

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-79499; File No. SR-CBOE-2016-084)

December 7, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change to Amend Exchange Rules Related to the Automated Improvement Mechanism

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that, on November 29, 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. 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 seeks to amend Exchange Rules related to the Automated Improvement Mechanism. The text of the proposed rule change is provided below.

(additions are underlined; deletions are [bracketed])

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**Chicago Board Options Exchange, Incorporated  
Rules**

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**Rule 6.74A. Automated Improvement Mechanism (“AIM”)**

Notwithstanding the provisions of Rule 6.74, a Trading Permit Holder 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”) pursuant to this Rule.

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

(a) – (b) No change.

**. . . Interpretations and Policies:**

**.01 – .02** No change.

**.03** [Initially, and for at least a Pilot Period expiring on January 18, 2017, there will be] There is no minimum size requirement for orders to be eligible for the Auction. [During this Pilot Period, the Exchange will submit certain data, periodically as required by the Commission, to provide supporting evidence that, among other things, there is meaningful competition for all size orders and that there is an active and liquid market functioning on the Exchange outside of the Auction mechanism. Any raw data which is submitted to the Commission will be provided on a confidential basis.]

**.04 – .05** No change.

**.06** [Subparagraph (b)(2)(E) of this rule will be effective for a Pilot Period until January 18, 2017. During the Pilot Period, the Exchange will submit certain data, periodically as required by the Commission, relating to the frequency with which early termination of the Auction occurs pursuant to this provision as well as any other provision, and also the frequency with which early termination pursuant to this provision results in favorable pricing for the Agency Order. Any raw data which is submitted to the Commission will be provided on a confidential basis.] Reserved.

**.07 – .09** No change.

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**Rule 24B.5A. FLEX Automated Improvement Mechanism**

Notwithstanding the provisions of Rule 24B.5, a FLEX Trader that represents agency orders may electronically execute an order it represents as agent ("Agency Order") against principal interest and/or against solicited orders provided it submits the Agency Order for execution into the automated improvement mechanism auction ("AIM Auction") pursuant to this Rule.

(a) AIM Auction Eligibility Requirements. A FLEX Trader (the "Initiating Trading Permit Holder") may initiate an AIM Auction provided all of the following are met:

- (1) the Agency Order is in a FLEX class designated as eligible for AIM Auctions as determined by the Exchange and within the designated AIM Auction order eligibility size parameters as such size parameters are determined by the Exchange; and
- (2) the Initiating Trading Permit Holder must stop the entire Agency Order as principal and/or with a solicited order(s) at the better of the BBO price improved by one minimum price improvement increment or the Agency Order's limit price.

(b) No change.

**. . . Interpretations and Policies:**

**.01 – .02** No change.

**.03** [Initially, and for at least a Pilot Period expiring on January 18, 2017, there will be] There is no minimum size requirement for orders to be eligible for the AIM Auction. [During this Pilot Period, the Exchange will submit certain data, periodically as required by the Commission, to provide supporting evidence that, among other things, there is meaningful competition for all size orders and that there is an active and liquid market functioning on the Exchange outside of the AIM Auction. Any raw data which is submitted to the Commission will be provided on a confidential basis.]

**.04 – .07** No change.

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The text of the proposed rule change is also available on the Exchange's website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange's Office of the Secretary, and at the Commission's Public Reference Room.

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

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in 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

In February 2006, CBOE obtained approval from the Securities and Exchange

Commission (the “Commission”) to adopt the AIM auction process.<sup>3</sup> AIM exposes certain orders electronically to an auction process to provide these orders with the opportunity to receive an execution at an improved price. The AIM auction is available only for orders that a Trading Permit Holder represents as agent (“Agency Order”) and for which a second order of the same size as the Agency Order (and on the opposite side of the market) is also submitted (effectively stopping the Agency Order at a given price).

The Commission approved two components of AIM on a pilot basis: (1) that there is no minimum size requirement for orders to be eligible for the auction; and (2) that the auction will conclude prematurely anytime there is a quote lock on the Exchange pursuant to Rule 6.45A(d).<sup>4</sup>

Eleven extensions to the pilot programs have previously become effective.<sup>5</sup> The pilot program is set to expire on January 18, 2017. The Exchange is seeking permanent approval of the pilot programs.

As evidenced by data submitted to the Commission on a monthly and confidential basis since the pilot programs inception, AIM offers meaningful competition for all size orders. Additionally, there is an active and liquid market functioning on the Exchange outside of AIM.

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<sup>3</sup> See Securities Exchange Release No. 53222 (February 3, 2006), 71 FR 7089 (February 10, 2006) (SR-CBOE-2005-60).

<sup>4</sup> A quote lock occurs when a CBOE Market-Maker’s quote interacts with the quote of another CBOE Market-Maker (i.e. when internal quotes lock).

