

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66035; File No. SR-CBOE-2011-122)

December 22, 2011

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Related to FLEX Options

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 12, 2011, the Chicago Board Options Exchange, Incorporated (“Exchange” or “CBOE”) filed with the Securities and Exchange Commission (the “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 is proposing to amend certain rules pertaining to the electronic trading of Flexible Exchange Options (“FLEX Options”) on the Exchange’s FLEX Hybrid Trading System platform.³ The Exchange is also proposing an amendment to eliminate certain European-Capped style settlement and currency provisions within the FLEX rules that pertain to both electronic

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ FLEX Options provide investors with the ability to customize basic option features including size, expiration date, exercise style, and certain exercise prices. FLEX Options can be FLEX Index Options or FLEX Equity Options. In addition, other products are permitted to be traded pursuant to the FLEX trading procedures. For example, credit options are eligible for trading as FLEX Options pursuant to the FLEX rules in Chapters XXIVA and XXIVB. See CBOE Rules 24A.1(e) and (f), 24A.4(b)(1) and (c)(1), 24B.1(f) and (g), 24B.4(b)(1) and (c)(1), and 28.17. The rules governing the trading of FLEX Options on the FLEX Request for Quote (“RFQ”) System platform are contained in Chapter XXIVA. The rules governing the trading of FLEX Options on the FLEX Hybrid Trading System platform are contained in Chapter XXIVB.

and open outcry trading. 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.

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 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, Proposed Rule Change

1. Purpose

The Exchange is in the process of enhancing the FLEX Hybrid Trading System platform (referred to herein as the "FLEX System" or the "System") in order to further integrate it with the Exchange's existing technology platform utilized for non-FLEX trading. In conjunction with the enhancement, the Exchange is proposing to make some modifications to the existing electronic trading processes utilized on the FLEX System platform.⁴ In particular, as discussed in more detail below, the Exchange is proposing to (i) revise and enhance the process for opening FLEX Option series with existing open interest, (ii) eliminate certain Trade Conditions that will no longer be supported in the new system and to add a new Trade Condition, (iii) eliminate European-Capped exercise style and foreign currency provisions that will no longer be

⁴ The Exchange notes that is [sic] rule change filing is primarily seeking to propose changes to the electronic trading processes utilized on the FLEX System platform. The Exchange is not proposing any changes to the open outcry trading processes for FLEX options, except for the proposed changes pertaining to foreign currencies.

supported in the new system, (iv) modify and simplify the allocation algorithms applicable to the FLEX electronic book and to the FLEX electronic RFQ process, and (v) include a description of complex order handling under the electronic RFQ process.⁵

Opening Trading in Existing Series

The first purpose of this proposed rule change is to revise and enhance the process for opening electronic trading in FLEX Option series with existing open interest. Under the current FLEX trading procedures, there are no trading rotations conducted at the opening of trading.⁶ Instead, to begin trading on a given day, a FLEX RFQ process is required to initiate a transaction when there are no FLEX Orders⁷ currently resting in the electronic book in the particular series

⁵ The FLEX System currently utilizes server software (residing on CBOE's servers) and client software (installed on Trading Permit Holder and Sponsored User workstations) that CBOE has licensed from Cinnober Financial Technology AB ("Cinnober"). In conjunction with the enhancements to the FLEX System, the Exchange will no longer utilize the Cinnober software and, as a result, the Exchange will no longer utilize the related Trading Permit Holder/Sponsored User software sublicense, which is part of the Sponsored User Agreement form that was put in place when the FLEX Hybrid Trading System was established. See Securities Exchange Act Release 56792 (November 15, 2007), 72 FR 65776 (November 23, 2007)(SR-CBOE-2006-99)(the "Original FLEX System Approval Order"). The Exchange also notes that, in conjunction with the enhancements to the FLEX System, the Exchange intends to make available certain risk management application tools that CBOE Trading Permit Holders may determine to use to assist with mitigating potential risks associated orders that exceed certain pre-trade thresholds.

