

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70857; File No. SR-CBOE-2013-107)

November 13, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change to Amend Its Rules Regarding Option Orders That Are Tied to Stock Orders

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 October 31, 2013, 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 the Substance of the Proposed Rule Change

The Exchange proposes to amend its rules regarding option orders that are tied to stock orders. 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 6.53. Certain Types of Orders Defined**

One or more of the following order types may be made available on a class-by-class basis. Certain order types may not be made available for all Exchange systems. The classes and/or systems for which the order types shall be available will be as provided in the Rules, as the context may indicate, or as otherwise specified via Regulatory Circular.

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

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

(a) – (x) No change.

(y) Tied to Stock. A tied to stock order is an option order that is tied to a stock order at the time of order entry (i.e. option order that, at the time it is entered into the System, is part of a trading strategy consisting of two or more orders, at least one of which is an order for the underlying stock, even though the component orders were submitted separately). Each tied to stock order submitted to the Exchange must be marked as “tied to stock” upon entry into the System.

*... Interpretation and Policies:*

.01 – .05 No change.

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### **Rule 6.77. Order Service Firms**

(a) – (d) No change.

(e) Order service firms must submit reports pursuant to Rule 15.2A with respect to the stock transactions it executes on behalf of market-makers pursuant to this Rule 6.77.

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### **Rule 15.2A. Reports of Execution of Stock Transactions**

In a manner and form prescribed by the Exchange, each Trading Permit Holder must submit to the Exchange as soon as practicable following the close of trading on each trading day a report of the following information regarding the stock legs of tied to stock orders, OCC orders, stock-option orders and other option orders that include stock components on the same ticket executed on that trading day: (a) time of execution, (b) execution quantity, (c) execution price, (d) venue of execution, and (e) any other information requested by the Exchange.

*... Interpretation and Policies:*

.01 The Exchange will announce by Regulatory Circular any determinations, including the manner and form of the report, that it must make pursuant to Rule 15.2A.

.02 Trading Permit Holders do not need to report information pursuant to Rule 15.2A with respect to stock-option orders or other option orders that include stock components on the same ticket that were submitted to the Exchange for electronic processing.

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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

The Exchange proposes to amend its rules regarding option orders that are tied to stock orders. The proposed rule change adds Rule 6.53(y), which defines a "tied to stock order" as an option order that is tied to a stock order at the time of order entry. In other words, a "tied to stock" order is an option order that, at the time it is entered into the System, is part of a trading strategy consisting of two or more orders, at least one of which is an order for the underlying stock, even though the component orders were submitted separately). Tied to stock orders do not include standard hedging strategies that include stock orders, as further discussed below. The proposed rule requires that each tied to stock order submitted to the Exchange be marked as "tied to stock" upon entry into the system. A tied to stock order can be a simple or complex order.

Tied to stock orders do not include qualified contingent cross (“QCC”) orders,<sup>3</sup> stock-option orders that are submitted on the same order ticket or submitted to the Exchange for electronic processing (such as to the complex order book (“COB”), complex order auction (“COA”) or automated improvement mechanism (“AIM”)),<sup>4</sup> or other option orders that include stock components on the same order ticket. Thus, those types of orders do not need to be marked as “tied to stock.” The Exchange is already aware that these types of orders include stock

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<sup>3</sup> A QCC order is an order to buy (sell) at least 1,000 standard option contracts or 10,000 mini-option contracts that is identified as being part of a qualified contingent trade coupled with a contra-side order to sell (buy) an equal number of contracts. These orders may only be entered in the standard increments applicable to simple orders in the options class under Rule 6.42. For purposes of this order type, a “qualified contingent trade” is a transaction consisting of two or more component orders, executed as agent or principal, where: (a) at least one component is an NMS stock, as defined in Rule 600 of Regulation NMS under Act; (b) all components are effected with a product or price contingency that either has been agreed to by all the respective counterparties or arranged for by a broker-dealer as principal or agent; (c) the execution of one component is contingent upon the execution of all other components at or near the same time; (d) the specific relationship between the component orders (e.g., the spread between the prices of the component orders) is determined by the time the contingent order is placed; (e) the component orders bear a derivative relationship to one another, represent different classes of shares of the same issuer, or involve the securities of participants in mergers or with intentions to merge that have been announced or cancelled; and (f) the transaction is fully hedged (without regard to any prior existing position) as a result of other components of the contingent trade. QCC orders may execute without exposure provided the execution is not at the same price as a public customer order resting in the electronic book and is at or between the national best bid or offer. A QCC order will be cancelled if it cannot be executed. See Rule 6.53(u).