<sup>5</sup> See Securities Exchange Act Release Nos. 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-2009-051); 62522 (July 16, 2010), 75 FR 43596 (July 26, 2010) (SR-CBOE-2010-067); 64930 (July 20, 2011), 76 FR 44636 (July 26, 2011) (SR-CBOE-2011-066); 67302 (June 28, 2012), 77 FR 39779 (July 5, 2012) (SR-CBOE-2012-061); 69867 (June 27, 2013), 78 FR 40230 (July 3, 2013) (SR-CBOE-2013-066); 72570 (July 9, 2014), 79 FR 41337 (July 15, 2014) (SR-CBOE-2014-054); 75476 (July 16, 2015), 80 FR 43548 (July 22, 2015) (SR-CBOE-2015-068); and 78316 (July 13, 2016) 81 FR 138 (July 19, 2016).

In addition to monthly data provided to the Commission on a confidential basis, the Exchange provided the Commission with a summary report (the “Report”), included herein as Exhibit 3, which demonstrates the price improvement benefits of AIM. Approving the pilot programs on a permanent basis will allow AIM to continue to offer meaningful price improvement and will not have an adverse effect on the market functioning on the Exchange outside of AIM.

Specifically, the Report contains eight categories of non-customer and customer auction data, as well as three categories of summary auction data, during the period January 2015 through June 2015. Each of the eight categories is divided into subcategories based on the spread of the National Best Bid or Offer (“NBBO”) at the time an auction was initiated. The data is further divided into the number of orders that were auctioned within each particular subcategory. Finally, for each subcategory, Exchange identified the per contract price improvement that occurred at each NBBO spread; the average number of participants responding to the auctions plus the initiator; the total volume the initiator received; the average percentage of orders the initiator received; and the percentage of contracts received by the auction initiator.

The various categories contained in the Report include:

- (1) Non-Customer Auction / Under 50 Contracts / CBOE not at NBBO
- (2) Non-Customer Auction / Under 50 Contracts / CBOE at NBBO
- (3) Non-Customer Auction / 50 Contracts and over / CBOE not at NBBO
- (4) Non-Customer Auction / 50 Contracts and over / CBOE at NBBO
- (5) Customer Auction / Under 50 Contracts / CBOE not at NBBO
- (6) Customer Auction / Under 50 Contracts / CBOE at NBBO
- (7) Customer Auction / 50 Contracts and over / CBOE not at NBBO
- (8) Customer Auction / 50 Contracts and over / CBOE at NBBO

(9) Summary of all Non-Customer Auctions for the Period

(10) Summary of all Customer Auctions for the Period

(11) Summary of all Auctions for the Period

The summary of all auctions overwhelming demonstrates that AIM offers competition and price improvement because the vast majority of contracts traded via AIM received price improvement beyond the NBBO. Specifically, with regards to Customer AIM auctions, of the 54,243,091 contracts traded via AIM during the Report period 41,278,408 contracts received price improvement beyond the NBBO.<sup>6</sup> In addition, of the 54,504,717 total contracts traded via AIM during the Report period 41,514,731 contracts received price improvement beyond the NBBO.<sup>7</sup>

Furthermore, the Exchange provided the Commission with data on a monthly and confidential basis on the number of times an AIM auction was terminated early because of a quote lock on the Exchange pursuant to CBOE Rule 6.45A(d). From January 2015 through June 2015, for example, there were less than two auctions ended early per month because of a quote lock. Thus, due to the infrequency with which a quote lock terminates an AIM auction, permanent approval of the pilot program to end AIM auctions early when there is a quote lock on the Exchange will have a de minimis impact on the marketplace. Also, modifying the “Quote Lock”<sup>8</sup> timer, which allows quotes from two or more CBOE Market-Makers to remain locked for a given time interval prior to trading with one another, will not impact AIM. The quote lock is what triggers both the Quote Lock timer and the termination of an AIM auction; thus, the length of the Quote Lock timer will not affect AIM.

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<sup>6</sup> See Exhibit 3, pages 46-47.

<sup>7</sup> See Exhibit 3, page 47.

<sup>8</sup> See Rule 6.45A(d)(i)(B) and RG16-158.

Additionally, in March 2012, CBOE obtained approval from the Commission to adopt the AIM auction process for FLEX Options.<sup>9</sup> AIM for FLEX Options exposes certain FLEX Options orders electronically to an auction process to provide these orders with the opportunity to receive an execution at an improved price. The FLEX AIM auction is available only for Agency Orders and for which a second order of the same size as the Agency Order (and on the opposite side of the market) is also submitted (effectively stopping the Agency Order at a given price).

The Commission approved on a pilot basis the component of AIM for FLEX Options that there is no minimum size requirement for orders to be eligible for the auction.<sup>10</sup> Although Exhibit 3 does not include data regarding AIM for FLEX Options, the Exchange has submitted to the Commission reports providing detailed FLEX AIM auction and order execution data since the Pilot's inception. Five extensions to the pilot program have previously become effective.<sup>11</sup> The pilot program is set to expire on January 18, 2017. The Exchange is seeking permanent approval of the pilot program.