⁶ See Rule 24B.3.

⁷ A "FLEX Order" refers to (i) FLEX bids and offers entered by FLEX Market-Makers and (ii) orders to purchase and orders to sell FLEX Options entered by FLEX Traders, in each case into the electronic book. A "FLEX Market-Maker" means a FLEX Trader that is appointed as a FLEX Appointed Market-Maker or a FLEX Qualified Market-Maker, each as described in Rule 24B.9. A "FLEX Trader" means a FLEX-participating Trading Permit Holder who has been approved by the Exchange to trade on the System. See Rule 24B.1(h), (j) and (l).

to be traded.⁸ Resting FLEX Orders may only be entered in the electronic book as “day orders” and are cancelled at the close of each trade day if unexecuted. Therefore, there would be no orders resting in the book from the prior day.⁹ As a result, under the current process, an initial RFQ is needed to open a particular series for trading each day. Once an RFQ is completed, the series is established in the FLEX System for the day and FLEX Orders may be entered directly into the FLEX electronic book throughout the day.

To make the process more efficient and useful for FLEX users, the Exchange is proposing to revise the procedure to provide that FLEX Option series with existing open interest will be automatically opened by the Exchange at a randomly selected time within a number of seconds after 8:30 a.m. (all times noted herein are Central Time), at which point in time FLEX Orders may be entered directly into the electronic book (if available) and/or FLEX RFQ auctions may be initiated pursuant to Rule 24B.5. As revised, it will no longer be necessary for there to be an initial RFQ each day before entering a FLEX Order in the electronic book in series with existing open interest. New FLEX Option series will continue to be subject to the existing requirement that there be an initial RFQ to initiate trading in the FLEX series on a given trading day.

Trade Conditions

The second purpose of this proposed rule change is to eliminate certain Trade Conditions that will no longer be supported for electronic trading in the new system and to add a new Trade

⁸ The Exchange may determine in a class-by-class basis to make an electronic book available in the FLEX System. See Rule 24B.5(b).

⁹ In the future, the Exchange may determine to enable “good-til-cancelled” functionality for FLEX Options. The introduction of such functionality would be the subject of a separate rule filing.

Condition. Currently, under Rule 24B.1, a “Trade Condition” means a contingency that has been placed on an RFQ, RFQ Order¹⁰ or FLEX Order. The following Trade Conditions are available in the System for a FLEX Trader to choose from: (i) Fill-or-Kill, which is a condition to execute an RFQ Order or FLEX Order in its entirety as soon as it is represented or canceled it; (ii) All-or-None, which is a condition to execute an RFQ Order or FLEX Order in its entirety or not at all; (iii) Minimum Fill, which is a condition to execute an RFQ Order or a FLEX Order in a minimum quantity or not at all; (iv) Lots Of, which is a condition to execute an RFQ Order or a FLEX Order in minimum lot sizes or not at all; (v) Intent to Cross, which is an RFQ condition indicating that the Submitting Trading Permit Holder intends to cross or act as principal and receive a crossing participation entitlement; and (vi) Hedge, which is a RFQ or FLEX Order condition contingent on trade execution in Non-FLEX Options or other Non-FLEX components (e.g., stock, futures, or other related instruments or interests). Trade Conditions, other than Intent to Cross or Hedge, are inputted but not disclosed on the System. FLEX Orders, other than those designated as Fill-or-Kill, are designated as day orders and, if unexecuted, are automatically cancelled at the close of each trade day.¹¹

The Exchange is now proposing to eliminate the Fill-or-Kill, Minimum Fill, Lots Of, and Intent to Cross Trade Conditions, as these functions will not be supported under the FLEX

¹⁰ An “RFQ Order” is an order to purchase or order to sell FLEX Options entered by the Submitting Trading Permit Holder during the RFQ Reaction Period. The “RFQ Reaction Period” means the period of time during which a Submitting Trading Permit Holder determined whether to accept or reject the RFQ Market. A “Submitting Trading Permit Holder” means the FLEX Trader that (i) initiates FLEX bidding and offering by submitting an RFQ or (ii) enters a FLEX Order into the electronic book. An “RFQ Market” means the bids or offers, or both, as applicable, entered in response to an electronic RFQ and FLEX Orders resting in the electronic book. See Rule 24B.1(s), (t), (v) and (x), and Rule 24B.5(a)(1)(iii).

