

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-65311; File No. SR-C2-2011-018)

September 9, 2011

Self-Regulatory Organizations; C2 Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Opening and Complex Order Price Check Parameter Features

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 August 26, 2011, C2 Options Exchange, Incorporated (“Exchange” or “C2”) 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)(iii) of the Act<sup>3</sup> and Rule 19b-4(f)(6) thereunder.<sup>4</sup> 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 expand the operation of an existing price check parameter feature to its opening rotation process and to include an additional price check parameter feature for its complex order process. The text of the proposed rule change is available on the Exchange’s website (<http://www.c2exchange.com/Legal/RuleFilings.aspx>), at the Exchange’s Office of the Secretary and at the Commission’s Public Reference Room.

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>4</sup> 17 CFR 240.19b-4(f)(6).

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

The Exchange has in place various price check parameter features that are designed to prevent incoming orders from automatically executing at potentially erroneous prices. These price check parameter features are designed to help maintain a fair and orderly market. The Exchange is proposing to expand the operation of an existing price check parameter feature to its opening rotation process and to include an additional price check parameter feature for its complex order process. The Exchange believes the below-described protection features will enhance the existing functionality and assist with the maintenance of fair and orderly markets by providing an automated process that helps to mitigate the potential risks associated with orders drilling through multiple price points on the opening (thereby resulting in executions at prices that are extreme and potentially erroneous) and complex orders trading at prices that are inconsistent with particular complex order strategies (thereby resulting in executions at prices that are extreme and potentially erroneous).

With respect to opening rotations, the Exchange is proposing to amend Rule 6.11, Openings (and sometimes Closings), to extend the application of an existing price check

parameter feature to apply to the opening order exposure process. By way of background, currently the Exchange has in place a price check parameter under Rule 6.17, Price Check Parameters, which provides in relevant part that the Exchange will not automatically execute eligible orders that are marketable if the execution would follow an initial partial execution on the Exchange and would be at a subsequent price that is not within an acceptable tick distance from the initial execution (which is equivalent to the national best bid or offer (“NBBO”)). For purposes of this provision, the acceptable tick distance is determined by the Exchange on a series-by-series and premium basis for market orders and/or marketable limit orders (provided it is not less than 2 minimum increment ticks) and announced via Regulatory Circular. Also by way of background, currently as part of the opening rotation process, additional steps are automatically taken through an order exposure process to address certain opening quote, acceptable price range, market order imbalance, and NBBO conditions. At the conclusion of the order exposure process, the remaining balance of any orders are automatically executed if marketable or booked if not marketable, except that any remaining balance of opening contingency orders not executed after an exposure on the opening are automatically cancelled. Orders that are subject to this opening order exposure process are not currently subject to the price check parameter described above.

The purpose of the proposed rule change is to extend the application of the existing price check protection feature to apply to orders that are subject to the opening order exposure process, with certain modifications described below. In particular, the Exchange is proposing to amend Rule 6.11 to instead provide that, following the exposure process, the Exchange will not automatically execute or book the remaining balance of any orders not executed after an exposure on the opening that are priced or would execute at a price that is not within an

acceptable tick distance from the initial exposure price. Any remaining balance of such orders will be cancelled.<sup>5</sup> The “acceptable tick distance” will be determined by the Exchange on a series-by-series and premium basis and will be the same as the acceptable tick distance established under Rule 6.17. In accordance with Rule 6.11.02, all pronouncements regarding the acceptable tick distances determined by the Exchange will be announced via Regulatory Circular. The Exchange notes that the only distinctions in the application of the existing price check parameter to the opening order exposure process are that: (i) the price from which the acceptable tick distance is measured will be the initial exposure price,<sup>6</sup> not the NBBO; and (ii) all orders that are part of the opening order exposure process will be subject to the price check parameter, not just market orders and/or marketable limit orders.

For example, the Exchange may determine that an acceptable tick distance for a series trading in penny increments with premiums ranging from \$1.00 - \$2.99 is five ticks (i.e., \$0.05). Thus, if the initial exposure price for a series is \$1.20, any remaining balance of an order not executed via the exposure process will be cancelled to the extent the order is priced or would execute at a price that is more than \$0.05 away from the initial exposure price of \$1.20 (e.g., a market order to buy that would execute above \$1.25 or a limit order to buy that is priced above \$1.25).

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<sup>5</sup> The Exchange notes that opening contingency orders are currently subject to the order exposure process and, under the price check parameter, would also be subject to execution at prices within the acceptable tick distance. Any remaining balance of any opening contingency order that is not executed within the acceptable tick distance will be cancelled.

