

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-68615; File No. SR-CBOE-2012-133)

January 10, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change to Codify in the CBOE Stock Exchange Rules a Cross Order Type Tied to a Related Derivative Component

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on December 31, 2012, 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 proposes to codify in its rules the availability of a cross order type tied to a related derivative component on CBOE Stock Exchange (“CBSX”). 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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CHAPTER L—CBOE Stock Exchange (CBSX) Rules

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¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

Rule 51.8 Types of Orders Handled

At the discretion of CBSX, and once the CBSX System is so enabled, any of the following types of orders may be accommodated on the CBSX System:

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(u) Tied Cross Only Order. A Tied Cross Only Order is an order to trade the stock component of a qualified contingent trade which meets the qualified contingent trade exemption pursuant to Rule 611(d) of Regulation NMS under the Exchange Act. A Tied Cross Only Order may be executed without regard to the protected NBBO. The order may only be executed against a contra Tied Cross Only Order for the same size and price and may only be executed at prices at or within the CBSX BBO and, when at the CBSX BBO, consistent with the requirements of Rule 52.11.

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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

Contingent trades play an important role in the investment and trading strategies of investors and the securities industry generally. A contingent trade is a multi-component trade involving orders for a security and a related derivative, or, in the alternative, orders for related securities, that

are executed at or near the same time. The financial instruments in a contingent trade may be equities, options, futures, bonds, and combinations thereof. The economics of the transaction are based on the relationship between the prices of the security and the related derivative, or between the prices of the related securities, and the execution of one order is contingent upon the execution of the other order(s). The sought-after spread or ratio between the relevant instruments is known and specified at the time of order placement, and this sought-after spread or ratio stands regardless of the prevailing price at the time of execution. Therefore, the parties to these transactions are focused on the net price of the transaction for all of the component instruments, rather than on the absolute price of any single component instrument. Indeed, with this focus on the relative prices of the component instruments to a contingent trade, the price of a component of a particular trade may or may not correspond to the prevailing market price of the security. The parties to the trade will not execute one side of the trade without the other component or components being executed in full (or in ratio) and at the specified spread or ratio.³

The Commission noted that qualified contingent trades potentially could become too risky and costly to be employed successfully if they were required to meet the trade-through provisions of Rule 611 of Regulation NMS under the Securities Exchange Act of 1934 (the “Exchange Act”). Absent an exemption, participants in contingent trades often would need to use the Rule’s intermarket sweep order exception and route orders to execute against protected quotations with better prices than an NMS stock component of the contingent trade. Any executions of these routed orders could throw the participants “out of hedge” and necessitate additional transactions in an attempt to correct the imbalance. As a practical matter, the difficulty of maintaining a hedge, and the risk of falling out of hedge, could dissuade participants from

³ Letter to Nancy M. Morris, Secretary, Commission, from Andrew Madoff, SIA Trading Committee, SIA, dated June 21, 2006 (“SIA Exemption Request”), page 2.

engaging in contingent trades, or at least raise the cost of such trades. The elimination or reduction of this trading strategy potentially could remove liquidity from the market.⁴

Due to the above reasons, on August 31, 2006, pursuant to Rule 611(d) of Regulation NMS, the Commission granted an exemption from the provisions of Rule 611 of Regulation NMS to each NMS stock component of certain qualified contingent trades (as defined in the exemptive order) (the “QCT Exemption”).⁵ On April 4, 2008, pursuant to Rule 611(d) of Regulation NMS under the Exchange Act, the Commission issued an order modifying the QCT Exemption.⁶

In addition to incorporating several exceptions codified in Rule 611(b) of Regulation NMS, CBSX Rule 52.7 also incorporates exemptions from the Order Protection Rule granted by Commission Order.⁷ The Exchange now wishes to further clarify that the CBSX System accommodates Tied Cross Only Orders, which are orders to trade the stock component of a qualified contingent trade (that qualifies for the QCT Exemption) on CBSX pursuant to Rule 611 of Regulation NMS under the Exchange Act, as approved by the Commission and as may be amended by the Commission pursuant to Rule 611(d) of Regulation NMS.

The following examples will explain how Tied Cross Only Orders trade on CBSX:

The NBBO in stock ABC is \$10.00-\$10.01 (5 x 5), while CBSX is quoting \$9.99 – \$10.02 (1 x 1). CBSX receives a Tied Cross Only Order to cross 10,000 shares at \$10.03 (consisting of an order to buy 10,000 shares at \$10.03 and an order to sell 10,000 shares at \$10.03). Since the order pair is priced outside the CBSX book, the order will be cancelled

⁴ See Exchange Act Release No. 54389 (August 31, 2006), page 7-8.

