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SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-67938; File No. SR-CBOE-2012-093)

September 27, 2012

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Related to AIM, SAM, FLEX AIM, FLEX SAM and FLEX Electronic RFQs

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 September 21, 2012, Chicago Board Options Exchange, Incorporated (the “Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared by the Exchange. The Exchange has designated the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> 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 certain amendments to its rules for trading FLEX Options<sup>5</sup> and Non-FLEX Options. The text of the proposed rule change is available on the

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

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

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

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

<sup>5</sup> 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

Exchange's website (www.cboe.org/Legal), at the Exchange's Office of the Secretary, and at the Commission.

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

In its filing with the Commission, the Exchange 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 Statutory Basis for, the Proposed Rule Change

1. Purpose

The Exchange recently received approval of a rule change filing, SR-CBOE-2011-123, which adopted certain rules pertaining to the electronic auction trading of FLEX Options on the Exchange's FLEX Hybrid Trading System platform.<sup>6</sup> In particular, the Exchange adopted rules to make modified versions of the Automated Improvement Mechanism ("AIM") and the Solicitation Auction Mechanism ("SAM") – which were already available for Non-FLEX Options under Rules 6.74A and 6.74B, respectively – available for FLEX Options under new Rules 24B.5A and 24B.5B, respectively. Under the FLEX AIM auction, a FLEX Trader that represents agency orders may electronically execute an order it represents as agency (an

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FLEX Options on the FLEX Request for Quote ("RFQ") System platform (which is limited to open outcry trading only) are contained in Chapter XXIVA. The rules governing the trading of FLEX Options on the FLEX Hybrid Trading System platform (which combines both open outcry and electronic trading) are contained in Chapter XXIVB. The Exchange notes that, currently, all FLEX Options are traded on the FLEX Hybrid Trading System platform.

<sup>6</sup> Securities Exchange Act No. 66702 (March 30, 2012), 77 FR 20675 (April 5, 2012)(SR-CBOE-2011-123 Approval Order).

“Agency Order”) against principal interest and/or against solicited orders provided it submits the Agency Order for execution into the AIM auction process. Under the FLEX SAM auction, a FLEX Trader that represents agency orders may electronically execute an Agency Order against solicited orders provided it submits the Agency Order for electronic execution into the SAM auction process, under which both the Agency Order and the solicited order will be designated in the FLEX Hybrid Trading System as all-or-none. Prior to launching the new FLEX AIM and FLEX SAM auctions, the Exchange is proposing to make certain changes detailed below to the FLEX auction trading rules, as well as corresponding changes to the Non-FLEX auction trading rules. The Exchange is also proposing certain other corresponding changes to various FLEX rules.

First, the existing FLEX AIM provisions in Rule 24B.5A(b)(1) provide in relevant part that auction responses cannot cross the Exchange’s best bid or offer (“BBO”) on the opposite side of the market. The Exchange is proposing to amend these provisions to describe what the system does in the event a response does cross the market. In particular, the text will be amended to provide that a FLEX AIM auction response that crosses the BBO on the opposite side of the market will be capped at the BBO price. (For example, if the BBO is \$1.00 - \$1.20 and a response is entered to sell at a price of \$0.99, the response will be capped at a price of \$1.00.) The existing FLEX SAM provisions in Rule 24B.5B(b)(1) are silent on what happens if an auction response crosses the BBO on the opposite side of the market; however, the FLEX SAM auction also operates in a fashion that is similar to the FLEX AIM auction. Therefore, the Exchange is proposing to amend these provisions to provide that a FLEX SAM auction response cannot cross the BBO on the opposite side of the market and a response that does cross the BBO on the opposite side of the market will be capped at the BBO price.

Second, currently the AIM, SAM, FLEX AIM, and FLEX SAM auctions each in relevant part provide that auction responses may be modified or canceled during the auction response period. The only way to modify a response would be for a Trading Permit Holder to cancel a prior response then submit a new response. As a result, the Exchange believes that the references to modifying responses in the rule text are unnecessary. Therefore, the Exchange is proposing to delete references to modifying responses in Rules 6.74A(b)(1), 6.74B(b)(1), 24B.5A(b)(1), and 24B.5B(b)(1), respectively. (The Exchange is also taking this opportunity to correct a numbering error in the text of Rule 24B.5A(b)(1)(changing a paragraph number from “(ix)” to “(viii)”.)