¹¹ See Rule 24B.1(y).

System enhancements. The Fill-or-Kill, Minimum Fill, Lots Of¹² and Intent to Cross¹³ Trade Conditions have generally not been actively used by FLEX Traders. Given the lack of use, the

¹² See proposed changes to Rule 24B.1(y). The Fill-or-Kill, Minimum Fill and Lots Of Trade Conditions were originally designed, in part, as an additional tool to assist FLEX Traders that are electronically trading in meeting certain minimum value size requirements applicable to the trading of FLEX Options; however, the minimum size requirements have been eliminated on a pilot basis (which the Exchange believes is one of the reasons why the Trade Conditions are largely not used). See, e.g., Rule 24B.4(a)(5) and .01(b). The minimum value size pilot is currently set to expire on March 30, 2012, unless otherwise extended or made permanent. It is the Exchange's intention to submit a separate rule change filing proposing to make the pilot permanent. In addition, if for some reason the minimum value size pilot is not extended or otherwise made permanent, FLEX Traders have other means to satisfy the minimum value size requirements (e.g., utilizing the All-or-None Trade Condition, or entering RFQ Orders or FLEX Orders that would trade against the electronic book with value sizes that would result in transaction sizes sufficient to meet the minimum value size requirement).

¹³ See proposed changes to Rules 24B.1(y) and 24B.5(a)(1)(iii)(D) and (d)(1)(i). The Exchange notes that the Intent to Cross Trade Condition is an optional feature that the Exchange may determine to make available electronically on a class-by-class basis in accordance with Rule 24B.5(d). The Intent to Cross Trade Condition was originally designed to allow for an electronic crossing participation entitlement for executions resulting from the electronic RFQ process. (To use the feature, the Submitting Trading Permit Holder must mark its RFQ with an "intent to cross" flag at the time the RFQ is originally submitted to be automatically allocated the applicable crossing participation entitlement for facilitation and solicitation transactions. If the RFQ is not flagged in this manner, the Submitting Member will not be automatically allocated the entitlement.) The Exchange notes that this crossing participation entitlement functionality has generally not been actively used by FLEX Traders. (The Exchange also notes that, apart from the Intent to Cross feature, a Submitting Trading Permit Holder also has (and will continue to have) the ability to enter an agency or proprietary FLEX Quote in response to the Submitting Member's own electronic RFQ in accordance with the provisions contained in Rule 24B.5(a)(1)(ii) and/or to cross FLEX Orders in accordance with the provisions contained in Rule 24B.5(b)(3). However, no crossing participation entitlement applies when these procedures are used.) In order to make a more efficient and effective trading platform offering available for FLEX Traders that includes a crossing participation entitlement feature, the Exchange has submitted a separate rule change filing proposing to make modified versions of the Automated Improvement Mechanism ("AIM") and Solicitation Auction Mechanism ("SAM") – which are currently available for non-FLEX Options under Rule 6.74A and 6.74B, respectively – available for FLEX Options. See SR-CBOE-2011-123.

Exchange no longer plans to support these Trade Conditions under the new FLEX System enhancements.

