

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-80421; File No. SR-CBOE-2017-029)

April 10, 2017

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to the Automated Improvement Mechanism and the Solicitation Auction Mechanism

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 31, 2017, 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 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 the Substance of the Proposed Rule Change

The Exchange proposes to reduce the order handling and exposure periods of the Exchange’s Automated Improvement Mechanism (“AIM”) and Solicitation Auction Mechanism (“SAM”). The text of the proposed rule change is available on the Exchange’s website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission’s Public Reference Room.

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 these statements may be examined at the places specified in

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

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

1. Purpose

The purpose of the proposed rule change is to reduce the order handling and exposure periods contained in Rules 6.74A and 6.74B from 1 second to a time period designated by the Exchange of no less than 100 milliseconds and no more than 1 second.

Rule 6.74A contains the requirements applicable to the execution of orders using AIM. AIM allows the Exchange's Trading Permit Holders ("TPHs") to electronically cross orders on the Exchange's Hybrid Trading System ("Hybrid"). Specifically, AIM allows TPHs to designate certain customer orders for price improvements and submit such orders into AIM with a matching facilitated or solicited contra order. Once the order is properly submitted, the Exchange commences an auction by broadcasting a message to all TPHs who have elected to receive AIM Request for Responses ("RFRs"). The RFR includes size and side of the order. Orders entered into AIM are currently exposed for a period of 1 second, giving an opportunity for additional trading interest to be entered before the orders are automatically executed. Agency orders entered into AIM must be for 50 standard contracts or 500 mini-option contracts or more.

Rule 6.74B contains the requirements applicable to the execution of orders using SAM. SAM allows TPHs to cross large all-or-none orders on Hybrid. Specifically, SAM allows TPHs to designate certain customer orders as all-or-none for price improvements and submit such orders into SAM with a matching solicited contra order. Once the order is properly submitted, the Exchange commences an auction by broadcasting a message to all TPHs who have elected to receive SAM RFRs. The RFR includes size and side of the order. Orders entered into SAM are

currently exposed for a period of 1 second, giving an opportunity for additional trading interest to be entered before the orders are automatically executed. Agency orders entered into SAM must be for 500 standard contracts or 5000 mini-option contracts or more.

Under the proposal, the Exchange could reduce the exposure period for AIM and SAM to no less than 100 milliseconds (but no more than 1 second) consistent with the exposure periods permitted on other Exchanges such as NASDAQ BX (“BX”), NASDAQ PHLX (“Phlx”) and the International Securities Exchange (“ISE”)³.

In adopting the current 1-second exposure period for both AIM and SAM, the Exchange recognized that TPHs had become automated to the point that they could react to these orders electronically within that timeframe. In this context, the Exchange recognizes that it is in all TPHs’ best interest to minimize the exposure period to a time frame that continues to allow adequate time for the TPHs to electronically respond, as both the order being exposed and the TPHs responding are subject to market risk during the exposure period. In this respect, our experience with the 1 second exposure period indicates that 100 milliseconds would provide an adequate response time.⁴ Indeed, most TPHs either respond to RFRs within a much smaller time

³ See Securities Exchange Act Release No. 76301 (October 29, 2015), 80 FR 68347 (November 4, 2015) (SR-BX-2015-032); Securities Exchange Act Release No. 77557 (April 7, 2016), 81 FR 21935 (April 13, 2016) (SR-PHLX-2016-40) and Securities Exchange Act Release No. 79733 (January 4, 2017), 82 FR 3055 (January 10, 2017) (SR-ISE-2016-26).

⁴ The Exchange has numerous TPHs that have the capability and do opt to respond within a 100 millisecond exposure period or less on its Hybrid trading platform. In this regard, the Exchange notes that it has other Hybrid electronic exposure mechanisms for which the applicable timers are currently set at 100 milliseconds or less and provide for an adequate response time. For example, the response timer for the Exchange’s Hybrid Agency Liaison (“HAL”), Complex Order Auction (“COA”), and Simple Auction Liaison (“SAL”) mechanisms are currently set at 100 milliseconds or less and numerous TPHs can and do opt to respond to HAL, SAL, and COA messages within these time frames. The Exchange believes that our experience with the HAL, SAL, and COA mechanisms supports our view that 100 milliseconds is sufficient time for TPHs to

window. This is best evidenced by a review of responses to the Exchange's HAL auction, which awards the trade to the first responder at the NBBO price. Within HAL, 99.8% of the traded responses are received in 3 milliseconds or less. The COA auction is also configured with an auction timer of 100 milliseconds, meaning that all traded responses are received during that interval. Accordingly, the Exchange does not believe it is necessary or beneficial to the orders being exposed to continue to subject them to market risk for a full second.

