

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68145; File No. SR-CBOE-2012-102)

November 2, 2012

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Extending the FLEX Exercise Settlement Values Pilot

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 October 25, 2012, 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 Exchange has designated the proposal as a “non-controversial” proposed rule change pursuant to Section 19(b)(3)(A) of the Act³ and Rule 19b-4(f)(6) thereunder.⁴ 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 extend the operation of its Flexible Exchange Options (“FLEX Options”) pilot program regarding permissible exercise settlement values for FLEX Index Options, which pilot program is currently set to expire on November 2, 2012 or the date on which the pilot program is approved on a permanent basis.⁵ The text of the proposed rule change

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ 15 U.S.C. 78s(b)(3)(A).

⁴ 17 CFR 240.19b-4(f)(6).

⁵ 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

is available on the Exchange's website (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 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 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, the Proposed Rule Change

1. Purpose

On January 28, 2010, the Exchange received approval of a rule change that, among other things, established a pilot program regarding permissible exercise settlement values for FLEX Index Options. The pilot program is currently set to expire on the earlier of November 2, 2012 or the date on which the pilot program is approved on a permanent basis.⁶ The purpose of this

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.

⁶ At the same time the permissible exercise settlement values pilot was established for FLEX Index Options, the Exchange also established a pilot program eliminating the minimum value size requirements for all FLEX Options. Securities Exchange Act Release Nos. 61439 (January 28, 2010), 75 FR 5831 (February 4, 2010)(SR-CBOE-2009-087)(Approval Order); 61676 (March 9, 2010), 75 FR 13191 (March 18, 2010)(SR-CBOE-2010-026)(technical rule change to include original pilots' conclusion date of March 28, 2011 in the rule text); 64110 (March 24, 2011), 76 FR 17463 (March 29, 2011)(SR-CBOE-2011-024)(extending the pilots through March 30, 2012); and 66701 (March 30, 2012), 77 FR 20673 (April 5, 2012)(SR-CBOE-2012-027)(extending the

rule change filing is to extend the pilot program through the earlier of November 2, 2013 or the date on which the pilot program is approved on a permanent basis. This filing simply seeks to extend the operation of the pilot program and does not propose any substantive changes to the pilot program.

Background on the Pilot

Under Rules 24A.4, Terms of FLEX Options, and 24B.4, Terms of FLEX Options, a FLEX Option may expire on any business day specified as to day, month and year, not to exceed a maximum term of fifteen years. In addition, the exercise settlement value for a FLEX Index Option can be specified as the index value determined by reference to the reported level of the index as derived from the opening or closing prices of the component securities (“a.m. settlement” or “p.m. settlement,” respectively) or as a specified average, provided that the average index value must conform to the averaging parameters established by the Exchange.⁷

However, prior to the initiation of the exercise settlement values pilot, only a.m. settlements were permitted if a FLEX Index Option expires on, or within two business days of, a third-Friday-of-the-month expiration (“Expiration Friday”).⁸

pilots through the earlier of November 2, 2012 or the date on which the respective pilot program is approved on a permanent basis). The pilot program eliminating the minimum value size requirements has been approved on a permanent basis in a separate rule change filing. See Securities Exchange Act Release No. 67624 (August 8, 2012), 77 FR 48580 (August 14, 2012)(SR-CBOE-2012-040).

⁷ See Rules 24A.4(b)(3) and 24B.4(b)(3); see also Securities Exchange Act Release No. 31920 (February 24, 1993), 58 FR 12280 (March 3, 1993)(SR-CBOE-92-17). The Exchange has determined to limit the averaging parameters to three alternatives: the average of the opening and closing index values on the expiration date; the average of the intra-day high and low index values on the expiration date; and the average of the opening, closing, and intra-day high and low index values on the expiration date. Any changes to the averaging parameters established by the Exchange would be announced to Trading Permit Holders via circular.

