

SECURITIES AND EXCHANGE COMMISSION
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January 17, 2014

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to the Exchange's Quote Risk Monitor Mechanism

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 January 15, 2014, Chicago Board Options Exchange, Incorporated ("Exchange" or "CBOE") filed with the Securities and Exchange Commission ("Commission") the proposed rule change as described in Items I and II 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 amend its Quote Risk Monitor Mechanism. The text of the proposed rule change is available on the Exchange's website (<http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>), at the Exchange's Office of the Secretary, at the Commission's Public Reference Room, and on the Commission's website (<http://www.sec.gov>).

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

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

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 operation of the Exchange’s Quote Risk Monitor (“QRM”) Mechanism is codified in Rule 8.18. The purpose of this proposed rule change is to add three new functions to QRM Mechanism to help Hybrid Market-Makers (as defined in Rule 8.18) and TPH organizations control the risk of multiple, nearly-simultaneous executions across related option series. The use of the new functions is voluntary. The proposed rule change also makes clear that the TPH organization with which a Hybrid Market-Maker is associated (as well as the Hybrid Market-Maker himself) may establish parameters by which the Exchange will activate the QRM Mechanism for the Hybrid Market-Maker (the current rule text only explicitly permits Hybrid Market-Makers to establish such parameters). The Exchange also proposes to make some changes to the Rule 8.18 text to make such rule more readable in conjunction with the other changes proposed herein.³

³ Specifically, the Exchange proposes to amend the beginning of the second sentence of Rule 8.18, which reads “Hybrid Market-Makers that use the QRM Mechanism shall specify, for each such option class in which the Hybrid Market-Maker is engaged in trading, a maximum number of contracts for such option class (the “Contract Limit”) and a rolling time period in seconds within which such Contract Limit is to be measured (the “Measurement Interval”)” to read: “The functionality of the QRM Mechanism that is available to Hybrid Market-Makers includes, for each such option class in which the Hybrid Market-Maker is engaged in trading: (i) a maximum number of contracts for such option class (the “Contract Limit”) and a rolling time period in milliseconds within which such Contract Limit is to be measured (the “Measurement Interval”);”. The Exchange’s systems will allow Hybrid Market-Makers to set the Measurement Interval in milliseconds (as opposed to seconds), so the Exchange proposes to provide this more precise option to Hybrid Market-Makers.

The first new function available to Hybrid Market Makers allows each Hybrid Market-Maker the ability to specify a maximum cumulative percentage that the Hybrid Market-Maker is willing to trade (the “Cumulative Percentage Limit”). Under the proposal, the cumulative percentage is the sum of the percentages of the original quoted size of each side of each series within a class that traded, and a rolling time period in milliseconds within which such Cumulative Percentage Limit is to be measured (the “Measurement Interval”). When the QRM Mechanism determines that the Hybrid Market-Maker has traded at least the Cumulative Percentage Limit for any option class on a trading platform during any rolling Measurement Interval, the QRM Mechanism will automatically cancel all of the electronic quotes being disseminated on that trading platform with respect to that Hybrid Market-Maker in that option class and any other classes with the same underlying security until the Hybrid Market-Maker refreshes those electronic quotes.⁴

By way of example, assume a Hybrid Market-Maker is quoting the following series:

- Series A Quote: 1.00 – 1.20 50 x 50
- Series B Quote 2.00 – 2.20 75 x75
- Series C Quote 3.00 – 3.20 100 x 100

⁴ The Exchange also proposes to delete the words “more than” from the specification that “When the Exchange determines that the Hybrid Market-Maker has traded more than the Contract Limit or Cumulative Percentage Limit for such option class on a trading platform during any rolling Measurement Interval, or has traded at least the Number of Series Fully Traded on a trading platform during any rolling Measurement Interval, the QRM Mechanism shall cancel all electronic quotes that are being disseminated on the same trading platform with respect to that Hybrid Market-Maker in that option class and any other classes with the same underlying security until the Hybrid Market-Maker refreshes those electronic quotes” and replace “more than” with the words “at least”. This is because the QRM Mechanism is triggered (and quotes are canceled) at the moment when the Hybrid Market-Maker trades the Contract Limit or Cumulative Percentage Limit (as opposed to when the Hybrid Market-Maker has traded more than Contract Limit or Cumulative Percentage Limit). The Exchange also proposes to delete the words “that are” from the above statement for reasons of grammatical simplicity.

