of FLEX Options. Further, the Exchange notes that it has not experienced any adverse effects from the operation of the pilot programs. The Exchange also believes that the extension of the exercise settlement values pilot and minimum value size pilot does not raise any unique regulatory concerns. In particular, although p.m. settlements may raise questions with the Commission, the Exchange believes that, based on the Exchange's experience in trading FLEX Options to date and over the pilot period, market impact and investor protection concerns will not be raised by this rule change. 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 (which offers the added benefits of transparency, price discovery, liquidity, and financial stability as compared to the over-the-counter market) 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 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 proposed rule change does not: (i) Significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act [15] and Rule 19b–4(f)(6) thereunder.[16]

A proposed rule change filed pursuant to Rule 19b–4(f)(6) under the Act [17] normally does not become operative for 30 days after the date of its filing. However, Rule 19b–4(f)(6) [18] permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon filing. The Commission notes that waiving the 30-day operative delay would prevent the expiration of the pilot programs on March 30, 2012, prior to the extension of the pilot programs taking effect, and believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest.[19] Therefore, the Commission designates the proposal operative upon filing.

At any time within 60 days of the filing of the 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.

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 email to *rule-comments@sec.gov.* Please include File Number SR–CBOE–2012–027 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–2012–027. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet Web site (*http://www.sec.gov/rules/sro.shtml*). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site 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 a.m. and 3 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–2012–027 and should be submitted on or before April 26, 2012.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.[20]

Kevin M. O'Neill,

Deputy Secretary.

[FR Doc. 2012–8170 Filed 4–4–12; 8:45 am]

BILLING CODE 8011–01–P

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66702; File No. SR–CBOE–2011–123]

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

March 30, 2012.

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

[15] 15 U.S.C. 78s(b)(3)(A).

[16] 17 CFR 240.19b–4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give 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 Exchange has satisfied this requirement.

[17] 17 CFR 240.19b–4(f)(6).

[18] 17 CFR 240.19b–4(f)(6).

[19] For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. *See* 15 U.S.C. 78c(f).

[20] 17 CFR 200.30–3(a)(12).

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

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 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 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 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 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

[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'').

[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).

[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).

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

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 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 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 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 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

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

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

[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.

[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).

[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).

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

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, 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 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 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

[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

[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).

[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).

[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.

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 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;

(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

[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).

[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 (November 23, 2007) (SR–CBOE–2006–99) (Adopting rules providing for the trading of FLEX Options on an electronic platform).

(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.

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 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 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.

[FR Doc. 2012–8171 Filed 4–4–12; 8:45 am]

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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).

[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.

[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).

[48] 17 CFR 200.30–3(a)(12).

SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–66704; File No. SR–CBOE–2012–030]

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to FLEX Transaction Fees

March 30, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"),[1] and Rule 19b–4 thereunder,[2] notice is hereby given that on March 29, 2012, Chicago Board Options Exchange, Incorporated (the "Exchange" or "CBOE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I, II, and III below, which items have been prepared by the self-regulatory organization. The Commission is publishing this notice to

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

[2] 17 CFR 240.19b–4.