⁸ For example, prior to the pilot, the exercise settlement value of a FLEX Index Option that expires on the Tuesday before Expiration Friday could have an a.m., p.m. or specified

Under the exercise settlement values pilot, this restriction on p.m. and specified average price settlements in FLEX Index Options was eliminated.⁹ The exercise settlement values pilot is currently set to expire on the earlier of November 2, 2012 or the date on which the pilot program is approved on a permanent basis.

Proposal

CBOE is proposing to extend the pilot program through the earlier of November 2, 2013 or the date on which the pilot program is approved on a permanent basis. CBOE believes the pilot program has been successful and well received by its membership and the investing public for the period that it has been in operation as a pilot. In support of the proposed extension of the pilot program, and as required by the pilot program's Approval Order, the Exchange has submitted to the Commission pilot program reports regarding the pilot, which detail the Exchange's experience with the program. Specifically, the Exchange provided the Commission an annual report analyzing volume and open interest for each broad-based FLEX Index Options class overlying an Expiration Friday, p.m.-settled FLEX Index Options series.¹⁰ The annual report also contained information and analysis of FLEX Index Options trading patterns. The

average settlement. However, the exercise settlement value of a FLEX Index Option that expires on the Wednesday before Expiration Friday could only have an a.m. settlement.

⁹ No change was necessary or requested with respect to FLEX Equity Options. Regardless of the expiration date, FLEX Equity Options are settled by physical delivery of the underlying.

¹⁰ The annual report also contained certain pilot period and pre-pilot period analyses of volume and open interest for Expiration Friday, a.m.-settled FLEX Index series and Expiration Friday Non-FLEX Index series overlying the same index as an Expiration Friday, p.m.-settled FLEX Index option.

Exchange also provided the Commission, on a periodic basis, interim reports of volume and open interest. The reports were provided to the Commission on a confidential basis.¹¹

The Exchange believes there is sufficient investor interest and demand in the pilot program to warrant its extension. The Exchange believes that, for the period that the pilot has been in operation, the program has provided investors with additional means of managing their risk exposures and carrying out their investment objectives. Furthermore, the Exchange believes that it has not experienced any adverse market effects with respect to the pilot program, including any adverse market volatility effects that might occur as a result of large FLEX exercises in FLEX Option series that expire near Non-FLEX expirations and use a p.m. settlement (as discussed below).

In that regard, based on the Exchange's experience in trading FLEX Options to date and over the pilot period, CBOE continues to believe that the restrictions on exercise settlement values are no longer necessary to insulate Non-FLEX expirations from the potential adverse market impacts of FLEX expirations.¹² To the contrary, CBOE believes that the restriction actually places the

¹¹ The Commission notes that although CBOE requested confidential treatment of the pilot reports under the Freedom of Information Act ("FOIA"), such confidentiality is subject to the provisions of FOIA. 5 U.S.C 552.

¹² In further support, the Exchange also notes that the p.m. and specified average price settlements are already permitted for FLEX Index Options on any other business day except on, or within two business days of, Expiration Friday. The Exchange is not aware of any market disruptions or problems caused by the use of these settlement methodologies on these expiration dates (or on the expiration dates addressed under the pilot program). The Exchange is also not aware of any market disruptions or problems caused by the use of customized options in the OTC markets that expire on or near Expiration Friday and have a p.m. or specified average exercise settlement value. In addition, the Exchange believes the reasons for limiting expirations to a.m. settlement, which is something the SEC has imposed since the early 1990s for Non-FLEX Options, revolved around a concern about expiration pressure on the New York Stock Exchange ("NYSE") at the close that are no longer relevant in today's market. Today, however, the Exchange believes stock exchanges are much better able to handle volume. There are multiple primary listing and unlisted trading privilege ("UTP") markets, and trading is

Exchange at a competitive disadvantage to its OTC counterparts in the market for customized options, and unnecessarily limits market participants' ability to trade in an exchange environment that offers the added benefits of transparency, price discovery, liquidity, and financial stability.