If the Cumulative Percentage Limit is set at 150% for the Hybrid Market-Maker and an order to buy 40 contracts of Series A is received, the series percentage would be 80% (i.e., 40/50). The cumulative percentage would also be 80%. If a second order to sell 25 contracts of Series B is received, the series percentage would be 33% (i.e., 25/75). The cumulative percentage would now be 113% (i.e., 80 + 33 = 113). If a third order to buy 70 contracts of Series C is received, the series percentage would be 70% (i.e., 70/100). The cumulative percentage would now be 183% (i.e., 113 + 70 = 183). Since 183% exceeds the Cumulative Percentage Limit of 150%, the Hybrid Market-Maker's quotes in the class, and any class on the same trading platform with the same underlying security, would be cancelled. This cancellation, however, would not occur until after execution of the third order. Due to firm quote obligations rules, the QRM Mechanism will not cancel quotes (and in the case of an Exchange-wide QRM Incident, orders) until after the execution of the order that caused the triggering of the QRM Mechanism. Note that percentages are added to one another, regardless of the denominator.

Percentages are also calculated based on the original quote size, not the remaining quote size. Using the quotes set forth above as an example, if an order to buy 40 contracts of Series A is received, the series percentage would be 80% (i.e., 40/50). The cumulative percentage would also be 80%. If a second order to sell 25 contracts of Series B is received, the series percentage would be 33% (i.e., 25/75). The cumulative percentage would then be 113% (i.e., 80 + 33 = 113). If a third order to buy 10 contracts of Series A is received, the series percentage would be 20% (i.e., 10/50). The cumulative percentage would then be 133% (i.e., 113 + 20 = 133). If a fourth order to buy 70 contracts of Series C is received, the series percentage would be 70% (i.e., 70/100). The cumulative percentage would then be 203% (i.e., 133 + 70 = 203).

The proposed rule change adds a second new function to the QRM Mechanism that would allow each Hybrid Market-Maker to specify the maximum number of series for which either side of the quote is fully traded (the “Number of Series Fully Traded”) and a Measurement Interval. When the QRM Mechanism determines that the Hybrid Market-Maker has traded at least the Number of Series Fully Traded for any option class on a trading platform during any rolling Measurement Interval, the QRM mechanism will automatically cancel all of the Hybrid Market-Maker’s electronic quotes being disseminated on the same trading platform in that option class and any other classes with the same underlying security until the Hybrid Market-Maker refreshes those electronic quotes.

To illustrate this functionality, assume that a Hybrid Market-Maker is quoting the following series:

- Series A Quote: 1.00 – 1.20 50 x 50
- Series B Quote 2.00 – 2.20 75 x 75
- Series C Quote 3.00 – 3.20 100 x 100

If the Number of Series Fully Traded is set at two, and an order to buy 50 contracts of Series A is received, the number of series traded in full will be one. If a second order to sell 25 contracts of Series B is received, the number of series traded in full will still be one because Series B did not trade in full. If a third order to buy 100 contracts of Series C is received, the number of series traded in full will then be two. Since two meets the parameter set for Number of Series Fully Traded, the Hybrid Market-Maker’s quotes on that trading platform in that class (and any other classes with the same underlying security traded on that trading platform) would be cancelled.

Whenever one of the QRM functions (i.e., Contract Limit, Cumulative Percentage Limit or Number of Series Fully Traded) has been triggered and the QRM Mechanism automatically

cancels all of the Hybrid Market-Maker's electronic quotes in all series of that option class traded on that trading platform (and any other classes with the same underlying security traded on that trading platform), such action by the Exchange shall be termed a "QRM Incident". Both of the new functionalities described above (along with the already-existing Contract Limit QRM functionality) are optional and Hybrid Market-Makers are not required to set parameters for the aforementioned QRM Mechanism functions.