Currently, in order to initiate a FLEX AIM auction the initiating Trading Permit Holder must stop the entire Agency Order as principal and/or with a solicited order(s) at the better of the BBO or the Agency Order's limit price. For purposes of Chapter XXIVB the term "BBO"

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<sup>9</sup> See Securities Exchange Release No. 66702 (March 30, 2012), 77 FR 20675 (April 5, 2012) (SR-CBOE-2011-123).

<sup>10</sup> The pilot for the FLEX AIM auction process was modeled after the pilot for non-FLEX Options described above, and included an initial expiration date of July 18, 2012 so that the FLEX pilot would coincide with the existing non-FLEX pilot.

<sup>11</sup> See Securities Exchange Act Release No. 67302 (June 28, 2012), 77 FR 39779 (July 5, 2012) (SR-CBOE-2012-061); 69938 (July 5, 2013), 78 FR 41481 (July 10, 2013) (SR-CBOE-2013-069); 72570 (July 9, 2014), 79 FR 41337 (July 15, 2014) (SR-CBOE-2014-054); 75476 (July 16, 2015), 80 FR 43548 (July 22, 2015) (SR-CBOE-2015-068); and 78316 (July 13, 2016) 81 FR 138 (July 19, 2016).

means the best bid or offer, or both, as applicable, entered in response to a Request for Quotes (“RFQ”)<sup>12</sup> or resting in the electronic book.<sup>13</sup> Generally speaking there is no existing BBO prior to a FLEX AIM because there either has not been an RFQ or a FLEX Order with the same terms as the order to be auctioned in FLEX AIM.<sup>14</sup> Thus, the monthly data submitted to the Commission does not show observable price improvement beyond the BBO because generally speaking no BBO exists prior to a FLEX AIM. Although the Exchange has agreed to modify its FLEX AIM rules to require the Agency Order to be stopped at the better of the BBO price improved by one minimum price increment or the Agency Order’s limit price, the Exchange does not believe there will be any difference in the way FLEX AIM functions. It’s likely that there will continue to be no BBO prior to a FLEX AIM; however, FLEX AIM will continue to offer the possibility for price improvement beyond the initiator’s stop price.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (the “Act”) and the rules and regulations thereunder applicable to the Exchange and, in particular, the requirements of Section 6(b) of the Act.<sup>15</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>16</sup> 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

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<sup>12</sup> RFQ is defined as the initial request supplied by a Submitting Trading Permit Holder to initiate FLEX bidding and offering. See Rule 24B.1(r).

<sup>13</sup> See Rule 24B.1(a).

<sup>14</sup> FLEX Order is defined as (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. See Rule 24B.1(j).

<sup>15</sup> 15 U.S.C. 78f(b).

<sup>16</sup> 15 U.S.C. 78f(b)(5).

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)<sup>17</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the proposed rule change protects investors and the public interest because the AIM and FLEX AIM pilot programs have allowed (1) smaller non-FLEX option and FLEX Option orders to receive the opportunity for price improvement pursuant to the AIM auction, and (2) with respect to non-FLEX options, Agency Orders in AIM auctions that are concluded early because of quote lock on the Exchange to receive the benefit of the lock price. Additionally, as noted above, the AIM pilot program offers meaningful price improvement and making it permanent will not have an adverse effect on the market functioning on the Exchange outside of AIM. Furthermore, although it's likely that there will continue to be no BBO prior to a FLEX AIM, the FLEX AIM mechanism will continue to offer the possibility for price improvement beyond the initiator's stop price and making the pilot permanent will not have an adverse effect on the market functioning on the Exchange outside of AIM.

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

CBOE does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act. The Exchange does not believe the proposed rule changes impose any burden on intramarket competition because it applies to all Trading Permit Holders. In addition, the Exchange does not

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<sup>17</sup>

Id.

believe the proposed rule changes will impose any burden on intermarket competition, as they are merely making pilot programs already in existence permanent and which are available to all market participants through Trading Permit Holders. Additionally, CBOE believes that the AIM and FLEX AIM pilot programs have improved competition because the auction process provides non-customer and customer orders with the opportunity to receive an execution at an improved price.

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

The Exchange neither solicited nor received comments on the proposed rule change.

III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the Exchange consents, the Commission will:

- A. by order approve or disapprove such proposed rule change, or
- B. institute proceedings to determine whether the proposed rule change should be disapproved.

IV. Solicitation of Comments

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

Electronic comments:

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or

- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number SR-CBOE-2016-084 on the subject line.

Paper comments:

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

All submissions should refer to File Number SR-CBOE-2016-084. 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-2016-084, 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.<sup>18</sup>

Eduardo A. Aleman  
Assistant Secretary

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<sup>18</sup> 17 CFR 200.30-3(a)(12).