

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-65438; File No. SR-CBOE-2011-087)

September 28, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Proposed Rule Change Related to Market-Wide Circuit Breakers

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”)¹ and Rule 19b-4 thereunder,² notice is hereby given that on September 27, 2011, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I and II, 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 Substance of the Proposed Rule Change

The Exchange proposes to amend Exchange Rule 6.3B to revise the current methodology for determining when to halt trading in all stock options trading on CBOE and in all stocks trading on the CBOE Stock Exchange, LLC (“CBSX,” the CBOE’s stock trading facility), due to extraordinary market volatility. The text of the rule proposal is available on the Exchange’s website (<http://www.cboe.org/legal>), 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 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 those statements may be examined at the places

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

specified in Item IV below. The Exchange has prepared summaries, set forth in sections A, B, and C below, of the most significant parts 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 its rules to revise the current methodology for determining when to halt trading in all stocks and stock options due to extraordinary market volatility. The Exchange is proposing this rule change in consultation with other equity, options, and futures markets, the Financial Industry Regulatory Authority, Inc. (“FINRA”), and staffs of the Commission and the Commodity Futures Trading Commission (“CFTC”).

Since May 6, 2010, when the markets experienced excessive volatility in an abbreviated time period, i.e., the “flash crash,” the exchanges and FINRA have implemented market-wide measures designed to restore investor confidence by reducing the potential for excessive market volatility. Among the measures adopted include pilot plans for stock-by-stock trading pauses³ and related changes to the stock market clearly erroneous execution rules⁴ and more stringent stock market maker quoting requirements.⁵ In addition, on April 5, 2011, the equities exchanges and FINRA filed a plan pursuant to Rule 608 of Regulation NMS to address extraordinary market volatility (the “Limit Up-Limit Down Plan”).⁶ As proposed, the Limit Up-Limit Down Plan is designed to prevent trades in individual NMS stocks from occurring outside specified price bands.

³ Exchange Rule 6.3C.

⁴ Exchange Rule 52.4.

⁵ Exchange Rules 53.23.01 and 53.56.01.

⁶ See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011).

The Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues (“Committee”) has recommended that, in addition to the initiatives already adopted or proposed, the markets should consider reforming the existing market-wide circuit breakers. Among other things, the Committee noted that the interrelatedness of today’s highly electronic markets warrants the need to review the present operation of the system-wide circuit breakers now in place. Specifically, the Committee recommended that the markets consider replacing the Dow Jones Industrial Average (“DJIA”) with the S&P 500® Index (“S&P 500”), revising the 10%, 20%, and 30% decline percentages, reducing the length of trading halts, and allowing halts to be triggered up to 2:30 p.m. (all times herein are Central).⁷

The exchanges and FINRA have taken into consideration the Committee’s recommendations, and with some modifications, have proposed changes to market-wide circuit breakers that the Exchange believes will provide for a more meaningful measure in today’s faster, more electronic markets, of when to halt stocks and stock options on a market-wide basis as a result of rapid market declines.

Background

The Exchange adopted its rule on market-wide trading halts in October 1988 as part of an effort by the securities and futures markets to implement a coordinated means to address

⁷ See Summary Report of the Committee, “Recommendations Regarding Regulatory Responses to the Market Events of May 6, 2010” (Feb, 18, 2011). The Exchange notes that CBOE submitted a comment letter to the Committee that recommended, among other things, reform of the market-wide circuit breaker rules. See Letter to Mary Schapiro, Chairman, Commission, and Gary Gensler, Chairman, CFTC, from Edward J. Joyce, President and Chief Operating Officer, CBOE (August 3, 2010). The proposed reforms set forth in this rule proposal differ slightly from the changes recommended in that comment letter, and represent consensus among the markets of how to address reform of the market-wide circuit breakers.

potentially destabilizing market volatility.⁸ The rule, currently reflected in Exchange Rule 6.3B, provides for market-wide halts in trading at specified levels in order to promote stability and investor confidence during a period of significant stress.⁹ As the Commission noted in the 1987 approval order, the rule was intended to enable market participants to establish an equilibrium between buying and selling interest and to ensure that market participants have an opportunity to become aware of and respond to significant price movements. Importantly, the market-wide circuit breakers were not intended to prevent markets from adjusting to new price levels; rather, they provide for a speed bump for extremely rapid market declines.¹⁰

In its current form,¹¹ the rule provides for Level 1, 2, and 3 declines and specified trading halts following such declines. The values of Levels 1, 2 and 3 are calculated at the beginning of each calendar quarter, using 10%, 20% and 30%, respectively, of the average closing value of the DJIA for the month prior to the beginning of the quarter. Each percentage calculation is rounded to the nearest fifty points to create the Levels' trigger points. The NYSE distributes new trigger levels quarterly to the media and via an NYSE Information Memo, and the new trigger

⁸ See Securities Exchange Act Release No. 26198 (Oct. 19, 1988).