The Exchange is also proposing to adopt an Immediate-or-Cancel Trade Condition. “Immediate-or-Cancel” will be defined as a condition to execute an RFQ Order or FLEX Order in its entirety or in part as soon as it is represented or cancel it. Thus, as proposed to be revised, there will be three Trade Conditions: Immediate-or-Cancel, All-or-None, and Hedge. Trade Conditions, other than Hedge, will be inputted but not disclosed on the System. In addition, FLEX Orders, other than those designated as Immediate-or-Cancel, will be designated as day orders and, if unexecuted, will be automatically cancelled at the close of each trade day.¹⁴

Foreign Currency Provisions

The third purpose of the proposed rule change is to eliminate certain provisions in the FLEX Rules that permit (i) FLEX Options to be designated with a European-Capped style exercise and (ii) FLEX Index Options to be designated for settlement in foreign currencies (and related index multiplier provisions for such currencies).¹⁵ These European-Capped style and foreign currency provisions have generally not been actively utilized.¹⁶ The Exchange no longer plans to support foreign currency settlements in the new FLEX System, so the Exchange is proposing to eliminate the provision within the rules and limit the [sic] currently for FLEX Index Options to U.S. dollars. These changes will apply to all FLEX trading on the Exchange, whether

¹⁴ See note 9, supra.

¹⁵ See proposed changes to Rules 24A.1(c) and (i), 24A.4(a)(2)(iii) and (b)(4), 24A.5(f), 24B.1(c) and (m), 24B.4(a)(2)(iii) and (b)(4), and 24B.5(e).

¹⁶ The Exchange notes that there is currently no open interest in any FLEX Option series with a European-Capped style exercise and currently no open interest [sic] any FLEX Index Option series that is designated for settlement in a foreign currency.

electronic or open outcry.¹⁷

Electronic Allocation Algorithms

The fourth purpose of the proposed rule change is to modify and simplify the allocation algorithms applicable to the FLEX electronic book and to the FLEX electronic RFQ process. Generally, and as discussed in more detail below, the algorithms are proposed to be simplified to be price-time priority, subject to public customer and non-Trading Permit Holder broker-dealer (“non-TPH broker-dealer”) priority and, if applicable, any applicable entitlement priority. In particular, the existing algorithms and proposed modifications are as follows:

FLEX Electronic Book: Currently, for the FLEX electronic book, all FLEX Orders are ranked and matched based on price-time priority, unless a FLEX Appointed Market-Maker is quoting at the best bid (offer) and a FLEX Appointed Market-Maker participation entitlement has been established.¹⁸ If a FLEX Appointed Market-Maker participation entitlement has been established, allocation among multiple bids (offers) at the same price is as follows: (i) all FLEX Orders for the account of a public customer ranked ahead of the FLEX Appointed Market-Maker will participate in the execution based on time priority; (ii) any FLEX Orders that are subject to

¹⁷ In the future, the Exchange may determine to re-enable the capability for settlement of FLEX Index Options in a foreign currency, such foreign currency settlement provisions would be the subject of a separate rule filing.

¹⁸ The Exchange may establish from time to time a participation entitlement formula that is applicable to FLEX Appointed Market Makers on a class-by-class basis with respect to open outcry RFQs, electronic RFQs and/or electronic book transactions. Any such FLEX Appointed Market-Maker participation entitlement shall: (i) be divided equally by the number of FLEX Appointed Market-Makers quoting at the BBO or BBO clearing price, as applicable; (ii) collectively be no more than: 50% of the amount remaining in the order when there is one other FLEX Market-Maker also quoting at the same price, 40% when there are two other FLEX Market-Makers also quoting at the same price; and 30% when there are three or more FLEX Market-Makers also quoting at the same price; and (iii) when combined with any crossing participation entitlement, shall not exceed 40% of the original order. See Rule 24B.5(d)(2)(ii).

the FLEX Appointed Market-Maker participation entitlement will participate in the execution based on a participation entitlement formula specified in Rule 24B.5(d)(2)(ii); then (iii) all other FLEX Orders will participate based on time priority.

