

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66048; File No. SR-CBOE-2011-116)

December 23, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to its Automated Improvement 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 December 14, 2011, the 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 amend its rules relating to its Automated Improvement Mechanism (“AIM”). The text of the proposed rule change is available on the Exchange’s Web site (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange’s Office of the Secretary, and at the Commission.

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

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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

1. Purpose

The purpose of the proposed rule change is to amend CBOE Rule 6.74A to (i) allow Trading Permit Holders (“TPHs”) to enter orders they represent as agent (“Agency Orders”) for fewer than 50 contracts into AIM at the national best bid or offer (“NBBO”); (ii) eliminate the requirement that there be at least three market-makers quoting in the relevant series in order for an AIM auction (“Auction”) to commence; (iii) allow TPHs that initiate an Auction (“Initiating TPHs”) to designate a limit price if it elects to automatically match the price and size of all Auction responses (“auto-match”); and (iv) eliminate the restriction that only market-makers with an appointment in the relevant option class may submit responses to a Request for Responses (“RFR”) for an Agency Order in an Auction.

This proposed rule change would make AIM more similar to current rules of the Boston Options Exchange Group, LLC (“BOX”)³ and the International Securities Exchange, LLC (“ISE”)⁴ relating to the Price Improvement Period (“PIP”) and Price Improvement Mechanism (“PIM”), respectively, which are automated price improvement mechanisms.⁵

AIM allows a TPH to submit an Agency Order along with a contra-side second order (a principal order or a solicited order for the same size as the Agency Order) into an Auction where other participants could compete with the Initiating TPH’s second order to execute against the

³ See BOX Rules Chapter V, Section 18.

⁴ See ISE Rule 723.

⁵ AIM, PIP and PIM have certain characteristics in common with each other. All three mechanisms (a) provide for the opportunity for customer price improvement, (b) have certain periods where the initial orders are exposed for potential price improvement, (c) have certain guidelines regarding the types of orders that may be eligible for price improvement, and (d) have certain defined rules related to the allocation of trades within price improvement auctions.

Agency Order, which guarantees that the Agency Order will receive an execution. Once an Auction commences, the Initiating TPH cannot cancel it.⁶

Under this proposal, Agency Orders of all sizes submitted to AIM will be guaranteed execution at a price at least as good as the NBBO while providing the opportunity for execution at a price better than the NBBO. The proposal will incent more TPHs to initiate and participate in Auctions and will allow even broader participation in Auctions by all types of market participants. As a result, CBOE expects the proposal will increase the number of and participation in Auctions, which would enhance competition in the Auctions. The Exchange believes that this proposal will ultimately provide additional opportunities for price improvement over the NBBO for its customers.

Elimination of Entry Price Restriction on Agency Orders for Fewer than 50 Contracts

CBOE Rule 6.74A(a)(2) and (3) currently provides that if an Initiating TPH submits an Agency Order to AIM for 50 contracts or more, the Initiating TPH must enter its contra-side second order (or stop the Agency Order) at the better of the NBBO or the Agency Order's limit price (if the order is a limit order); however, if an Initiating TPH submits an Agency Order to AIM for fewer than 50 contracts, the Initiating TPH must stop the entire Agency Order at the better of the NBBO price improved by one minimum price improvement increment or the Agency Order's limit price (if the order is a limit order). The Exchange is proposing to eliminate this distinction and allow Initiating TPHs to submit to AIM Agency Orders of any size at the NBBO.

The Exchange believes this proposal will increase the likelihood that TPHs will initiate Auctions for Agency Orders for fewer than 50 contracts because the TPHs will only be required

⁶ See CBOE Rule 6.74A(b)(1)(A).

to guarantee an execution at the NBBO, which will provide additional customer orders with an opportunity for price improvement over the NBBO. The Exchange believes the proposal will also encourage increased participation in AIM by TPHs willing to trade with an Agency Order for fewer than 50 contracts at the NBBO but not better than the NBBO.

In support of this proposal, the Exchange notes that both BOX⁷ and ISE⁸ allow entry of orders into PIP and PIM, respectively, at the NBBO without distinguishing between orders of more than or fewer than 50 contracts. Because BOX and ISE are currently able to offer their customers price improvement for orders of fewer than 50 contracts at the NBBO in PIP and PIM, respectively, the Exchange has determined that it is important for competitive purposes that it be able to offer the same opportunities to its customers for price improvement on CBOE through AIM.

The Exchange notes that certain allocation differences exist between AIM and PIM as well as AIM and PIP. As proposed, our AIM change would make the handling of AIM trades for 50 or more contracts consistent with AIM trades under 50 contracts.⁹ However, unlike PIM, which requires auctions to commence at prices better than the ISE best bid or offer and thus precludes an auction initiator from establishing priority ahead of any resting ISE interest, an AIM Auction can begin and conclude at the CBOE best bid or offer. This means that, like for

⁷ See supra note 3; see also Securities Exchange Act Release No. 34-59654 (March 30, 2009), 74 FR 15551 (April 6, 2009) (SR-BX-2009-08) (order approving proposed rule change allowing entry of orders into PIP at the NBBO when BOX's best bid or offer is inferior to the NBBO with no order size distinction).