<sup>4</sup> A stock-option order is an order to buy or sell a stated number of units of an underlying stock or a security convertible into the underlying stock (“convertible security”) coupled with the purchase or sale of options contract(s) on the opposite side of the market representing either (i) the same number of units of the underlying stock or convertible security, or (ii) the number of units of the underlying stock necessary to create a delta neutral position, but in no case in a ratio greater than eight-to-one (8.00), where the ratio represents the total number of units of the underlying stock or convertible security in the option leg to the total number of units of the underlying stock or convertible security in the stock leg (or such lower ratio as may be determined by the Exchange on a class-by-class basis). Only those stock-option orders with no more than the applicable number of legs, as determined by the Exchange on a class-by-class basis, are eligible for processing.

components, and thus does not require market participants to add the “tied to stock” marking to indicate the stock components for regulatory purposes, as discussed below.

The proposed rule change also adopts Rule 15.2A, which provides that each Trading Permit Holder must submit to the Exchange as soon as practicable following the close of trading on each trading day a report of the following information regarding the stock legs of any tied to stock orders, QCC orders, stock-option orders and other option orders that include stock components executed on that trading day: (a) time of execution, (b) execution quantity, (c) execution price, (d) venue of execution, and (e) any other information requested by the Exchange. Proposed Interpretation and Policy .01 provides that the Exchange will designate by Regulatory Circular any determinations<sup>5</sup> that it must make under Rule 15.2A, including the manner and form in which Trading Permit Holders should submit these reports to the Exchange. Proposed Interpretation and Policy .02 provides that Trading Permit Holders do not need to report information pursuant to Rule 15.2A with respect to stock-option orders or other option orders with stock components that [sic] on the same order ticket submitted to the Exchange for electronic processing (such as to COB, COA or AIM). Because the Exchange routes for execution through a routing broker to stock exchanges or trading centers the stock components of these orders, the Exchange will already have access to the transaction information for the stock components of these orders.

The Exchange is responsible for regulating its markets and Trading Permit Holders. To carry out its regulatory responsibilities, the Exchange needs to have sufficient trade data to effectively monitor cross-market trading activity, assist with investigations of potential violations of federal securities laws and Exchange rules, and perform market reconstructions or other

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<sup>5</sup> This includes any updates or changes to any determinations made by the Exchange.

analysis necessary to understand trading activity. CBOE currently requires Trading Permit Holders to submit various execution data in real-time or daily to help the Exchange monitor trading activity.<sup>6</sup> The Exchange believes that as use of electronic, interconnected markets continues to increase, access to additional cross-market order information, specifically information regarding stock trades tied to option orders, would enhance the Exchange's ability to monitor this trading activity and therefore allow it to more effectively fulfill its regulatory responsibilities.

The Exchange believes the additional information it will receive pursuant to proposed Rule 15.2A (including information from orders service firms) will enhance its ability to effectively monitor and conduct surveillance of the CBOE market and its Trading Permit Holders, and their relevant cross-market trading activity, and thus to detect and investigate illegal activity in a more timely fashion. The Exchange also believes that the proposed rule change will improve its ability to conduct more timely and accurate trading analyses, market reconstructions, complex enforcement inquiries or investigations, and inspections and examinations. The proposed marking of tied to stock orders will greatly improve the Exchange's ability to tie an executed stock leg to the applicable option order and thus the Exchange's ability to conduct

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<sup>6</sup> See, e.g., Rules 4.13 (requires Trading Permit Holders to submit reports to the Exchange related to position limits); 6.24 (which requires Trading Permit Holders to systemize certain order information); 6.51 (requires Trading Permit Holders to report to the Exchange certain information regarding transactions on and off the Exchange); 8.9 (requires Clearing Trading Permit Holders to report to the Exchange executed orders by Market-Makers for the purchase or sale of equity securities, as well as opening and closing positions in those securities); 15.2 (requires Trading Permit Holders to submit to the Exchange a daily report of all transactions); and 15.3 (requires Trading Permit Holders, upon request of the Exchange, to submit a report of the total uncovered short positions in each option contract class); see also Rule 15.1, Interpretation and Policy .01. Pursuant to Appendix A—Applicability of Rules of the Exchange to Chapter L of the CBOE Rules, these rules (except for Rule 6.24) also apply to CBSX Trading Permit Holders.

surveillances related to these orders, such as surveillances for compliance with Regulation SHO and frontrunning rules.