As proposed to be revised and simplified, allocation among multiple bids (offers) at the same price in the FLEX electronic book would be as follows: (i) public customer and non-TPH broker-dealers will participate in the execution based on time priority; (ii) if applicable, any FLEX Orders that are subject to the FLEX Appointed Market-Maker participation entitlement will participate in the execution based on a participation entitlement formula specified in Rule 24B.5(d)(2)(ii);¹⁹ then (iii) all other FLEX Orders will participate in the execution based on time priority.

FLEX Electronic RFQs: Currently, for the electronic RFQ process, executions of RFQ Orders occur at a single price that will leave bids and offers which cannot trade with each other (referred to as the “BBO clearing price”). In determining the priority of bids and offers, the FLEX System gives priority to FLEX Quotes²⁰ and FLEX Orders whose price is better than the BBO clearing price, then to FLEX Quotes and FLEX Orders at the BBO clearing price. Currently, the allocation among multiple FLEX Quotes and FLEX Orders priced at the BBO clearing price is as follows:

- General: The allocation among multiple FLEX Quotes and FLEX Orders priced at the BBO clearing price is generally as follows: (i) any FLEX Quotes subject to a FLEX Appointed Market-Maker participation entitlement will participate in the

¹⁹ Id.

²⁰ A “FLEX Quote” refers to (i) FLEX bids and offers entered by FLEX Market-Makers and (ii) orders to purchase and orders to sell FLEX Options entered by FLEX Traders, in each case in response to an RFQ. See Rule 24B.1(k).

- execution based on a participation entitlement formula (as described above); (ii) FLEX Orders resting in the electronic book will participate in the execution pursuant to the current book priority algorithm (discussed above); (iii) FLEX Quotes for the account of public customers and non-TPH broker-dealers will participate in the execution based on time priority; then (iv) all other FLEX Quotes will participate in the execution based on time priority.
- Lock/Crossed Markets: In the event the RFQ Market²¹ is locked or crossed (e.g., \$1.25-\$1.20), allocation among multiple FLEX Quotes and FLEX Orders that are priced at the BBO clearing price and are on the same side of the market as the RFQ Order is as follows: (i) FLEX Orders resting in the electronic book will participate in the execution pursuant to the current book priority algorithm (discussed above); (ii) if applicable, an RFQ Order for the account of a public customer or non-TPH broker-dealer will participate in the execution, then any FLEX Quotes subject to a FLEX Appointed Market-Maker participation entitlement will participate in the execution based on a participation entitlement formula (discussed above); (iii) FLEX Quotes for the account of public customers and non-TPH broker-dealers will participate in the execution based on time priority; (iv) if applicable, an RFQ Order for the account of a Trading Permit Holder will participate in the execution, then any FLEX Quotes that are subject to a FLEX Appointed Market-Maker participation entitlement will participate in the execution based on a participation entitlement formula (discussed

²¹ The “RFQ Market” means the bids or offers, or both, as applicable, entered in response to an electronic Request for Quotes and FLEX Orders resting in the electronic book. See Rule 24B.1(s).

above); then (v) all other FLEX Quotes will participate in the execution based on time priority.

- Intent to Cross Trade Condition/Crossing Participation Entitlement: In the event the Submitting Trading Permit Holder has indicated an intention to cross with respect to any part of the FLEX trade, the Submitting Trading Permit Holder may obtain a crossing participation entitlement if a crossing participation entitlement has been established by the Exchange pursuant to Rule 24B.5(d), the Submitting Trading Permit Holder has indicated an intention to cross as part of the RFQ, and the RFQ Order submitted during the RFQ Reaction Period matches or improves the BBO clearing price. In such an event, the incoming RFQ Order will be eligible to trade with the FLEX Quotes and FLEX Orders at the BBO clearing price as discussed above. The allocation among multiple FLEX Quotes and FLEX Orders that are priced at the BBO clearing price and on the same side of the market as the crossing participation entitlement is as follows: (i) FLEX Orders resting in the electronic book will participate in the execution pursuant to the current book priority algorithm (discussed above); (ii) FLEX Quotes for the account of public customers and non-TPH broker-dealers will participate in the execution based on time priority; (iii) the crossing participation entitlement will participate in the execution pursuant to the crossing participation entitlement formula discussed in Rule 24B.5(d)(2)(i); (iv) any FLEX Quotes subject to a FLEX Appointed Market-Maker participation entitlement will participate in the execution pursuant to the participation entitlement formula (discussed above); then (v) all other FLEX Quotes will participate in the execution based on time priority.