<sup>6</sup> The initial exposure price varies depending on the particular conditions that exist. For certain conditions, the initial exposure price is the NBBO. For other conditions, the initial exposure price is the widest point within the acceptable opening range or the NBBO, whichever is better. See Rule 6.11(e)-(f).

The Exchange believes that extending the existing price protection feature to include the opening exposure process will assist with the maintenance of fair and orderly markets by helping to mitigate the potential risks associated with orders drilling through multiple price points when the Exchange first opens for trading (thereby resulting in executions at prices that are extreme and potentially erroneous). Rather than automatically executing or booking orders at extreme and potentially erroneous prices, the Exchange will cancel orders that exceed the price check parameter back to order entry firms so that the orders can be further evaluated.

With respect to the complex order process, the Exchange is proposing to amend Rule 6.13, Complex Order Execution, to include a new price check parameter feature. Specifically, the Exchange is proposing to introduce a new price check parameter feature (the “buy-buy/sell-sell strategy parameter”) that the Exchange may determine to make available on a class-by-class basis (and announce via Regulatory Circular in accordance with Rule 6.13.01). In classes where the buy-buy/sell-sell strategy parameter feature is activated, the complex order book (“COB”) will not automatically execute an eligible complex order that is a limit order where (i) all the components of the strategy are to buy and the order is priced at zero, any net credit price, or a net debit price that is less than the number of individual option series legs in the strategy (or applicable ratio) multiplied by the applicable minimum net price increment for the complex order; or (ii) all the components of the strategy are to sell and the order is priced at zero, any net debit price, or a net credit price that is less than the number of individual option series legs in the strategy (or applicable ratio) multiplied by the applicable minimum net price increment for the complex order. Such a complex order under this feature will be rejected (and, thus, could not route to COB or the complex order RFR auction (“COA”) for processing). As proposed, in classes where the buy-buy/sell-sell strategy parameter feature is available, it will also be

available for COA responses under Rule 6.13(c), complex orders and responses under Rule 6.51, Automated Improvement Mechanism (“AIM”), and 6.52, Solicitation Auction Mechanism (“SAM”), and AIM customer-to-customer immediate crosses under Rule 6.51.08 (“CTC”).<sup>7</sup> Such paired complex orders and responses under these provisions will be rejected. In this regard, if any paired order submitted by an order entry firm for AIM, SAM or CTC processing exceeds the parameters, then both the order that exceeds the parameters and the paired contra-side order will be rejected regardless of whether the contra-side order exceeds the parameters. However, to the extent that only the paired contra-side order submitted by an order entry firm for AIM or SAM processing would exceed the price check parameter, the paired contra-side order will be rejected while the original Agency Order may be rejected or, at the order entry firm’s discretion, continue processing as an unpaired complex order (e.g., the original Agency Order would route to COB or COA for processing).

For example, under the new buy-buy/sell-sell strategy parameter feature, a limit order to sell 1 Mar 45 call where the individual option series trades in a minimum increment of \$0.05 and the minimum net price increment for the complex order is \$0.01 would be rejected if it has a net price of \$0.00, any net debit price, or a net credit price that is less than \$0.01 (\$0.01 X (1 option leg)).<sup>8</sup> Such an order would appear to be erroneously priced because normally a person selling

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<sup>7</sup> AIM, SAM and CTC are mechanisms that may be used to cross two paired orders. COA is a mechanism that may be used to expose an unpaired complex order for price improvement. Orders submitted for COA, AIM or SAM or COA processing are exposed for price improvement through an auction (and thus other market participants may submit responses), whereas orders submitted for CTC processing are executed immediately without exposure.

<sup>8</sup> If, for example, the individual option series trades in a minimum increment of \$0.05 and the minimum net price increment for the complex order is \$0.05, then the minimum net credit price calculation for the scenario above would be \$0.05 (\$0.05 X (1 options leg)).

one series would expect to receive a net credit price of at least \$0.01 (a price of at least \$0.01 – the minimum net price trading increment for the complex order - for the series being sold).

As another example, a limit order to sell 1 Mar 45 call and sell 1 Mar 50 call where the individual option series trade in a minimum increment of \$0.05 and the minimum net price increment for the complex order is \$0.01 would be rejected if it has a net price of \$0.00, any net debit price, or a net credit price that is less than \$0.02 ( $\$0.01 \times (2 \text{ options legs})$ ).<sup>9</sup> Such an order would appear to be erroneously priced because normally a person selling two series would expect to receive a net credit price of at least \$0.02 (a price of at least \$0.01 - the minimum net price increment for the complex order - for each series being sold).