The Exchange believes the proposed rule change to mark tied to stock orders will place minimal additional burden on Trading Permit Holders, because the marking will merely be adding one additional notation when entering a tied to stock order. The Exchange also believes the proposed rule change to report to the Exchange information regarding stock trades will place minimal additional burden on Trading Permit Holders because they already have the capability to gather the required information, as the Exchange believes that stock exchanges (on which stock legs will be executed) require reporting of transaction information for stock trades in a similar manner as the Exchange does for option trades. Additionally, as discussed above, Exchange rules already require Trading Permit Holders to systemize or report various types of information regarding their orders and transactions to the Exchange. Further, the Exchange believes that this proposed rule change will substantially decrease its administrative burden in having to otherwise manually gather this cross-market information and tie stock legs to option orders in connection with its regulatory duties.

Order service firms,<sup>7</sup> which are Trading Permit Holders, will be subject to the reporting requirements set forth in proposed Rule 15.2A with respect to stock transactions that they execute on behalf of market-makers on the floor of the Exchange. The proposed rule change adds paragraph (e) to Rule 6.77 to include this reporting requirement, as the Exchange believes

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<sup>7</sup> Order service firms are regular Trading Permit Holder organizations that are registered with the Exchange for the purpose of taking orders for the purchase or sale of stocks or commodity futures contracts (and options thereon) from market-makers on the floor of the Exchange and forwarding such orders for execution. Rule 6.77(a).

that including all requirements applicable to order service firms in a single Exchange rule will benefit these firms.

The Exchange will announce the implementation date of the proposed rule change in a Regulatory Circular to be published no later than 90 days following the effective date. The implementation date will be no later than 180 days following the effective date.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with 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>8</sup> Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>9</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 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>10</sup> requirement that the rules of an exchange not be designed to permit unfair discrimination between customers, issuers, brokers, or dealers.

In particular, the Exchange believes the proposed rule change will significantly aid the Exchange's efforts to prevent fraudulent and manipulative acts and practices with respect to option orders that are tied to stock, because it will greatly improve the Exchange's ability to tie

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<sup>8</sup> 15 U.S.C. 78f(b).

<sup>9</sup> 15 U.S.C. 78f(b)(5).

<sup>10</sup> Id.

executed stock legs to the applicable option orders that were separately entered. This, along with the additional stock transaction information that the Exchange will receive pursuant to proposed Rule 15.2A, will provide the Exchange with information that will permit CBOE to more efficiently and effectively conduct its regulatory surveillances of CBOE trading activity and cross-market trading activity, such as surveillances to ensure compliance with Regulation SHO and frontrunning rules. Because the proposed rule change will enhance the Exchange's surveillance of cross-market trading activity, the Exchange believes the proposed rule change will also remove impediments to and perfect the mechanism of a free and open market and a national market system. In addition, the Exchange believes the proposed rule change will promote just and equitable principles of trade and protect investors by allowing the Exchange to detect and investigate illegal activity in a more timely fashion and improving the Exchange's ability to conduct more timely and accurate trading analyses, market reconstructions, complex enforcement inquiries or investigations, and inspections and examinations. Finally, the Exchange believes that the proposed changes to Rule 6.77 will benefit investors by including all requirements with respect to stock transactions executed by orders service firms, respectively, in a single place within the Exchange's rules.

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

CBOE does not believe that the proposed rule change will impose any burden on competition not necessary or appropriate in furtherance of the purposes of the Act. The proposed rule change will impose the same marking and reporting requirements on all Trading Permit Holders that submit tied to stock orders to CBOE. The Exchange believes that the proposed rule change does not impose any burden on intermarket competition not necessary or appropriate in furtherance of the purposes of the Act. While the proposed rule change may impose

requirements with respect to tied to stock orders submitted to CBOE that other options exchanges do not, the Exchange believes that, as discussed above, any additional burden imposed on Trading Permit Holders by this proposed rule change is minimal. The Exchange believes that stock exchanges (on which stock legs will be executed) already require reporting of transaction information for stock trades in a similar manner as the proposed rule change will require. Additionally, the marking requirement for tied to stock orders is only one additional piece of information that the Trading Permit Holder must enter when submitting a tied to stock order. The Exchange believes the benefits that the proposed rule change will provide with respect to its regulatory responsibilities far outweigh any minimal additional burden imposed on Trading Permit Holders.

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-2013-107 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-2013-107. 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. 20549-1090 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 offices 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-2013-107, 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>11</sup>

Kevin M. O'Neill  
Deputy Secretary

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<sup>11</sup> 17 CFR 200.30-3(a)(12).