As proposed to be revised and simplified, first, as discussed above, the Exchange would eliminate the “Intent to Cross” Trade Condition. As a result, the Intent to Cross/Crossing Participation Entitlement scenario under the electronic RFQ process described above would no longer be applicable.²² Second, the Exchange would eliminate the concept of a “BBO clearing price” (except in the limited scenario noted below where the RFQ Market is locked or crossed). Thus, an incoming RFQ Order would be eligible to trade with FLEX Quotes and FLEX Orders at the best price(s) (i.e., an incoming RFQ Order could trade at multiple price points). Third, at a given price point, allocation among multiple FLEX Quotes and FLEX Orders at the same price would be as follows:

- General: The allocation among multiple FLEX Quotes and FLEX Orders priced at the same price would be as follows: (i) FLEX Quotes and FLEX Orders for the account of public customers and non-TPH broker-dealers will participate in the execution based on time priority; (ii) any FLEX Quotes and FLEX Orders subject to a FLEX Appointed Market-Maker participation entitlement will participate in the execution (as described above); then (iii) all other FLEX Quotes and FLEX Orders will participate in the execution based on time priority.
- Lock/Crossed Markets: In the event the RFQ Market is locked or crossed (e.g., \$1.25-\$1.20), FLEX Quotes and FLEX Orders would be eligible to trade at a single BBO clearing price pursuant to the existing BBO clearing price process (i.e., (i) the BBO clearing price will leave bids and offers which cannot trade with each other; and (ii) in determining priority of FLEX Quotes and FLEX Orders to be traded, the

²² See proposed changes to Rule 24B.5(a)(1)(iii)(D) and (d)(2)(i).

System gives priority to FLEX Quotes and FLEX Orders whose price is better than the BBO clearing price, then to FLEX Quotes and FLEX Orders at the BBO clearing price based on the general allocation algorithm noted above). The allocation among multiple FLEX Quotes and FLEX Orders that are priced at the same price and are on the same side of the market as the RFQ Order would be as follows: (i) FLEX Quotes and FLEX Orders for the account of public customers and non-TPH broker-dealers will participate in the execution based on time priority; (ii) an RFQ Order will participate in the execution, then any FLEX Quotes and FLEX Orders that are subject to a FLEX Appointed Market-Maker participation entitlement will participate in the execution (as described above); then (iii) all other FLEX Quotes and FLEX Orders will participate in the execution based on time priority.

All other provisions of Rule 24B.5 will apply unchanged. As noted above, these changes re [sic] intended to simplify the allocation algorithms. The Exchange believes these changes will make the applicable programming for FLEX allocation algorithms less complicated, which should make for efficient and effective processing of complex orders (and also make it easier for users to understand) if there is a more consistent allocation algorithm applied across the various FLEX electronic processes described above (i.e., for FLEX electronic book priority and for FLEX RFQ priority generally and in locked or crossed and crossing participation entitlement scenarios).

The Exchange notes that the proposed changes to the existing series opening process and allocation algorithms are similar to other existing opening processes and allocation algorithms.²³

²³ With respect to the existing series opening process, the Exchange notes that various exchanges' rules provide for automatic openings of existing series. See, e.g., CBOE Rule

As such, the Exchange believes that the proposed rule change does not present any new, unique or substantive issues.