⁸ See supra note 4; see also Securities Exchange Act Release No. 34-57847 (May 21, 2008), 73 FR 30987 (May 29, 2008) (SR-ISE-2008-29) (order approving proposed rule change allowing entry of orders into PIM at the NBBO when ISE's best bid or offer is inferior to the NBBO with no order size distinction).

⁹ PIP and PIM also do not distinguish between orders over 50 contracts and orders under 50 contracts.

orders of 50 or more contracts on CBOE, the Initiating TPH can trade at a price in which resting interest existed and can establish priority over resting broker-dealer interest. Although PIP allows auctions to occur at the BOX best bid or offer, PIP uses an order allocation structure based on price-time priority sequence with priority for public customer orders (like CBOE) and secondary priority for non-BOX Participant broker-dealers. On CBOE, when an Auction concludes at the CBOE best bid or offer, first priority is for public customers, second priority is for the Initiating TPH (for 40%), third priority is for nonpublic customer resting orders or quotes that are unchanged from when the Auction began, and last priority is for RFR responses. The Exchange references these differences for informational purposes but does not believe that the differences are material to the Exchange's goals of handling AIM orders of all sizes the same and allowing Auctions of orders smaller than 50 contracts at the NBBO (like PIP and PIM).

The Exchange further notes that certain components of AIM were approved on a pilot basis, including that there is no minimum size requirement for orders to be eligible for the Auction.¹⁰ The Commission has approved six one-year extensions to the pilot programs, most recently until July 18, 2012.¹¹ In connection with the pilot programs, the Exchange has submitted, and will continue to submit, to the Commission reports providing detailed AIM Auction and order execution data, including monthly data regarding executions through AIM of Agency Orders for more or fewer than 50 contracts, as supporting evidence that, among other things, there is meaningful competition for all size orders.

¹⁰ See Securities Exchange Act Release No. 53222 (February 3, 2006), 71 FR 7089 (February 10, 2006) (SR-CBOE-2005-60) (order approving implementation of AIM).

¹¹ See Securities Exchange Act Release Nos. 34-54147 (July 14, 2006), 71 FR 41487 (July 21, 2006) (SR-CBOE-2006-64); 56094 (July 18, 2007), 72 FR 40910 (July 25, 2007) (SR-CBOE-2007-80); 58196 (July 18, 2008), 73 FR 43803 (July 28, 2008) (SR-CBOE-2008-76); 60338 (July 17, 2009), 74 FR 36803 (July 24, 2009) (SR-CBOE-2009-51); 62522 (July 16, 2010), 75 FR 43596 (July 26, 2010) (SR-CBOE-2010-67); and 34-64930 (July 20, 2011), 76 FR 44636 (July 26, 2011) (SR-CBOE-2011-66).

Elimination of Three Market-Maker Requirement

CBOE Rule 6.74A(a)(4) currently requires that there be at least three market-makers quoting in the relevant series for an Auction to commence. The Exchange is proposing to eliminate this requirement. The Exchange does not believe that customer orders should be denied the benefits of AIM simply because there may be less than three market-makers quoting in a relevant options class at a specific point in time. Any concern regarding an Auction starting with a lower number of market-makers quoting in a relevant series is offset by the broad participation and competition that would be present once an Auction commenced.

In support of this proposal, the Exchange notes that both PIP¹² and PIM¹³ permit auctions to commence without the condition that there be a minimum number of market-makers quoting in the particular series. The Exchange believes that AIM, and in turn the customers that benefit from AIM, would be disadvantaged if the three market-maker requirement remained as a condition to start an Auction because this requirement potentially reduces the number of Auctions and, as a result, opportunities for price improvement. Because BOX and ISE are currently able to offer their customers price improvement without a minimum quoter requirement in PIP and PIM, respectively, the Exchange believes it is essential for competitive purposes that it be able to offer the same opportunities for price improvement on CBOE through AIM.

Addition of Option to Designate Auto-Match Limit Price

¹² See supra note 3; see also Securities Exchange Act Release No. 34-58999 (November 21, 2008), 73 FR 72536 (November 28, 2008) (SR-BSE-2008-54) (order approving proposed rule change to eliminate requirement that there be at least three market-makers quoting in the relevant series for an auction to commence).

¹³ See supra note 4; see also Securities Exchange Act Release No. 34-58710 (October 1, 2008), 73 FR 59008 (October 8, 2008) (SR-ISE-2008-63) (order approving proposed rule change to eliminate requirement that there be at least three market-makers quoting in the relevant series for an auction to commence).

CBOE Rule 6.74A(b)(1)(A) currently allows an Initiating TPH to enter its contra-side second order in one of two formats: (1) a specified single price; or (2) a non-price specific commitment to auto-match all Auction responses achieved during the Auction. In this case, the Initiating TPH would have no control over the match price. The Exchange is proposing to provide Initiating TPHs with the additional option to auto-match competing prices from other market participants up to a designated limit price. The Initiating TPH will still not be able to cancel the auto-match instruction after an Auction commences and will have no control over the prices at which it receives an allocation of the Auction other than the outside boundary established by the designated limit price.

