed by the Exchange, each Trading Permit Holder shall report to the Exchange, the name, address, and social security or tax identification number of any

Exchange notes that FLEX Options are subject to the options disclosure document (“ODD”) requirements of Rule 9b-1¹¹ under the Act.¹² No broker or dealer can accept an order from a customer to purchase or sell an option contract relating to an options class that is the subject of a definitive ODD (including FLEX Options), or approve the customer’s account for the trading of such an option, unless the broker or dealer furnishes or has furnished to the customer a copy of the definitive ODD. The ODD contains a description, special features, and special risks of FLEX Options. Lastly, similar to any other options, FLEX Options are subject to Trading Permit Holder organization supervision and suitability requirements, such as in CBOE Rules 9.8, Supervision of Accounts, and 9.9, Suitability of Recommendations.

In proposing the pilot itself and in now proposing to make it permanent, CBOE is cognizant of the need for market participants to have substantial options transaction capacity and flexibility to hedge their substantial investment portfolios, on the one hand, and the potential for adverse effects that the minimum value size restrictions were originally designed to address, on the other. However, the Exchange has not experienced any adverse market effects with respect to the pilot program. CBOE is also cognizant of the OTC market, in which similar restrictions

customer who, acting alone, or in concert with others, on the previous business day maintained aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of option contracts dealt in on the Exchange. The report shall indicate for each such class of options, the number of option contracts comprising each such position and, in the case of short positions, whether covered or uncovered.” For purposes of this Rule, the term “customer” in respect of any Trading Permit Holder includes “the Trading Permit Holder, any general or special partner of the Trading Permit Holder, any officer or director of the Trading Permit Holder, or any participant, as such, in any joint, group or syndicate account with the Trading Permit Holder or with any partner, officer or director thereof.” CBOE Rule 4.13(d). Moreover, the Exchange and its Trading Permit Holder organizations each have the authority, pursuant to CBOE Rule 12.10, Margin Required is Minimum, to impose additional margin as deemed advisable.

¹¹ 17 CFR 240.9b-1.

¹² 15 U.S.C. 78a et seq.

on minimum value size do not apply. In light of these considerations and Secretary Geithner's comments on moving the standardized parts of OTC contracts onto regulated exchanges, CBOE believes that making the pilot permanent is appropriate and reasonable and will provide market participants with additional flexibility in determining whether to execute their customized options in an exchange environment or in the OTC market. 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, enhanced efficiency in initiating and closing out positions, increased market transparency, and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of FLEX Options.

For the foregoing reasons, CBOE believes that the minimum value size pilot program is reasonable and appropriate, promotes just and equitable principles of trade, and facilitates transactions in securities while continuing to foster the public interest and investor protection, and therefore should be made permanent.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act¹³ in general and furthers the objectives of Section 6(b)(5) of the Act¹⁴ in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. Specifically, the Exchange believes that the permanent approval of the pilot program, which eliminates minimum value size requirements, would provide greater opportunities for investors to manage risk through the use of FLEX Options. Further, the Exchange notes that it has not experienced any adverse effects from the operation of

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

the pilot program. The Exchange also believes that making the minimum value size pilot permanent does not raise any unique regulatory concerns. The Exchange also believes that the proposed rule change would continue to provide Trading Permit Holders and investors with additional opportunities to trade customized options in an exchange environment and subject to exchange-based rules, and investors would benefit as a result.

B. Self-Regulatory Organization's Statement on Burden on Competition

CBOE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act.

C. Self-Regulatory Organization's Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others

The Exchange neither solicited nor received comments on the proposal.

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

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period (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 or disapprove such proposed rule change, or

(B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2012-040 on the subject line.

Paper comments:

- Send paper comments in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File Number SR-CBOE-2012-040. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>).

Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549, on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the 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-2012-040 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.¹⁵

Kevin M. O'Neill
Deputy Secretary

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¹⁵ 17 CFR 200.30-3(a)(12).