TPHs who initiate AIM or SAM auctions ("Initiating TPH") are required to guarantee an execution at the National Best Bid/Offer ("NBBO") or a better price and are subject to market risk while the order is exposed in AIM or SAM. While responding TPHs are also subject to market risk, the Initiating TPH is the most exposed because the market can move against them during the entire auction period and they have guaranteed the customer an execution at the NBBO or better based on market prices prior to the commencement of the auction. In today's fast paced markets, large price changes can occur in 1 second or less, leaving Initiating TPHs vulnerable to trading losses as a result of their choice to seek price improvement for their customer. The Initiating TPH acts in a critical role in the price improvement process, and its willingness to guarantee the customer an execution at the NBBO or better price is essential to the customer order gaining the opportunity for price improvement.

When approving the existing 1 second order handling and exposure period for AIM and SAM, the Commission concluded that reducing each of the exposure periods from 3 seconds to 1

respond to CBOE's AIM and SAM mechanisms which operate on the Hybrid Trading System and employ the same type of mechanical messaging as the HAL, SAL, and COA mechanisms. The Exchange also notes that any delay or latency associated with submitting responses to an AIM or SAM auction would be the same as responding to HAL, SAL, or COA because all such responses are processed over the same network. Further, CBOE has received no complaints from TPHs concerning the current 100 millisecond timer on the COA mechanism and the current 20 millisecond timers on the HAL and SAL mechanisms.

second could facilitate the prompt execution of orders, while continuing to provide the TPHs in Hybrid with an opportunity to compete for exposed bids and offers.⁵ Continuing on that same logic, the Exchange believes that reducing its AIM and SAM order handling and exposure periods from 1 second to no less than 100 milliseconds will benefit TPHs. Since TPHs react to these orders electronically, and often opt to respond at the beginning or the end of the 1 second period, the Exchange believes that having the flexibility to reduce the time periods will continue to provide TPHs with sufficient time to ensure effective interaction with orders.⁶ At the same time, this flexibility will allow the Exchange to provide investors and other TPHs with more timely executions, thereby reducing their market risk.

This shortened exposure period is fully consistent with the electronic nature of Hybrid. TPHs have electronic systems available that would allow them to respond in a meaningful way within the proposed timeframe. The Exchange anticipates that TPHs will continue to compete within the proposed auction duration designated by the Exchange.

The Exchange will continue to provide TPHs with sufficient time to respond, compete, and provide price improvement for orders. Although the Exchange currently plans to reduce the time period allowed to respond to AIM and SAM to 100 milliseconds, the Exchange believes it is appropriate to provide the flexibility to choose a response period of up to 1 second as this is consistent with the Rules of other options markets.⁷

⁵ See Securities Exchange Act Release No. 58088 (July 2, 2008), 73 FR 39747 (July 10, 2008) (SR-CBOE-2008-016).

⁶ The Exchange believes that the proposed timeframe would give TPHs sufficient time to respond, compete and provide price improvement for orders. The Exchange also notes that electronic systems are readily available to, if not already in place for, TPHs that allow them to respond in a meaningful way within the proposed timeframe.

⁷ See supra note 1.

To substantiate that TPHs can receive, process and communicate a response to an auction broadcast within 100 milliseconds, the Exchange surveyed its top 15 AIM and SAM responders. The Exchange received responses from all of the TPHs surveyed and each TPH confirmed that they can receive, process and communicate a response back to the Exchange within 100 milliseconds.

Also in consideration of this proposed rule change, the Exchange reviewed all responses that resulted in traded orders in December 2016. This review of both AIM and SAM responses indicated that approximately 63% of AIM responses and 63% of SAM responses that resulted in price improving executions at the conclusion of the auction occurred within 100 milliseconds of the initial order. In addition to the 63% of AIM responses and 63% of SAM responses that occur within 100 milliseconds of the initial order, approximately 20% of AIM responses and 15% of SAM responses that resulted in price improving executions at the conclusion of the auction occurred in the final 800-1000 milliseconds (i.e. within 200 milliseconds of the end of the RFR). The timing of these responses indicates that TPHs have configured their trading systems to either respond immediately to an AIM or SAM auction or to wait until the end of an auction period to reduce the risk of the market moving.

