

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77511; File No. SR-CBOE-2016-024)

April 4, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to AIM Retained Orders

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 22, 2016, 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. On April 1, 2016, the Exchange filed Amendment No. 1 to the proposal. On April 4, 2016, the Exchange filed Amendment No. 2 to the proposal.³ The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of the Terms of Substance of the Proposed Rule Change

The 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.

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ In Amendment No. 2, which superseded Amendment No. 1 in its entirety, the Exchange proposed changes to amend the proposed rule text of Interpretation and Policy .08 to Rule 6.53C in Exhibit 5 to include references to Rule 6.74A when referring to proposed Interpretation and Policy .09 to Rule 6.74A.

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 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 Exchange proposes to amend Rule 6.74A (Automated Improvement Mechanism ("AIM")) to clarify how orders submitted for electronic crossing into the AIM auction are treated if an auction cannot occur, to adopt Interpretation and Policy .09 to Rule 6.74A (AIM Retained Order Functionality) to describe the Exchange's AIM Retained Order ("A:AIR") functionality in the Rules, and make minor edits to Interpretation and Policy .08 to Rule 6.53C (Price Check Parameters) relating to the treatment of complex AIM orders marked A:AIR and correct certain typographical errors.

Under Rule 6.74A (Automated Improvement Mechanism ("AIM")), a Trading Permit Holder ("TPH") that represents agency orders may electronically execute an order it represents as agent ("Agency Order") against principal interest or against a solicited order provided it submits the Agency Order for electronic execution into the AIM auction ("Auction") for processing. Matched Agency Orders may be processed via AIM subject to certain eligibility requirements contained in Rule 6.74A(a). Specifically, to be eligible for processing via AIM, the Agency Order must be: (1) in a class designated as eligible for Auctions and within the

designated eligibility size parameters as determined by the Exchange; (2) stopped with a principal or solicited order priced at the national best bid or offer (“NBBO”) (if 50 standard option contracts or 500 mini-option contracts or greater) or one cent/one minimum increment better than the NBBO (if less than 50 standard option contracts or 500 mini-option contracts); and (3) submitted in a series in which at least three Market-Makers are quoting if submitted during regular trading hours.⁴ Orders submitted for crossing into AIM, which are ineligible for Auction processing will result in both the Agency Order and the matching contra order(s) being cancelled.

A:AIR functionality is an enhancement to AIM that allows TPHs the flexibility to choose, on an order-by-order basis, whether an Agency Order should continue into the Hybrid Trading System⁵ for processing rather than cancel in the event that an Auction cannot occur.⁶

A:AIR functionality essentially allows for the entry of Agency Orders into AIM with contingency processing instructions for handling in the event that the order cannot be processed via Auction. For example, using the A:AIR functionality, a TPH might submit a matched Agency Order for 50 standard contracts that is stopped with a principal interest or solicited order priced outside of the NBBO and into AIM. In such a case, the order would not initiate an

⁴ See Rule 6.74A(a).

⁵ The Hybrid Trading System refers to the Exchange’s trading platform as defined in Rule 1.1(aaa) (Hybrid Trading System).

⁶ There are a variety of circumstances in which an AIM order may be submitted to the Exchange for processing, but an auction may not occur. For example, TPH may submit an order for AIM processing, which is not AIM eligible because one or more of the conditions required for an AIM auction to occur pursuant to Rule 6.74A(a) is not present. In addition, an order that is otherwise AIM eligible may not be able to process for a variety of reasons, including, but not limited to circumstances in which AIM functionality is suspended. In either of such cases, A:AIR functionality may allow the Agency Order to process despite the overall order not being AIM eligible.

auction (as the eligibility requirement in Rule 6.74A(a)(2) would not be met),⁷ but would continue into the Hybrid Trading System and be booked at the Agency Order limit price (rather than cancelled if A:AIR functionality were not used) and the contra order would be cancelled.

The Exchange notes that A:AIR functionality is currently available for use on the Exchange and is referred to in the Rules (although not using that term)⁸ and explained in various Information and Regulatory Circulars.⁹ A:AIR functionality, however, is not explicitly defined in the Rules. Accordingly, this filing is intended to further codify, clarify, and describe A:AIR functionality in the Rules. Specifically, the Exchange proposes to adopt Interpretation and Policy .09 to Rule 6.74A (AIM Retained Order Functionality), under which the Exchange would define an AIM Retained Order as the transmission of two or more orders for crossing pursuant to Rule 6.74A, with the Agency Order priced at the market or a limit price in the standard increment for the option series and marked with a contingency instruction to route the Agency Order for processing and cancel any contra orders if an Auction cannot occur (including if the conditions described in Rule 6.74A(a) are not met).

Furthermore, to ensure that A:AIR orders are properly priced to allow the Exchange to book the Agency Order in the event an Auction cannot occur, proposed Interpretation and Policy .09 to Rule 6.74A would provide that orders marked "A:AIR" with Agency Orders that are not priced at the market or that are priced with a limit price not in the standard increment for the option series in which they are entered would be cancelled. For example, if a TPH were to

⁷ See Rule 6.74A(a).

⁸ See Interpretation and Policy .08 to Rule 6.53C (Price Check Parameters) at paragraphs (c)(5), (d), (f)(2), and (g)(4) referring to orders that instruct the System to process the Agency Order as an unpaired order if an AIM Auction cannot be initiated.