Electronic RFQ Processing of Complex Orders

The fifth purpose of the proposed rule change is to amend the FLEX System rules to describe certain complex order handling procedures. Under the current FLEX electronic trading procedures, multi-legged RFQs and FLEX Orders are permitted. However, there is no provision for an electronic complex order book for multi-legged, complex orders to rest. The electronic book, to the extent the Exchange determines to make it available for a given class, is only available for simple orders.

To more fully describe the electronic processing of complex orders, the Exchange is proposing to adopt Interpretation and Policy .01 under Rule 24B.5. This Interpretation and Policy will provide that there is no electronic complex order book for multi-legged, complex orders. To trade electronically, complex orders will only be eligible to trade with other complex orders through the electronic RFQ process described in Rule 24B.5(a)(1). The order allocation for such complex orders executed through the RFQ process will [sic] the same as is applicable to

6.2B (which, among other things, provides for an opening rotation to automatically begin in index options at a randomly selected time within a number of seconds after 8:30 a.m. for index options). A distinction with FLEX Options is that an existing series will move immediately to an opening state (there is no rotation). The Exchange has designed the system this way for simplicity and due to the customized nature of FLEX Options, which has no or very limited secondary trading and no need for daily opening rotations. This aspect of the existing opening series process is not new or unique. In fact, CBOE Rule 24B.3 already provides that there shall be no trading rotations in FLEX Options, either at the opening or at the close of trading. With respect to the allocation algorithm, the Exchange notes that various exchanges' rules provide for executions at best price(s) and the use of price-time priority with public customer and participation entitlement priority overlays. See, e.g., CBOE Rules 6.45A(a) and 6.45B(a) (which, among various allocation algorithm alternatives, may permit an executions [sic] at best price(s) using price-time priority with public customer and participation entitlements priority overlays).

simple orders (which is proposed to be amended as described above under the “FLEX Electronic RFQ [sic] heading). To the extent the Exchange determines to make an electronic book available for simple, resting FLEX Orders, there will be no “legging” of complex orders represented in the electronic RFQ process with FLEX Orders that may be represented in the individual series legs represented in the electronic book. In the event there are bids (offers) in any of the individual component series legs represented in the electronic book when an electronic RFQ for a complex order strategy is submitted to the System, the electronic RFQ will not commence. In the event an unrelated FLEX Order in any of the individual series legs is received during the duration of an electronic RFQ, such FLEX Order will not be considered in the electronic RFQ allocation. Further, to the extent that a complex RFQ Order or responsive FLEX Quote is not executed, any remaining balance of the complex order or FLEX Quote will be automated [sic] cancelled if not traded at the conclusion of the electronic RFQ process.

Section 11(a)(1) of the Act

Finally, the Exchange believes the proposed changes to the priority and allocation rules for electronic FLEX trading are consistent with Section 11(a)(1) of the Act²⁴ and the rules promulgated thereunder. By way of background, when the FLEX Hybrid Trading System was originally approved, the Commission believed that the priority and allocation rules for electronic FLEX trading were consistent with Section 11(a) of the Act.²⁵ The Commission believed,

²⁴ 15 U.S.C. 78k(a). Section 11(a)(1) prohibits a member of a national securities exchange from effecting transactions on that exchange for its own account, the account of an associated person, or an account over which it or its associated person exercises discretion unless an exception applies.

²⁵ See Original FLEX System Approval Order, note 5, *supra*; see also Securities Exchange Act Release No. 56311 (August 23, 2007), 72 FR 50133 (August 30, 2007)(SR-CBOE-2006-99)(notice of filing of the proposed FLEX System), which includes a more detailed