⁹ Exchange Rule 6.3B does not currently contain any reference to the specific levels of decline in the DJIA that would trigger a market-wide trading halt. Instead, the rule was amended in 1997 to provide that a market-wide halt will be triggered on the Exchange whenever a market-wide halt is in effect on the New York Stock Exchange ("NYSE"). See Securities Exchange Act Release No. 38221 (January 31, 1997), 62 FR 5871 (February 7, 1997)(SR-CBOE-96-78).

¹⁰ See note 8, supra.

¹¹ The methodology for calculating market-wide trading halts was last amended in 1998, when declines based on specified point drops in the DJIA were replaced with the current methodology of using a percentage decline that is recalculated quarterly. See Securities Exchange Act Release No. 39846 (April 9, 1998), 63 FR 18477 (April 15, 1998) (SR-NYSE-98-06, SR-Amex-98-09, SR-BSE-98-06, SR-CHX-98-08, SR-NASD-98-27, and SR-Phlx-98-15).

levels are also available on the NYSE website.¹² The values then remain in effect until the next quarterly calculation, notwithstanding whether the DJIA has moved and a Level 1, 2, or 3 decline is no longer equal to an actual 10%, 20%, or 30% decline in the most recent closing value of the DJIA.

Once a market-wide circuit breaker is in effect, trading in all securities on the Exchange, including stock options on CBOE and stocks on CBSX, halt for the time periods specified below:

Level 1 Halt

anytime before 2:00 p.m. – one hour;

at or after 2:00 p.m. but before 2:30 p.m. – 30 minutes;

at or after 2:30 p.m. – trading shall continue, unless there is a Level 2 Halt.

Level 2 Halt

anytime before 1:00 p.m. – two hours;

at or after 1:00 p.m. but before 2:00 p.m. – one hour;

at or after 2:00 p.m. – trading shall halt and not resume for the rest of the day.

Level 3 Halt

at any time – trading shall halt and not resume for the rest of the day.

Proposed Amendments

As noted above, the Exchange, other equities, options, and futures markets, and FINRA propose to amend the market-wide circuit breakers to take into consideration the recommendations of the Committee, and to provide for more meaningful measures in today's markets of when to halt trading in all stocks and stock options. Accordingly, the Exchange proposes to amend Rule 6.3B as follows: (i) replace the DJIA with the S&P 500; (ii) replace the

¹² See, e.g., NYSE Regulation Information Memos 11-19 (June 30, 2011) and 11-10 (March 31, 2011).

quarterly calendar recalculation of Rule 6.3B triggers with daily recalculations: (iii) replace the 10%, 20%, and 30% market decline percentages with 7%, 13%, and 20% market decline percentages; (iv) modify the length of the trading halts associated with each market decline level; and (v) modify the times when a trading halt may be triggered. The Exchange believes that these proposed amendments update the rule to reflect today's high-speed, highly electronic trading market while still meeting the original purpose of the market-wide circuit breaker rules: to ensure that market participants have an opportunity to become aware of and respond to significant price movements.

First, the Exchange proposes to replace the DJIA with the S&P 500. The Exchange believes that because the S&P 500 is based on the trading prices of 500 stocks, as compared to the 30 stocks that comprise the DJIA, the S&P 500 represents a broader base of stocks against which to measure whether extraordinary market-wide volatility is occurring. In addition, as noted by the Committee, using an index that correlates closely with derivative products, such as the E-Mini and SPY, will allow for a better cross-market measure of market volatility.

Second, the Exchange proposes to change the recalculation of the trigger values from once every calendar quarter to daily. The Exchange believes that updating the trigger values daily will better reflect current market conditions. In particular, a daily recalculation will ensure that the percentage drop triggers relate to current market conditions, and are not compared to what may be stale market conditions. As noted in the proposed rule, the daily calculations of the trigger values will be published before the trading day begins.¹³

¹³ The Exchange and other markets will advise via Circular (or Trader Alert or similar notice) the specific methodology for publishing the daily calculations, as well as the manner by which the markets will halt trading in all stocks and stock options should a Rule 6.3B trading halt be triggered.

