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Ms. Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.W.
Washington, D.C. 20549-1090

RE: SR-CBOE-2011-123 (FLEX AIM and SAM Auctions)

Dear Ms. Murphy:

The Chicago Board Options Exchange, Incorporated ("CBOE" or the "Exchange") submits this response to CTC Trading Group, L.L.C.'s ("CTC") comment letter regarding CBOE proposed rule change filing SR-CBOE-2011-123.

CBOE's proposed rule change seeks to adopt two new electronic auction mechanisms for trading FLEX Options referred to as the FLEX Automated Improvement Mechanism and the FLEX Solicitation Auction Mechanism (the "FLEX AIM and SAM Auctions"). Generally, under these mechanisms a Trading Permit Holder (referred to in the rules as a "FLEX Trader") representing a FLEX agency order and contra-side interest against which the agency order may trade could initiate an auction. Certain conditions apply, including a condition that the initiating FLEX Trader in essence "stop" the entire agency order. An auction message would then be broadcast to all FLEX Traders that elect to receive the message. FLEX Traders then have a set period of time to respond (the response period will be established by CBOE on a class-by-class basis and not be less than 3 seconds). At the conclusion of the auction period, an execution and allocation occurs. The FLEX AIM Auction would be available for crossing any size agency order with a facilitation and/or solicited interest. The FLEX SAM Auction would be available for crossing larger sized agency orders of at least 500 contracts with solicited interest only.

These proposed FLEX auction mechanisms are designated to augment the existing electronic RFQ auction mechanism that has already been available for FLEX Options trading since 2007 (and which may be used for both crossing and non-crossing and for which the response period is currently set at 3 seconds for all FLEX options). As the proposed rule change notes, the proposed FLEX AIM and SAM Auction mechanisms are substantially similar to existing auction mechanisms that CBOE already has had in place for non-FLEX options for several years.[1] CBOE is simply seeking to make

[1] The AIM Auction mechanism rule for non-FLEX Options (Rule 6.74A) has been in effect since 2006, and the SAM Auction mechanism rule for non-FLEX Options (Rule 6.74B) has been in effect since 2008. See Securities Exchange Act Release Nos. 53222 (February 3, 2066)(SR-CBOE-2005-60) and 57610 (April 3, 2008)(SR-CBOE-2008-14). Other options exchanges have similar auction mechanisms. See, e.g., International Securities Exchange Rules 716 (describes Facilitation and Solicited Order Mechanisms for crossing orders) and 723 (describes Price

substantially similar technology available for the electronic trading of FLEX Options. As noted, the CBOE is proposing a minimum 3-second response timer for FLEX Options, which is consistent with the existing minimum timer used for FLEX electronic RFQ auctions. By contrast, for non-FLEX Options, the timers for similar crossing and non-crossing auctions are set much lower. For example, on CBOE the non-FLEX AIM and SAM Auction timers are currently set at 1 second. The timers for other non-crossing auctions are set even lower (e.g., the timers for the Simple Auction Liaison (SAL) under CBOE Rule 6.13A and the Hybrid Agency Liaison (HAL) under CBOE Rule 6.14A are set at 150 milliseconds; the timers for Complex Order Auctions (COA) under Rule 6.53C is set at 250 milliseconds). Also, we note that the PIP response timer for crossing on BOX was recently reduced from 1 second to 100 milliseconds on a pilot basis.[2] CBOE believes the length of the FLEX AIM and SAM Auction timers is reasonable and appropriate considering these various timers noted above.

FLEX Options provide Trading Permit Holders and investors with an 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. CBOE believes that offering the AIM and SAM automated processes for auctioning FLEX orders in a manner consistent with our longstanding auctions for non-FLEX orders 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.

Although CBOE thinks the FLEX Option offer is an improved and comparable alternative to the OTC, the vast majority of all customized options trading continues to occur in the OTC markets. Making the AIM and SAM Auctions available for FLEX trading is essential in our ability to attract order flow and compete effectively with the OTC market. In that regard, the auction mechanisms are designed to further facilitate the trading of customized options in an exchange environment and, in particular, to attract order flow to the Exchange by firms seeking to cross their customers' orders with proprietary or solicited interest that would otherwise trade in the OTC market (with little or no restriction). At the same time, the auction mechanisms are designed to encourage liquidity by other market participants by requiring that the orders be exposed for a reasonable period of time before a cross can occur. As designed, we believe these auction mechanisms will attract additional order flow to CBOE and create liquidity in those FLEX products, which the Exchange believes ultimately will benefit all market participants who trade on FLEX products on CBOE.

Improvement Mechanism for crossing orders), and Boston Options Group Exchange, LLC ("BOX") Chapter V, Section 18 (describes Price Improvement Period ("PIP") process for crossing orders).

[2] See Securities Exchange Act Release No. 66306 (February 2, 2012)(SR-BX-2011-084).

Minimum Response Timer

In its comment letter, CTC notes that it has no objection to a 3-second auction response timer for *existing* FLEX Option series. However, CTC requests that the minimum response period for *new* FLEX Option series and crosses should be extended to 1 minute. We disagree and respectfully decline CTC's suggestion. In today's markets, a 1-minute timer far exceeds the standards that have been set for any other exchange timer.