⁵ See Exchange Act Release No. 54389 (August 31, 2006).

⁶ See Exchange Act Release No. 57620 (April 4, 2008).

⁷ See CBSX Rule 52.7(a)(9).

Consider now, in example 2, a situation in which the NBBO is \$10.00-\$10.01 (5 x 5), while CBSX is quoting \$9.99 – \$10.02 (2 x 2). CBSX receives a Tied Cross Only Order to cross 10,000 shares at \$10.02 (consisting of an order to buy 10,000 shares at \$10.02 and an order to sell 10,000 shares at \$10.02). The Tied Cross Only Order received is also greater in size than any single public customer order currently resting on the CBSX Book at \$10.02. As a Tied Cross Only Order is a qualified contingent trade meeting the QCT Exemption, a trade-through is permitted and the shares will not be routed to external markets. Rather, the buy order will trade directly against the sell order at \$10.02, provided that the order meets the requirements of CBSX Rule 52.11. CBSX Rule 52.11 provides that a CBSX Trader may cross two original orders at the established bid or offer irrespective of existing interest at such bid/offer so long as the cross transaction is (i) for at least 5,000 shares; (ii) is for a principal amount of at least \$100,000; and (iii) is greater in size than any single public customer order resting on the CBSX Book at the proposed cross price. In this example, the Tied Cross Only Order meets all three criteria; the order is for 10,000 shares, is for the principal amount of \$100,200 and is greater in size than any single public customer order currently resting on the CBSX Book at the proposed cross price. Therefore, the buy order will trade against the sell order at \$10.02

In this third example, the NBBO is \$10.00-\$10.01 (5 x 5), while CBSX is quoting \$9.99-\$10.02 (2 x 2). CBSX receives a Tied Cross Only Order to cross 9,000 shares at \$10.02 (consisting of an order to buy 9,000 shares at \$10.02 and an order to sell 9,000 shares at \$10.02). The Tied Cross Only Order received is also greater in size than any single public customer order currently resting on the CBSX Book at \$10.02. In this scenario however, the Tied Cross Only Order does not meet all the requirements of Rule 52.11. Although the order is for over 5,000 shares and is greater than any single customer order on the CBSX book at \$10.02, it is for a

principal amount of only \$90,180, which is less than the required \$100,000. Consequently, if there is any existing interest at the proposed cross price resting on the CBSX Book, the Tied Cross Only Order will be cancelled.

In this final example, the NBBO is \$10.00-\$10.01 (5 x 5), while CBSX is quoting \$9.99 – \$10.03 (2 x 2). CBSX receives a Tied Cross Only Order to cross 10,000 shares at \$10.02 (consisting of an order to buy 10,000 shares at \$10.02 and an order to sell 10,000 shares at \$10.02). In this example, the order pair is priced within the CBSX BBO. Accordingly, the buy order would cross against the sell order at 10,000 shares at \$10.02.

Finally, it should be noted that it is incumbent on the user placing a Tied Cross Only Order to represent to the Exchange that the transaction meets the QCT exemption.

The Exchange believes that the codification of this order type will clarify that CBSX accommodates market participants with flexibility in executing transactions that meet the specific requirements of this order type.

2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Act and the rules and regulations thereunder and, in particular, the requirements of Section 6(b) of the Act.⁸ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁹ requirements that the rules of an exchange be designed to promote just and equitable principles of trade, to prevent fraudulent and manipulative acts, to remove impediments to and to perfect the mechanism for a free and open market and a national market system, and, in general, to protect investors and the public interest. Tied Cross Only Orders provide investors with an additional tool to facilitate the execution of qualified contingent trades, a type of trade

⁸ 15 U.S.C. 78f(b).

⁹ 15 U.S.C. 78f(b)(5).

recognized by the Commission as beneficial to market participants. The clarification that CBSX accommodates this order type should clear up any possible confusion and therefore inform investors. Further, the proposed rule change is not designed to permit unfair discrimination between customers, issuers, brokers, or dealers, in that all such investors may enter Tied Cross Only Orders.

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. Rather, the proposed rule change merely codifies the availability of a cross order type tied to a related derivative component. As discussed above, Tied Cross Only Orders are orders to trade the stock component of a qualified contingent trade, a type of trade already recognized by the Commission as beneficial to market participants.

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

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 from the date on which it was filed, or such shorter

time as the Commission may designate, it has become effective pursuant to Section 19(b)(3)(A)¹⁰ of the Act and Rule 19b-4(f)(6)¹¹ thereunder.

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

At any time within 60 days of the filing of this 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:

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-2012-133 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-2012-133. 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-2012-133 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.¹²

Kevin M. O'Neill
Deputy Secretary

¹² 17 CFR 200.30-3(a)(12).