Third, normally an auction would conclude after 1 second in the case of AIM and SAM, or after 3 seconds (or whatever longer period of time the Exchange may designate) in the case of FLEX AIM and FLEX SAM. In addition, respective AIM, SAM, FLEX AIM and FLEX SAM auction provisions set out various circumstances during which an auction would conclude early. Currently, the provisions are silent on what would happen in the event the option series is subject to a trading halt while an auction is ongoing. In such an event, the relevant auction would conclude early and the Agency Order would execute (or not execute) in accordance with the allocation provisions set out in the relevant rules. Therefore, the Exchange is proposing to amend Rules 6.74A(b)(2), 6.74B(b)(2), 24B.5A(b)(2) and 24B.5B(b)(2), respectively, to indicate that an auction would conclude early in the event of a trading halt in the series on the Exchange and the Agency Order would execute (or not execute) in accordance with the allocation provisions set out in the relevant rules.<sup>7</sup>

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<sup>7</sup> The Exchange notes that NASDAQ OMX PHLX LLC (“Phlx”) has a similar provision within its electronic auction rules related to the early conclusion of an auction due to a trading halt. See Phlx Rule 1080(n).

Fourth, the Exchange is proposing to make some clarifications regarding the application of certain provisions in the FLEX AIM and FLEX SAM auction rules to complex orders. The Exchange is also proposing to make similar clarifications to the FLEX electronic Request for Quote (“RFQ”) auction rules. By way of background, the existing FLEX AIM and FLEX SAM auctions each respectively provide in relevant part, for simple orders, that only one auction may be ongoing at any given time in a series and auctions in the same series may not queue or overlap in any manner. Further, unrelated FLEX Orders may not be submitted to the electronic book for the duration of an auction. For complex orders, the same conditions apply. In addition, certain other conditions also apply.<sup>8</sup> For instance, the complex order processing provisions currently provide that, in the event there are bids (offers) in any of the individual component series legs represented in the electronic book when an Agency Order is submitted to the auction, the auction will not commence. The complex order processing provisions also currently provide that, in the event an unrelated FLEX Order in any of the individual series legs is received during the duration of the auction response period, such FLEX Order will not be considered in the auction allocation. The Exchange believes this later provision is unnecessary and potentially confusing, since the rules also include a condition that unrelated FLEX Orders may not be submitted to the electronic book for the duration of an auction.

In order to provide more clarity on the application of these various provisions to complex orders, the Exchange is proposing to revise the FLEX AIM and FLEX SAM rules to further describe how these “unrelated auction/order” provisions apply to complex orders. In particular,

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<sup>8</sup> Complex orders are only eligible to trade with other complex orders through the FLEX AIM and FLEX SAM auctions. (As a result, to the extent the Exchange determines to make an electronic book available for resting FLEX Orders, there is no “legging” of complex orders with FLEX Orders that may be represented in the individual series legs represented in the electronic book.) Order allocation is the same as would be applicable for simple orders. See Rules 24B.5A.05 and 24B.5B.01.

the proposed revisions will make clear that only one FLEX AIM auction (or FLEX SAM auction, as applicable) may be ongoing at any given time for a given complex order strategy and FLEX AIM auctions (or FLEX SAM auctions, as applicable) involving any of the same individual series legs of the strategy may not queue or overlap in any manner. In the event there are bids (offers) in any of the individual component series legs represented in the electronic book when an Agency Order is submitted to the auction, the auction will not commence. In addition, unrelated FLEX Orders in any of the individual series legs may not be submitted to the electronic book for the duration of auction response period.<sup>9</sup>

The Exchange is also taking this opportunity to propose similar clarifications to the FLEX electronic RFQ process. In particular, the Exchange is proposing to amend the electronic RFQ provisions for simple orders to provide that only one electronic RFQ may be ongoing at any given time in a series and electronic RFQs in the same series may not queue or overlap in any manner. (The electronic RFQ provisions for simple orders are currently silent on the topic of multiple RFQs involving the same series.) The Exchange is also proposing to amend the electronic RFQ provisions for complex orders to make clear that only one electronic RFQ may be ongoing at any given time for a given complex order strategy and electronic RFQs involving

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<sup>9</sup> In discussing the FLEX AIM and FLEX SAM auctions, the Exchange had previously indicated that 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-Trading Permit Holder broker-dealers in the electronic book. See Securities Exchange Act Release No. 66052 (December 23, 2011), 77 FR 306 (January 4, 2012)(SR-CBOE-2011-123 Proposal Notice). The Exchange notes that these scenarios would not occur when a complex order is traded via the FLEX AIM or FLEX SAM auction. Because the FLEX AIM and FLEX SAM auctions each include a condition that the auction is not permitted to commence when there is a FLEX Order resting in the electronic book in any individual component series legs and a condition that unrelated orders are not accepted for the duration of the auction, there would be no scenario where there would be a complex order traded in a FLEX AIM or FLEX SAM auction when there are corresponding bids (offers) in the electronic book.