CTC indicates that a 3-second timer for a new FLEX series and cross would present a technological challenge because market-making firms would have to be ready to price the infinite possibility of strikes, expirations and settlement styles. CTC adds that responding would be extremely risky because firms would be quoting into a "dark market" and the 3-second response time would add to the existing risk by placing additional reliance and stress on systems to anticipate trading outcomes and having a reasonable chance to validate pricing through safety checks. CTC also claims the 3-seocnd interval is inconsistent with the manual, open outcry process (which uses a 3 or 5 minute window, depending on the type of FLEX option). CTC adds that FLEX orders are not normally time sensitive because FLEX customers do not normally need highly customized hedges on a moment's notice.

While we acknowledge that the FLEX market may be thinly traded or a bit more complex given its customized nature, this does not mean that the auctions should be subject to unnecessarily lengthy timers. FLEX AIM and SAM Auction mechanisms are not intended for "manual" use. They are intended to be automated and FLEX Traders desiring to participate in the FLEX AIM and SAM Auctions need to dedicate resources to program to the auctions. Assuming a FLEX Trader develops the technology to electronically trade, CBOE believes the 3-second interval is sufficient to electronically process and respond to an auction in today's markets, where technology operates in milliseconds and nanoseconds

In this respect, our experience indicates that 3 seconds would provide an adequate response time.[3] Accordingly, CBOE does not believe it is necessary or beneficial to the orders being exposed to subject them to market risk for a full 1-minute period.

FLEX Solicitation Auction Mechanism

On the second page of CTC's letter under the heading "Flex Solicitation Auction Mechanism," CTC raises questions about the existing electronic RFQ auction mechanism for FLEX Options and says that the existing mechanism should not be allowed to migrate to the CBOE*direct* platform. Other than the aforementioned heading, CTC makes no mention of the FLEX SAM Auction in these comments. CTC indicates that the existing electronic RFQ auction provides a mechanism that allows market participants to utilize multiple logins, market participants to respond to their own RFQs, locked/crossed markets to be created, and executions to occur through the best

[3] The Exchange believes that our experience with various auction mechanisms that have been in operation over the years supports our view that 3 seconds is sufficient time for market participants that choose to program to the auction system to respond to the FLEX AIM and SAM Auction mechanisms, which will operate on the CBOE*direct* platform and employ the same type of mechanical messaging as existing auction mechanisms.

bid or offer. We respectfully believe that these comments by CTC have no relevance to the instant proposed rule change, which simply seeks to implement the two new FLEX AIM and SAM Auction mechanisms and which does not propose any changes to the existing electronic RFQ auction mechanism. Nonetheless, we would like to take the opportunity to respond to CTC's comments.

Certain aspects of the existing electronic RFQ auction mechanism were recently amended in anticipation of a planned migration from the existing FLEX electronic trading platform to the CBOEdirect platform which is expected to begin before the end of March 2012 (see Securities Exchange Act Release No. 66348 (February 7, 2012)(SR-CBOE-2011-122)). Under the existing (and amended) process, the system dynamically calculates and disseminates to all FLEX Traders an RFQ Market given the current responses and orders resting in the FLEX Book (so all FLEX Traders have the ability to see what the current market is). It is possible for firms to have multiple logins. It is also possible that the party that initiated an auction can respond to their own RFQ along with other market participants. In addition, it is possible that the RFQ Market can be locked (e.g., $1.20 - $1.20) or crossed (e.g., $1.25 - $1.20). These are designs of the system that have existed since it was first implemented in 2007. However, trades should not occur through the best bid or offer. Instead, under the existing (and amended) process, in a locked/crossed market scenario trades would occur at a single clearing price that will leave bids and offers which cannot trade with each other (referred to as a "BBO clearing price"). In determining the priority of responses and order in the FLEX Book, the system gives priority to responses and orders whose price is better than the BBO clearing price, then to responses and orders priced at the BBO clearing price. CBOE notes that, due to a system issue, in certain circumstances trades may have incorrectly occurred at a price that was through the best bid or offer.[4] The Exchange anticipates that this issue will not exist when trading in FLEX Options converts to the CBOE*direct* platform.

Although the CTC letter does not raise questions about the FLEX SAM Auction, we note that this auction 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. Specifically, an agency order would be executed against the contra-side solicited order unless there is sufficient size to execute the entire agency order at a price (or prices) that improves the proposed crossing price.[5] The FLEX SAM Auction presents nothing unique in this regard. This structure is entirely consistent with how the existing SAM Auction operates for non-FLEX Options.

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[4] See CBOE Regulatory Circular RG12-042 (March 6, 2012).

[5] In the case where there is one or more public customers or non-Trading Permit Holder 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. See proposed Rule 24B.5B(b)(3).

Consistent with the comments provided above, CBOE respectfully requests that the Commission approve CBOE's proposed rule change. Should you have any questions regarding this letter, please contact or me at 312-786-7576.

Sincerely,

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cc: Tina Barry, Division of Trading and Markets, SEC
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