The Exchange notes that when the Initiating TPH selects the auto-match feature prior to the start of an Auction (with or without a designated limit price), the available liquidity at improved prices is increased and competitive final pricing is out of the Initiating TPH's control. The Exchange believes the proposal will encourage increased participation in AIM because it allows TPHs willing to trade with an Agency Order at a price better than the NBBO, but only up to a certain price, to initiate an Auction.

In support of this proposal, the Exchange also notes that both PIP¹⁴ and PIM¹⁵ permit initiating participants to elect to auto-match up to a designated limit price. The Exchange believes that AIM, and in turn the customers that benefit from AIM, would be disadvantaged if TPHs are not provided with the option to auto-match up to a designated limit price because this

¹⁴ See supra note 3; see also Securities Exchange Act Release No. 34-61805 (March 31, 2010), 75 FR 17454 (April 6, 2010) (SR-BX-2010-22) (order approving implementation of auto-match feature with the option to auto-match up to a designated limit price).

¹⁵ See supra note 4; see also Securities Exchange Act Release No. 34-62644 (August 4, 2010), 75 FR 48395 (August 10, 2010) (SR-ISE-2010-61) (order approving implementation of auto-match feature with the option to auto-match up to a designated limit price).

lack of flexibility reduces the number of Auctions and, as a result, opportunities for price improvement. Because BOX and ISE currently allow initiating participants or members, respectively, the option to auto-match up to the NBBO achieved during an auction or up to a designated limit price, the Exchange believes it is important for competitive purposes that it be able to offer the same opportunities for price improvement on CBOE through AIM.

The Exchange will provide the Commission with the following data: (1) the percentage of trades effected through AIM in which the Initiating TPH submitted an Agency Order with an auto-match instruction that included a designated limit price and the percentage that did not include a designated limit price; and (2) the average amount of price improvement provided to AIM Agency Orders when the Initiating TPH submitted an auto-match instruction that included a designated limit price and the average amount that did not include a designated limit price, versus the average amount of price improvement provided to AIM Agency Orders when the Initiating TPH submitted a single price (no auto-match instruction).

After effectiveness of the proposal, and at least one week prior to implementation of the rule change, CBOE will issue a notice to TPHs informing them of the implementation of the additional auto-match feature. This will give TPHs an opportunity to make any necessary modifications to coincide with the implementation date.

Elimination of Relevant Option Class Restriction

CBOE Rule 6.74A(b)(1)(D) currently provides that only market-makers with an appointment in the relevant option class may submit responses to an RFR in an Auction. The Exchange is proposing to eliminate this restriction and allow all TPHs that receive an RFR to submit responses in an Auction. The Exchange notes that the elimination of this restriction will allow for broader participation in Auctions by all types of market participants (e.g. public

customers, broker-dealers and market-makers). This broader participation will increase competition in Auctions because more market participants will be able to submit responses to RFRs, which responses may result in better prices for customers.

In support of this proposal, the Exchange notes both PIP¹⁶ and PIM¹⁷ permit all participants and members, respectively, to submit competing prices in an auction. The Exchange believes that the elimination of the restriction on which TPHs may compete in an Auction would increase the opportunities for all types of market participants to participate in AIM and submit price responses, leading to more robust competition in AIM

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to a national securities exchange and, in particular, the requirements of Section 6(b) of the Act¹⁸. Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁹ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest.

¹⁶ See supra note 3; see also Securities Exchange Act Release No. 34-51651 (May 3, 2005), 70 FR 24848 (May 11, 2005) (SR-BSE-2005-01) (order approving proposed rule change to eliminate certain restrictions on the ability of certain market participants to participate in PIP).

¹⁷ See supra note 4; see also Securities Exchange Act Release No. 34-50819 (December 8, 2004), 69 FR 75093 (December 15, 2004) (SR-ISE-2003-06) (order approving proposed rule change to implement PIM without a restriction on which members may submit auction responses).

¹⁸ 15 U.S.C. 78f(b).

¹⁹ 15 U.S.C. 78f(b)(5).

In particular, the Exchange believes this proposed rule change is a reasonable modification designed to provide additional flexibility for TPHs to obtain executions on behalf of their customers while continuing to provide meaningful, competitive Auctions. The Exchange also believes that the proposed rule change will increase the number of and participation in Auctions, which will ultimately enhance competition in the AIM Auctions and provide customers with additional opportunities for price improvement. These changes are consistent with changes made by other exchanges and they serve to remove impediments to and to perfect the mechanism for a free and open market and a national market system.

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

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

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

No written comments were solicited or received with respect to 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 (i) as the Commission may designate up to 90 days of such date if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will: (A) by order approve or disapprove such proposed rule change, or (B) institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an e-mail to rule-comments@sec.gov. Please include File Number SR-CBOE-2011-116 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-2011-116. 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 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 CBOE. 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-2011-116, 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.²⁰

Kevin M. O'Neill
Deputy Secretary

²⁰ 17 CFR 200.30-3(a)(12).