⁹ See, e.g., Regulatory Circular RG13-053 (Limit Up-Limit Down Order Handling); Regulatory Circular RG13-009 (AIM Primary Order Allowed in Penny Increments); Information Circular IC07-62 (Automated Improvement Mechanism (AIM)).

submit a matched Agency Order into AIM for processing in a class with a minimum increment of a nickel, which was stopped with a contra order at \$0.07, both the Agency Order and the contra order would be cancelled because the order, which is not priced in the minimum increment for the class, would not be eligible for AIM processing and because the System would not be able to book an order at \$0.07 in a class with a minimum increment of a nickel. Notably, this provision of proposed Interpretation and Policy .09 to Rule 6.74A is consistent with previous descriptions of A:AIR functionality by the Exchange and Exchange rules that only permit orders at the standard increment to enter the book.¹⁰ Finally, proposed Interpretation and Policy .09 to Rule 6.74A would provide that A:AIR order functionality will be made available on those order management platforms as determined by the Exchange and announced via Regulatory Circular. This provision is intended to make clear that A:AIR functionality may not be available on all trading platforms in use on the Exchange.¹¹

The Exchange also notes that although orders submitted into AIM, which are not marked A:AIR and are ineligible for Auction processing will result in both the Agency Order and the matching contra order(s) being cancelled, the Rules do not explicitly provide as much. Accordingly, the Exchange proposes to add language to Rule 6.74A(a) to provide that in the event that a Trading Permit Holder submits a matched Agency Order for electronic execution into the Auction that is ineligible for processing because it does not meet the conditions

¹⁰ See Regulatory Circular RG13-009 (AIM Primary Order Allowed in Penny Increments); see also Rule 6.42.

¹¹ A:AIR functionality is not currently supported on Floor Broker Workstation (“FBW”), FBW2, or the PULSe trader workstation. FBW, FBW2, and PULSe are order handling tools used for manual handling of orders. Thus, when ineligible AIM orders are rejected back to FBW, FBW2, and PULSe users, a person is present to decide how best to handle such orders. FBW, FBW2, and PULSe users can either re-route such orders to be booked or for alternative electronic processing on the Exchange or to their broker on the floor of the Exchange.

described in paragraph (a), both the Agency Order and any solicited contra orders will be cancelled unless marked as an AIM Retained order pursuant to proposed Interpretation and Policy .09 to Rule 6.74A.¹²

The Exchange also proposes to make minor changes to Interpretation and Policy .08 to Rule 6.53C regarding price reasonability checks on complex orders to harmonize references to A:AIR functionality in Rule 6.53C with the language in proposed Interpretation and Policy .09 to Rule 6.74A. Specifically, the Exchange proposes to modify Interpretation and Policy .08(c)(5), (d), (f)(2), and (g)(4) to Rule 6.53C (Price Check Parameters) to change references to AIM orders that instruct the System to process the Agency Order as an unpaired order if an AIM auction cannot be initiated, to instead refer to AIM Retained (“A:AIR”) orders as defined in proposed Interpretation and Policy .09 to Rule 6.74A. These changes are non-substantive and intended only to harmonize existing references to A:AIR functionality currently in the Rules with the definition of A:AIR orders set forth in proposed Interpretation and Policy .09 to Rule 6.74A. The proposed rule change also makes non-substantive changes in these paragraphs to capitalize the defined term Agency Order, consistent with Rule 6.74A.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of

¹² Notably, the A:AIR functionality is used primarily by smart router technology to ensure that ineligible AIM orders are submitted into the Hybrid Trading System for processing and not cancelled. Whereas traditional brokers and dealers are equipped to manually handle cancelled orders that are returned to them and may revise the cancelled orders’ terms or contact their customers for further instructions, smart routers are generally all electronic algorithmic systems that may not allow for manual handling of cancelled orders.

Section 6(b) of the Act.¹³ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)¹⁴ 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)¹⁵ requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

The proposed rule change seeks to provide additional clarity and completeness in the Rules regarding functionalities in use at the Exchange. The Exchange is continuously updating the Rules to provide additional detail, clarity, and transparency regarding its operations and trading systems. The Exchange believes that the adoption of detailed, clear, and transparent rules reduces burdens on competition and promotes just and equitable principles of trade. The Exchange also believes that A:AIR functionality is valuable enhancement to AIM, which provides the opportunity for execution of customer orders that a TPH submitted for crossing via AIM but cannot be executed via AIM and helps prevent inadvertent mishandling of Agency Orders (i.e. customer orders) submitted for Auction. The Exchange believes that these outcomes serve to protect investors' interests by helping to ensure that ineligible AIM Agency Orders are processed rather than cancelled. In addition, the Exchange believes that price improvement

¹³ 15 U.S.C. 78f(b).

¹⁴ 15 U.S.C. 78f(b)(5).

¹⁵ Id.

mechanisms promote competition amongst market participants and that enhancements to such price improvement mechanisms promote competition between exchanges. A:AIR functionality makes such mechanisms easier to use and minimizes the risk of order submitted into AIM being mishandled. Thus, the Exchange believes that the A:AIR functionality is an enhancement consistent with the purposes of the Act.

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

The Exchange 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 Exchange notes that price improvement mechanisms are widely used across the national options exchanges. The exchanges have developed these mechanisms in order to provide market participants diverse opportunities to seek valuable price improvement and as a means to compete with one another for order flow. Such price improvement mechanisms not only promote intermarket competition for order flow between the exchanges, but also intramarket competition between market participants competing for orders directly through the auction process.

Accordingly, the exchanges are continuously making enhancements and adding functionalities to their price improvement mechanisms in order to provide more competitive marketplaces for market participants and better compete with one another. A:AIR functionality is simply one of many enhancements that the Exchange has made to AIM for this purpose.

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 written 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, as modified by Amendment No. 2, 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-2016-024 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2016-024. 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-2016-024, 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.¹⁶

Robert W. Errett
Deputy Secretary

¹⁶ 17 CFR 200.30-3(a)(12).