any of the same individual series legs of the strategy may not queue or overlap in any manner. In the event there are bids (offers) in any of the individual component series legs represented in the electronic book when an electronic RFQ is submitted, the electronic RFQ will not commence. In addition, unrelated FLEX Orders in any of the individual series legs may not be submitted to the electronic book for the duration of electronic RFQ response period. (The Exchange is also taking this opportunity to correct a typographical error in the text (changing the phrase “automated cancelled” to “automatically cancelled”).)

Fifth, the Exchange is proposing to make some changes to further describe the process for trading FLEX Options that have special exercise prices and premium terms based on a method for fixing such a number or based a percentage.<sup>10</sup> The Exchange is proposing to amend the FLEX Index Options provisions in Rules 24A.4(b)(2) and 24B.4(b)(2) to provide that exercise prices may be specified in terms of a percentage of the price of the underlying security at the time of the trade. This description of one particular method for fixing exercise prices for FLEX Index Options is parallel to an existing provision for FLEX Equity Options. The Exchange is proposing to amend the FLEX Index Options provisions to provide that premiums may be specified in terms of (i) a dollar amount, (ii) a method for fixing such a number at the time a FLEX Request for Quote or FLEX Order is traded, or (iii) a percentage of the index value calculated at the time of the trade or as of the close of trading on the Exchange on the trade date.

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<sup>10</sup> For FLEX Index Options, exercise prices shall be specified in terms of (i) a specific index value number, (ii) a method for fixing such a number at the time a FLEX Request for Quote or FLEX Order is traded, or (iii) a percentage of index value calculated as of the close of trading on the Exchange on the trade date. For FLEX Equity Options, exercise prices and premiums may be stated in (i) a dollar amount, (ii) a method for fixing such a number at the time a FLEX Request for Quote or FLEX Order is traded, or (iii) a percentage of the price of the underlying security at the time of the trade or as of the close of trading on the Exchange on the trade date. See existing Rules 24A.4(b)(2) and (c)(2) and 24B.4(b)(2) and (c)(2).

This description of premium terms for FLEX Index Options is parallel to the existing terms for FLEX Equity Options.

In addition, the Exchange notes that, currently for FLEX Options, exercise prices and premiums that are stated using a percentage-based methodology (e.g., an exercise price based on the percentage of the close of the underlying stock or a method for fixing the number based on the gross-weighted average of the underlying stock) may be stated in a percentage increment that is no smaller than 0.01%. The existing rules do not currently provide this level of detail, so the Exchange is proposing to include a description within the rules. In particular, the Exchange is proposing to amend the descriptions in Rules 24A.4(b)(2) and (c)(2) and 24B.4(b)(2) and (c)(2) to provide that exercise prices and premiums stated using a percentage-based methodology may be stated in a percentage increment determined by the Exchange on a class-by-class basis that may not be smaller than 0.01% and that the percentage increments will be rounded as provided within the rules. Corresponding changes are also being proposed to Rules 24A.5(f) and 24B.5(e), which pertain to incremental changes to bids and offers for FLEX Options trading via the electronic and open outcry RFQs, and to Rules 24B.5A(b)(1) and 24B.5B(a)(3), which pertain to incremental changes to bids and offers for FLEX Options trading via FLEX AIM and FLEX SAM.

The Exchange notes that the existing rules provide for FLEX Equity Options that exercise prices may be rounded to the nearest minimum tick or other decimal increment determined by the Exchange on a class-by-class basis that may not be smaller than \$0.01, and that premiums will be rounded to the nearest minimum tick.<sup>11</sup> The existing rules are silent with respect to rounding for FLEX Index Option exercise prices. Therefore, as with FLEX Equity

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<sup>11</sup> In this regard, the Exchange notes that exercise price and premium values equal to or higher than 0.005 will be rounded up and less than 0.005 will be rounded down.

Options, the Exchange is proposing to provide that FLEX Index Option exercise prices may be rounded to the nearest minimum tick or other decimal increment determined by the Exchange on a class-by-class basis that may not be smaller than \$0.01.

The Exchange is also proposing to adopt new Interpretation and Policy .02 to Rule 24B.5, which will provide that there is no electronic book for FLEX Options with exercise prices and premiums that are based on a methodology for fixing such a number or based on a percentage as provided in Rules 24B.2(b)(2) and 24B.2(c)(2). Similar to FLEX Option complex orders, these types of FLEX Options may only trade in open outcry or electronically via one of the three electronic auction mechanisms, i.e., the electronic RFQ process, FLEX AIM or FLEX SAM.