Third, the Exchange proposes to decrease the current Level 1, 2, and 3 declines of 10%, 20%, and 30% to a Level 1 Market Decline of 7%, a Level 2 Market Decline of 13%, and Level 3 Market Decline of 20%. In particular, as demonstrated by the May 6, 2010 flash crash, the current Level 1 10% decline may be too high a threshold before determining whether to halt trading across all securities. In fact, since adoption, the markets have halted only once, on October 27, 1997.¹⁴ Accordingly, to reflect the potential that a lower, yet still significant decline may warrant a market-wide trading halt, the Exchange proposes to lower the market decline percentage thresholds.

As further proposed, the Exchange would halt trading based on a Level 1 or Level 2 Market Decline only once per day. For example, if a Level 1 Market Decline were to occur and trading were halted, following the reopening of trading, the Exchange would not halt the market again unless a Level 2 Market Decline were to occur. Likewise, following the reopening of trading after a Level 2 Market Decline, the Exchange would not halt trading again unless a Level 3 Market Decline were to occur, at which point, trading in all stocks and stock options would be halted until the next trading day.

Fourth, to correspond with the lower percentages associated with triggering a trading halt, the Exchange also proposes to shorten the length of the market-wide trading halts associated with each Level. As proposed, a Level 1 or 2 Market Decline occurring after 8:30 a.m. and up to and including 2:25 p.m. or, in the case of an early scheduled close, 11:25 a.m., would result in a trading halt in all stocks and stock options for 15 minutes.

The Exchange believes that by reducing the percentage threshold, coupled with the reduced length of a trading halt, the proposed rule would allow for trading halts for serious

¹⁴ At that time, the triggers were based on absolute declines in the DJIA (350 point decrease for a Level 1 halt and 550 point decrease for a Level 2 halt).

market declines, while at the same time, would minimize disruption to the market by allowing for trading to continue after the proposed more-abbreviated trading halt. The Exchange believes that in today's markets, where trading information travels in micro-second speed, a 15-minute trading halt strikes the appropriate balance between the need to halt trading for market participants to assess the market, while at the same time reducing the time that the market is halted.

Finally, because the proposed Level 1 and Level 2 trading halts will now be 15 minutes, the Exchange proposes amending the rule to allow for a Level 1 or 2 Market Decline to trigger a trading halt up to 2:25 p.m. (or, in the case of an early scheduled close, 11:25 a.m.) Under the current rule, a trading halt cannot be triggered after 1:30 p.m., and this time corresponds to the need for the markets both to reopen following a 30-minute halt and to engage in a fair and orderly closing process. However, as the markets experienced on May 6, 2010, even if the Level 1 decline had occurred that day, because the market decline occurred after 1:30 p.m., it would not have triggered a halt under the current rule. The Committee recommended that trading halts be triggered up to 2:30 p.m. The Exchange agrees that the proposed amendments must strike the appropriate balance between permitting trading halts as late in the day as feasible without interrupting the closing process.

Accordingly, to accommodate certain existing exchange rules concerning closing procedures, including, for example, the publication of imbalance information beginning at 2:45 p.m. and the restrictions on entry and cancellation of market on close ("MOC") and limit on close ("LOC") orders after 2:45 p.m.,¹⁵ the Exchange proposes that the last Level 1 or Level 2 Market Decline trading halt should be 2:25 p.m. (or, in the case of an early scheduled close,

¹⁵ See, e.g., NYSE Rule 123C.

11:25 a.m.). The Exchange proposes 2:25 p.m. as the cut-off time so that there is time following the 15-minute trading halt for the markets to reopen before the 2:45 cut-off for entry and cancellation of MOC and LOC orders under exchange rules.

As with current Level 3 declines, under the proposed rule, a Level 3 Market Decline would halt trading for the remainder of the trading day, including any trading that may take place after 3:00 p.m., and would not resume until the next trading day.

In addition to these proposed changes, the Exchange proposes to add to Rule 6.3B how the markets will reopen following a 15-minute trading halt.¹⁶ For stocks, similar to the reopening procedures set forth in Rule 6.3C, the Exchange proposes that if a circuit breaker is initiated in all stocks, all markets will halt trading in those stocks until the primary listing market has resumed trading in the stock or notice has been provided by the primary listing market that trading may resume. As further proposed, if the primary listing market does not reopen a stock within 15 minutes following the end of the trading halt, other markets may resume trading in that stock. For options overlying stocks, similar to the reopening procedures set forth in Rule 6.3.06, the Exchange proposes that if a circuit breaker is initiated in all stocks, all markets will halt trading in the options on those stocks until the primary listing market has resumed trading in the stock or notice has been provided by the primary listing market that trading may resume. If the primary listing market does not reopen a stock within 15 minutes following the end of the trading halt, other markets may resume trading in the options on that stock if at least one market has resumed traded [sic] in the stock. For all other stock options, e.g., stock index options, the

¹⁶ Upon reopening, a rotation shall be held in each class of options and stock in accordance with the Exchange's opening procedures, see, e.g., Rules 6.3B and 51.3, unless the Exchange concludes that a different method of reopening is appropriate under the circumstances, including but not limited to, no rotation, an abbreviated rotation or any other variation in the manner of the rotation.