The Exchange also notes that certain position limit, aggregation and exercise limit requirements continue to apply to FLEX Index Options in accordance with Rules 24A.7, Position Limits and Reporting Requirements, 24A.8, Exercise Limits, 24B.7, Position Limits and Reporting Requirements, and 24B.8, Exercise Limits. Additionally, all FLEX Options remain subject to the position reporting requirements in paragraph (a) of CBOE Rule 4.13, Reports Related to Position Limits.¹³ Moreover, the Exchange and its Trading Permit Holder

dispersed among several exchanges and alternative trading systems. In addition, the Exchange believes that surveillance techniques are much more robust and automated. In the early 1990s, it was also thought by some that opening procedures allow more time to attract contra-side interest to reduce imbalances. The Exchange believes, however, that today order flow is predominantly electronic and the ability to smooth out openings and closes is greatly reduced (e.g., market-on-close procedures work just as well as openings). Also other markets, such as the NASDAQ Stock Exchange, do not have the same type of pre-opening imbalance disseminations as the NYSE, so many stocks are not subject to the same procedures on Expiration Friday. In addition, the Exchange believes that the NYSE has reduced the required time a specialist has to wait after disseminating a pre-opening indication. So, in this respect, the Exchange believes there is less time to react in the opening than in the close. Moreover, to the extent there may be a risk of adverse market effects attributable to p.m. settled options (or certain average price settled options related to the closing price) that would otherwise be traded in a non-transparent fashion in the OTC market, the Exchange continues to believe that such risk would be lessened by making these customized options eligible for trading in an exchange environment because of the added transparency, price discovery, liquidity, and financial stability available.

¹³ CBOE Rule 4.13(a) provides that “[i]n a manner and form prescribed by the Exchange, each Trading Permit Holder shall report to the Exchange, the name, address, and social security or tax identification number of any customer who, acting alone, or in concert with others, on the previous business day maintained aggregate long or short positions on the same side of the market of 200 or more contracts of any single class of option contracts dealt in on the Exchange. The report shall indicate for each such class of options, the number of option contracts comprising each such position and, in the case of

organizations each have the authority, pursuant to CBOE Rule 12.10, Margin Required is Minimum, to impose additional margin as deemed advisable. CBOE continues to believe these existing safeguards serve sufficiently to help monitor open interest in FLEX Option series and significantly reduce any risk of adverse market effects that might occur as a result of large FLEX exercises in FLEX Option series that expire near Non-FLEX expirations and use a p.m. settlement.

CBOE is also cognizant of the OTC market, in which similar restrictions on exercise settlement values do not apply. CBOE continues to believe that the pilot program is appropriate and reasonable and provides market participants with additional flexibility in determining whether to execute their customized options in an exchange environment or in the OTC market. CBOE continues to believe that market participants benefit from being able to trade these customized options in an exchange environment in several ways, including, but not limited to, enhanced efficiency in initiating and closing out positions, increased market transparency, and heightened contra-party creditworthiness due to the role of OCC as issuer and guarantor of FLEX Options.

If, in the future, the Exchange proposes an additional extension of the pilot program, or should the Exchange propose to make the pilot program permanent (which the Exchange currently intends to do), the Exchange will submit, along with any filing proposing such amendments to the pilot program, an additional pilot program report covering the extended period during which the pilot program was in effect and including the details referenced above

short positions, whether covered or uncovered.” For purposes of this Rule, the term “customer” in respect of any Trading Permit Holder includes “the Trading Permit Holder, any general or special partner of the Trading Permit Holder, any officer or director of the Trading Permit Holder, or any participant, as such, in any joint, group or syndicate account with the Trading Permit Holder or with any partner, officer or director thereof.” Rule 4.13(d).