Sixth, the Exchange is also proposing to adopt new Interpretation and Policy .03 to Rule 24B.5 (pertaining to electronic RFQs), new Interpretation and Policy .06 to Rule 24B.5A (pertaining to FLEX AIM), and new Interpretation and Policy .02 to Rule 24B.5B (pertaining to FLEX SAM). These Interpretations and Policies will describe the post-trade verification procedures that apply to electronic RFQ, FLEX AIM and FLEX SAM transactions involving multi-part complex order strategies or exercise prices and premiums that are based on a methodology for fixing such a number or based on a percentage. By way of example, when a FLEX Option complex order is traded, the transaction execution is based on an overall net price and then, post-trade, the individual component series legs are reported at prices that equal the overall net price. As another example, when an exercise price is based on a percentage of the price of the underlying security as of the close of trading on the Exchange on the trade date, the transaction execution is based on the percentage formula and then, post-trade, the values are updated to reflect the actual exercise price after the closing price is available.

The rules currently do not describe the post-trade verification process for electronic

trading, and the Exchange believes the additional detail may be helpful to market participants. The Exchange notes that the process for post-trade verification for electronic trades generally takes the manual process that has existed for open outcry transactions and adapts it to an electronic environment. The proposed Interpretations and Policies describe that the party that initiated the transaction shall input the applicable complex order leg price, exercise price and/or premium information into the FLEX Hybrid Trading System. Once the information is inputted into the System, the contra-party(ies) to the transaction shall then have a designated period of time to notify FLEX Officials of any inaccuracies in the content of a transaction and of the corrections to any inaccurate information, which designated period of time will be determined by the Exchange and will not be less than 5 minutes or more than 30 minutes from the time the initiating party inputs the information into the System. (Currently, the Exchange has set this period in the System at 10 minutes.)

Finally, seventh, the Exchange is proposing non-substantive changes to reorganize certain text within Rules 24B.5A and 24B.5B to be consistent with the format of other rules. Specifically, the Exchange is proposing to amend Rule 24B.5A to relocate the sentence “This rule supersedes Exchange Rule 6.74A.” to a location above Rule 24B.5A’s Interpretations and Policies, and to amend Rule 24B.5B to relocate the sentence “This rule supersedes Exchange Rule 6.74B.” to a location above Rule 24B.5B’s Interpretations and Policies. Again, these changes are not substantive. They are merely being made to so the rules are formatted consistently with other rules contained in Chapter XXIVB.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act<sup>12</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>13</sup> 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. In particular, the Exchange believes that the use of FLEX Options provides CBOE Trading Permit Holders and investors with additional tools to trade customized options in an exchange environment<sup>14</sup> and greater opportunities to manage risk. The Exchange believes that the FLEX AIM and FLEX SAM auctions adopted under rule change filing SR-CBOE-2011-123 should serve to further those objectives and encourage use of FLEX Options by making auctions mechanisms available for FLEX Options trading that are similar to auction mechanisms already available for Non-FLEX Options trading, which the Exchange believes should make the FLEX Hybrid Trading System more efficient and effective and easier for users to understand. The Exchange believes that the further refinements being proposed in this instant rule change filing, and corresponding changes to the AIM and SAM auctions for

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<sup>12</sup> 15 U.S.C. 78f(b).

<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> FLEX Options provide Trading Permit Holders and investors 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. The Exchange believes that making these changes will make the FLEX Hybrid Trading System an even more attractive alternative when market participants consider 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 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 as issuer and guarantor of FLEX Options.

Non-FLEX Options, as well as similar changes to the FLEX electronic RFQ process, should also serve to further those objectives by more clearly and fully describing certain aspects of the operation of the FLEX Hybrid Trading System and of the aforementioned auction processes.

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

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 does not (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative for 30 days from the date on which it was filed, or such shorter time as the Commission may designate if consistent with the protection of investors and the public interest, provided that the self-regulatory organization has given the Commission written notice of its intent to file the proposed rule change at least five business days prior to the date of filing of the proposed rule change or such shorter time as designated by the Commission, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>15</sup> and Rule 19b-4(f)(6) thereunder.<sup>16</sup> At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend 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.

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

<sup>16</sup> 17 CFR 240.19b-4(f)(6).

#### 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-2012-093 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-2012-093. 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-2012-093 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.<sup>17</sup>

Kevin M. O'Neill  
Deputy Secretary

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