As another example, assume two paired complex orders are submitted to an AIM auction and the minimum net price increment for the complex orders is \$0.01. If the original Agency Order is a market order to sell 1 Mar 45 call and sell 1 Mar 50 call (which satisfies the price check parameter because the parameter is only triggered by limit prices), but the contra-side order to buy 1 Mar 45 call and buy 1 Mar 50 call has a net price of \$0.00, the AIM auction will not initiate because the contra-side order does not satisfy the price check parameter. Such a contra-side order would appear to be erroneously priced because normally a person buying two series would expect to pay a net debit price of at least \$0.02 (a price of at least \$0.01 - the minimum net price increment for the complex order - for each series being purchased). The contra-side order would be rejected. The paired original Agency Order would either be rejected along with the contra-side order or, at the order entry firm's discretion, continue processing as an unpaired complex order.

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<sup>9</sup> If, for example, the individual option series trades in a minimum increment of \$0.05 and the minimum net price increment for the complex order is \$0.05, then the minimum net credit price calculation for the scenario above would be \$0.10 ( $\$0.05 \times (2 \text{ options legs})$ ).

The Exchange believes that this new price protection feature will assist with the maintenance of fair and orderly markets by helping to mitigate the potential risks associated with complex orders that are entered at net limit prices that are inconsistent with the particular “buy-buy” or “sell-sell” strategy (thereby resulting in execution at prices that are extreme and potentially erroneous). Rather than automatically execute, book or auction orders at prices inconsistent with the strategy, the Exchange will reject the orders back to the order entry firms.<sup>10</sup>

## 2. Statutory Basis

The proposed rule change is consistent with Section 6(b) of the Act<sup>11</sup> in general and furthers the objectives of Section 6(b)(5) of the Act<sup>12</sup> 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. The Exchange believes the proposed rule change will assist in the automatic execution and processing of orders that are subject to the Exchange’s opening and complex order processing. The Exchange also believes the proposed rule change will enhance the existing price check parameter functionality and assist with the maintenance of fair and orderly markets by providing an automated process that helps to mitigate the potential risks associated with orders drilling through multiple price points on the opening (thereby resulting in executions at prices that are extreme and potentially erroneous) and complex orders trading at prices that are inconsistent

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<sup>10</sup> The Exchange notes that the proposed buy-buy/sell-sell strategy parameter feature for limit orders is very similar to the logic behind an existing debit-to-credit/credit-to-debit strategy parameter feature and an existing vertical/butterfly strategy parameter feature under Rule 6.13.04(b) and (c), respectively. These existing price protection parameters also prevent complex orders from being automatically executed or booked at prices that would be inconsistent with the particular complex order strategies.

<sup>11</sup> 15 U.S.C. 78f(b).

<sup>12</sup> 15 U.S.C. 78f(b)(5).

with particular complex order strategies (thereby resulting in executions at prices that are extreme and potentially erroneous).

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

The Exchange does not believe that the proposed rule change will impose any burden on competition that is not necessary or appropriate in furtherance of the purposes of the Act.

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 foregoing 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 for 30 days after the date of the filing, or such shorter time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A) of the Act<sup>13</sup> and Rule 19b-4(f)(6) thereunder.<sup>14</sup>

A proposed rule change filed under Rule 19b-4(f)(6)<sup>15</sup> normally does not become operative prior to 30 days after the date of the filing. However, pursuant to Rule 19b-4(f)(6)(iii),<sup>16</sup> the Commission may designate a shorter time if such action is consistent with the protection of investors and the public interest. The Exchange has asked the Commission to waive the 30-day operative delay so that the proposal may become operative immediately upon

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<sup>13</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>14</sup> 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 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.

<sup>15</sup> 17 CFR 240.19b-4(f)(6).

<sup>16</sup> 17 CFR 240.19b-4(f)(6)(iii).

filing. The Exchange notes that waiving the 30-day operative delay will enable the Exchange to implement these protection promptly, which will allow market participants to benefit from these protections without delay. In addition, the Exchange notes that the proposed opening price check parameter feature is an extension of the Exchange's existing price check parameter feature with certain modifications (as discussed above) and is intended to address problematic executions that have previously occurred on the open. The Exchange further notes that the proposed new complex order price check parameter feature is similar to existing price check parameter features for complex orders (as discussed above) and is designed to address problematic executions that have previously occurred with complex orders. The Exchange has informed the Commission that it is proposing these changes in response to requests the Exchange received from market participants. For these reasons, the Commission believes that waiving the 30-day operative delay is consistent with the protection of investors and the public interest, and designates the proposed rule change to be operative upon filing with the Commission.<sup>17</sup>

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.

#### 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:

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<sup>17</sup> For purposes only of waiving the operative delay for this proposal, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. See 15 U.S.C. 78c(f).

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-C2-2011-018 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-C2-2011-018. 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 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-C2-2011-018 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>

Elizabeth M. Murphy  
Secretary

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