Exchange proposes that if a circuit breaker is initiated in all stocks, all markets shall halt trading in such other stock options and may resume trading in such options anytime after the 15-minute halt period.¹⁷

2. Statutory Basis

The basis under the Act for these proposed rule changes are [sic] the requirement under Section 6(b)(5)¹⁸ that an Exchange have rules that are designed to promote just and equitable principles of trade, 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. Specifically, this rule proposal supports the objectives of perfecting the mechanism of a free and open market and the national market system because it promotes uniformity across markets concerning when and how to halt trading in all stocks and stock options as a result of extraordinary market volatility.

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

The Exchange neither solicited nor received comments on the proposal.

¹⁷ The Exchange understands that other markets are submitting similar rule changes and revising procedures to address market-wide circuit breakers and reopenings for stocks, options and futures. The Exchange believes it is integral that the markets have consistent procedures for market-wide circuit breakers and reopenings (e.g., our intention is to have [sic] same ability to reopen trading in stock index options when futures markets reopen). As a result, to the extent it may be necessary, the Exchange reserves the right to modify its proposed rule change in order to conform its procedures based on a review of the rule change filings and procedures of the other equities, options and futures markets.

¹⁸ 15 U.S.C. 78f(b)(5).

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 changes to the market-wide circuit breaker regime are consistent with the Act. The Commission specifically requests comment on the following:

- As discussed above, the proposed rule change would narrow the percentage market declines that would trigger a market-wide halt in trading. How would the proposed changes interact with the existing single-stock circuit breaker pilot program¹⁹ or, if approved, the proposed NMS Plan to establish a limit-up/limit-down mechanism for individual securities?²⁰

¹⁹ See Securities Exchange Act Release No. 64735 (June 23, 2011), 76 FR 38243 (June 29, 2011) (SR-BATS-2011-016; SR-BYX-2011-011; SR-BX-2011-025; SR-CBOE-2011-049; SR-CHX-2011-09; SR-EDGA-2011-15; SR-EDGX-2011-14; SR-FINRA-2011-023; SR-ISE-2011-028; SR-NASDAQ-2011-067; SR-NYSE-2011-21; SR-NYSEAmex-2011-32; SR-NYSEArca-2011-26; SR-NSX-2011-06; SR-Phlx-2011-64) (approving the “Phase III Pilot Program”). The Phase III Pilot Program has been extended through January 2012. See, e.g., Securities Exchange Act Release 65094 (August 10, 2011), 76 FR 50779 (August 16, 2011) (SR-NASDAQ-2011-011).

²⁰ See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011).

- To what extent could the concurrent triggering of single stock circuit breakers in many S&P 500 Index stocks lead to difficulties in calculating the index? Would the triggering of many single stock circuit breakers in a general market downturn cause the index calculation to become stale and thereby delay the triggering of the market-wide circuit breaker?
- Should the market-wide circuit breaker be triggered if a sufficient number of single-stock circuit breakers or price limits are triggered, and materially affect calculations of the S&P 500 Index?
- Should market centers implement rules that mandate cancellation of pending orders in the event a market-wide circuit breaker is triggered? If so, should such a rule require cancellation of all orders or only certain order types (e.g., limit orders)? Should all trading halts trigger such cancellation policies or should the cancellation policies apply only to a Level 3 Market Decline?
- Should some provision be made to end the regular trading session if a market decline suddenly occurs after 3:25 p.m. but does not reach the 20% level?
- In the event of a Level 3 Market Decline, should some provision be made for the markets to hold a closing auction?
- Should the primary market have a longer period (e.g., 30 minutes) to reopen trading following a Level 2 Market Decline before trading resumes in other venues?
- In the event of a Level 3 Market Decline, should the markets wait for the primary market to reopen trading in a particular security on the next trading day before trading in that security resumes?

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-2011-087 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-2011-087. 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, DC 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 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 publicly available. All submissions should refer

to File Number SR-CBOE-2011-087 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.²¹

Elizabeth M. Murphy
Secretary

²¹ 17 CFR 200.30-3(a)(12).