however, that neither a Submitting Trading Permit Holder²⁶ who trades against an electronic RFQ Market nor any other FLEX Trader who itself submits an RFQ Quote electronically qualifies for the “effect-versus-execute” exception to [sic] section 11(a).²⁷ Nevertheless, the Commission believed that other exceptions may apply. For example, FLEX Market-Makers qualify for the market-maker exception. The Commission also noted that, with respect to non-market-maker Trading Permit Holders, the FLEX Hybrid Trading System appeared reasonably designed to cause RFQ Quotes constituting the RFQ Market and the RFQ Order that trades against the RFQ Market to yield to non-member interest, consistent with the “G” exception.²⁸ The Exchange believes the proposed changes [sic] the electronic RFQ process and allocation algorithms are consistent with the Original FLEX System Approval Order because the System will continue to be designed to cause RFQ Quotes constituting the RFQ Market and the RFQ Order that trades against the RFQ Market to yield to non-member interest (i.e., public customers and non-TPH broker-dealers continue to have priority).

With respect to the electronic book, in the Original FLEX System Approval Order the Commission noted that, if the Exchange enables an electronic book in a FLEX Option class, any transaction involving a booked order must comply with Section 11(a) of the Act. If a FLEX Trader cannot avail itself of any other exception, it must rely on the “G” exception, which

discussion of the priority and allocation rules and section 11(a)) and existing Rule 24B.5(b)(2)(ii) and (d)(4).

²⁶ The Exchange notes that, under the Original FLEX Approval Order, the term “Submitting Member” is used instead of “Submitting Trading Permit Holder.” The Exchange subsequently revised its rules to replace the term “Member” with “Trading Permit Holder.” See Securities Exchange Act Release No. 62382 (June 25, 2010), 75 FR 38164 (July 1, 2010)(SR-CBOE-2010-058).

²⁷ 17 CFR 240.11a2-2(T).

requires, among other things, that a member order yield to a non-member order at the same price, even if the member order has time priority. It was noted that the FLEX System has not been programmed to cause a member order on the electronic book to yield to a later-arriving non-member order at the same price, although Rule 24B.5(b)(2)(ii) prohibits a member order that is relying on the “G” exemption from resting on the electronic book. The Commission believed that a member may rely on the “G” exemption if it sends an order to the electronic book and then cancels it immediately if it is not executed in full. The Exchange notes that the proposed changes to the electronic book allocation algorithm are consistent with the Original FLEX System Approval Order and Trading Permit Holders and Rule 24B.5(b)(2)(ii), a Trading Permit Holder order that is relying on the “G” exemption continues to be prohibited from resting on the electronic book and such a Trading Permit Holder may rely on the “G” exemption if it sends an order to the electronic book and then cancels it immediately if it is not executed in full.

2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act²⁹ in general and furthers the objectives of Section 6(b)(5) of the Act³⁰ in particular in that it should promote just and equitable principles of trade, serve to remove impediments to and perfect the mechanism of a free and open market and a national market system, and protect investors and the public interest. In particular, the Exchange believes that the use of FLEX Options provide CBOE Trading Permit Holders and investors with additional tools to trade customized options in an exchange

²⁸ See 15 U.S.C. 78k(a)(1)(G)(setting forth all requirements for the “G” exemption).

²⁹ 15 U.S.C. 78f(b).

³⁰ 15 U.S.C. 78f(b)(5).

environment³¹ and greater opportunities to manage risk. The proposed changes to the existing series opening process and the allocation algorithms should serve to further those objectives and encourage use of FLEX Options by enhancing and simplifying the existing processes, which should make the system more efficient and effective and easier for users to understand.

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.

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.

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

³¹ FLEX Options provide Trading Permit Holders and investors with an improved but comparable 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. The Exchange believes that making these changes 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: (1) enhanced efficiency in initiating and closing out positions; (2) increased market transparency; and (3) heightened contra-party creditworthiness due to the role of The Options Clearing Corporation as issuer and guarantor of FLEX Options.

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-2011-122 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-2011-122. 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 available publicly. All submissions should refer to File Number SR-CBOE-2011-122 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.³²

Kevin M. O'Neill
Deputy Secretary

³² 17 CFR 200.30-3(a)(12).