and consistent with the pilot program's Approval Order. The pilot program report would be submitted to the Commission at least two months prior to the new expiration date of the pilot program. The Exchange will also continue, on a periodic basis, to submit interim reports of volume and open interest consistent with the terms of the exercise settlement values pilot program as described in the pilot program's Approval Order. All such pilot reports would continue to be provided on a confidential basis.¹⁴ As noted in the pilot program's Approval Order, any positions established under the pilot program would not be impacted by the expiration of the pilot program.¹⁵

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with Section 6(b) of the Act¹⁶ in general and furthers the objectives of Section 6(b)(5) of the Act¹⁷ 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. Specifically, the Exchange believes that the proposed extension of the pilot program, which permits additional exercise settlement values, would provide greater opportunities for investors to manage risk through the use of FLEX Options. Further, the

¹⁴ If the Exchange seeks permanent approval of the pilot program, the Exchange recognizes that certain information in the pilot reports may need to be made available on a public basis. The Commission notes that although CBOE requested confidential treatment of the pilot reports under FOIA, such confidentiality is subject to the provisions of FOIA. 5 U.S.C. 552.

¹⁵ For example, a position in a pm-settled FLEX Index Option series that expires on Expiration Friday in January 2015 could be established during the exercise settlement values pilot. If the pilot program were not extended (or made permanent), then the position could continue to exist. However, the Exchange notes that any further trading in the series would be restricted to transactions where at least one side of the trade is a closing transaction. See Approval Order, supra note 6, footnotes 9 and 10.

¹⁶ 15 U.S.C. 78f(b).

¹⁷ 15 U.S.C. 78f(b)(5).

Exchange believes that it has not experienced any adverse effects from the operation of the pilot program, including any adverse market volatility effects that might occur as a result of large FLEX exercises in FLEX Option series that expire near Non-FLEX expirations and use a p.m. settlement. The Exchange also believes that the extension of the exercise settlement values pilot does not raise any unique regulatory concerns. In particular, although p.m. settlements may raise questions with the Commission, the Exchange believes that, based on the Exchange's experience in trading FLEX Options to date and over the pilot period, market impact and investor protection concerns will not be raised by this rule change. The Exchange also believes that the proposed rule change would continue to provide Trading Permit Holders and investors with additional opportunities to trade customized options in an exchange environment (which offers the added benefits of transparency, price discovery, liquidity, and financial stability as compared to the over-the-counter market) and subject to exchange-based rules, and investors would benefit as a result.

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

Because the proposed rule change does not: (i) significantly affect the protection of investors or the public interest; (ii) impose any significant burden on competition; and (iii) become operative prior to 30 days from the date on which it was filed, or such shorter time as the Commission may designate, the proposed rule change has become effective pursuant to Section

19(b)(3)(A) of the Act¹⁸ and Rule 19b-4(f)(6) thereunder.¹⁹

A proposed rule change filed pursuant to Rule 19b-4(f)(6) under the Act²⁰ normally does not become operative for 30 days after the date of its filing. However, Rule 19b-4(f)(6)²¹ permits the Commission to designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange requested that the Commission waive the 30-day operative delay so that the proposed rule change may become operative upon filing. The Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest. The Commission notes that waiving the 30-day operative delay would prevent the expiration of the pilot programs on November 2, 2012, prior to the extension of the pilot program becoming operative. Therefore, the Commission hereby waives the 30-day operative delay and designates the proposal operative upon filing.²²

At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

¹⁸ 15 U.S.C. 78s(b)(3)(A).

¹⁹ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires a self-regulatory organization to give the Commission written notice of its intent to file the proposed rule change, along with a brief description and text of the proposed rule change, at least five business days prior to the date of filing of the proposed rule change, or such shorter time as designated by the Commission. The Exchange has satisfied this requirement.

²⁰ 17 CFR 240.19b-4(f)(6).

²¹ 17 CFR 240.19b-4(f)(6).

²² For purposes only of waiving the 30-day operative delay, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-2012-102 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-2012-102. 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 the 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-2012-102 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.²³

Kevin M. O'Neill
Deputy Secretary

²³ 17 CFR 200.30-3(a)(12).