Accordingly, the Exchange believes that an auction time as low as 100 milliseconds will continue to provide TPHs with sufficient time to respond to, compete for, and provide price improvement for orders, and will provide investors and other market participants with more timely executions, and reduce their market risk. Moreover, Rule 6.74A(b) provides that only one AIM 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. As a result, TPHs may be unable to initiate AIM auctions on behalf of their customers. Reducing the auction time to 100 milliseconds will decrease the likelihood that an

auction is underway when a customer order is received. Accordingly, the Exchange believes it is less likely that an auction attempt would be blocked due to another auction being in progress if the timer were to be reduced.

The Exchange believes that the information outlined above regarding price improving transactions in AIM and SAM and the feedback provided by TPHs provides substantial support for its assertion that reducing the auction 1 second to as low as 100 milliseconds will continue to provide TPHs with sufficient time to ensure competition for orders entered into AIM and SAM and could provide customers with additional opportunities for price improvements.

With regard to the impact of this proposal on system capacity, the Exchange has analyzed its capacity and represents that it has the necessary systems capacity to handle the potential additional traffic associated with the additional transactions that may occur with the implementation of the proposed reduction in the AIM and SAM duration to no less than 100 milliseconds. Additionally, the Exchange represents that its systems will be able to sufficiently maintain an audit trail for order and trade information with the reduction in the AIM and SAM duration.

Upon effectiveness of the proposed rule change, and at least six weeks prior to implementation of the proposed rule change, the Exchange will issue a circular to TPHs, informing them of the implementation date of the reduction of the AIM and SAM duration from 1 second to the auction time designated by the Exchange to allow TPHs to perform any necessary systems changes. The Exchange also represents that it will issue a circular at least four weeks prior to any future changes, as permitted by its rules, to the auction time.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the

Exchange and, in particular, the requirements of Section 6(b) of the Act.⁸ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁹ requirements that the rules of an exchange be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to foster cooperation and coordination with persons engaged in regulating, clearing, settling, processing information with respect to, and facilitating transactions in securities, to 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. Additionally, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁰ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the proposed rule change will provide investors with more timely execution of their options orders, while ensuring there is adequate exposure of orders in AIM. Additionally, the proposed rule change will allow more investors the opportunity to receive price improvement through AIM and SAM, and will reduce the market risk for TPHs using AIM and SAM. Finally, as mentioned above, other options exchanges, such as the BX, Phlx, and ISE, have already amended their rules to permit response times consistent with those proposed here.¹¹ As such, the Exchange believes the proposed rule change would help perfect the mechanism for a free and open national market system and generally help protect investors' and the public's interest.

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

¹⁰ Id.

¹¹ See note 1 supra.

The Exchange believes the proposed rule change is not unfairly discriminatory because the AIM and SAM duration would be the same for all TPHs. All TPHs who have elected to participate in AIM and SAM auctions have today, and will continue to have, an equal opportunity to receive and respond to AIM and SAM messages. Additionally, CBOE believes the reduction in the AIM and SAM duration reduces the market risk for all TPHs using AIM and SAM. The reduction in time period reduces the market risk for the Initiating TPH as well as any TPHs providing orders in response to an AIM and SAM auction. Moreover, based on the feedback the Exchange received from its TPHs, the Exchange believes that a reduction in the RFR period to a minimum of 100 milliseconds would not impair TPHs' ability to compete in the AIM and SAM. The Exchange believes these results support the assertion that a reduction in the AIM and SAM duration would not be unfairly discriminatory and would benefit investors.

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. The proposed rule change is not designed to address any aspect of competition, but instead would continue to provide market participants with sufficient time to respond, compete, and provide price improvement for orders entered into AIM and SAM. The proposed rule also provides investors and other market participants with more timely executions, thereby reducing their market risk. As proposed, the rule does not impose an undue burden on competition because TPHs who elect to participate in AIM and SAM are capable of responding to the RFR in under 100 milliseconds (based on the recent TPH survey, review of auction responses, and shorter response periods in other auction mechanisms available on the Exchange, as discussed above). Finally, the proposed rule change offers the same exposure period to all TPHs and would not impose a competitive burden on any particular participant.

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 proposed rule change.

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 up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange 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-2017-029 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2017-029. 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, D.C. 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such 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-2017-029, 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.¹²

Eduardo A. Aleman
Assistant Secretary

¹² 17 CFR 200.30-3(a)(12).