The Exchange has above proposed that, when the QRM Mechanism automatically cancels all of a Hybrid Market-Maker's electronic quotes in an option class, the Exchange will also cancel all of the Hybrid Market-Maker's electronic quotes in any other classes with the same underlying security. The purpose of this is because the risk involved in trading beyond a Market-Maker's risk profile extends to classes that have the same underlying security (since often the only difference between such classes is the multiplier of number of units of the underlying security).

However, the Exchange has also limited cancellation of quotes to those being disseminated on the same trading platform. When a Hybrid Market-Maker has traded at least the Contract Limit or Cumulative Percentage Limit, on an option class on a trading platform during any rolling Measurement Interval, or has traded the Number of Series Fully Traded on an option class on a trading platform during any rolling Measurement Interval, the QRM Mechanism shall cancel all electronic quotes being disseminated on the same trading platform. This qualification is proposed because of the Exchange's SPX options class. SPX options (and QIXs on the S&P 500) are traded on the Exchange's Hybrid 3.0 platform, while SPX options with End-of-Week expiration ("SPXW") trade on the Exchange's Hybrid platform. The Exchange believes that the differences between trading on the two platforms are such that a Market-Maker exceeding his

risk profile trading on one platform will not necessarily mean that the Market-Maker will have exceeded his risk profile on the other platform. This will also allow a Market-Maker to set different QRM limits on SPX and SPXW.

Finally, the proposed amendment adds a third function that allows the Exchange to cancel all quotes and orders of a Hybrid Market-Maker or TPH Organization once a specified number of QRM Incidents has been reached. Under this proposed functionality, a Hybrid Market-Maker or a TPH organization may specify a maximum number of QRM Incidents with respect to all QRM Functions (i.e., Contract Limit, Cumulative Percentage Limit and Number of Series Fully Traded) and a Measurement Interval on an Exchange-wide basis. When the Exchange determines that such Hybrid Market-Maker or TPH organization has reached its QRM Incident limit during any rolling Measurement Interval, the QRM Mechanism shall cancel all of the Hybrid Market-Maker's or TPH organization's electronic quotes and Market-Maker orders resting in the Book in all option classes on the Exchange and prevent a Hybrid Market-Maker or TPH organization from sending additional quotes or orders to the Exchange until the Hybrid Market-Maker or TPH organization reactivates its ability to send quotes or orders in a manner prescribed by the Exchange.⁵

Once the QRM Mechanism is triggered and quotes (and in the case of an Exchange-wide cancellation, orders) are cancelled, all counters that determine whether the QRM Mechanism is triggered and a QRM Incident occurs will be reset for all classes for which quotes (and in the case of an Exchange-wide cancellation, orders) were canceled for all parties for whom such

⁵ The Exchange will announce such manner to Trading Permit Holders via Regulatory Circular. The current plan for such reactivation is for the Hybrid Market-Maker or TPH Organization to contact the Exchange's Help Desk to request reactivation, though the Exchange is examining the possibility of creating a systematized manner for Hybrid Market-Makers or TPH Organizations to reactivate.

quotes (and in the case of an Exchange-wide cancellation, orders) were canceled. This means that, if the QRM Mechanism is triggered due to a party's reaching the Contract Limit, Cumulative Percentage Limit, or Number of Series Fully Traded for a class, and quotes (and in the case of an Exchange-wide cancellation, orders) are canceled, the number of contracts traded in all classes for which quotes and orders were canceled would be reset to zero, the cumulative percentage for all classes for which quotes and orders were canceled would be reset to zero, and the number of series that are fully traded for all classes for which quotes and orders were canceled would be reset to zero. If the Exchange cancels all of the Hybrid Market-Maker's or TPH organization's electronic quotes and Market-Maker orders resting in the Book, and the Hybrid Market-Maker or TPH organization does not reactivate its ability to send quotes or orders, the block will be in effect only for the trading day that the Hybrid Market-Maker or TPH organization reached its QRM Incident limit.

As with the Contract Limit, Cumulative Percentage Limit or Number of Series Fully Traded QRM functions, Hybrid Market-Makers and TPH organizations are not required to set parameters for the Exchange-wide QRM. All QRM Mechanism functionalities are currently optional.

The Exchange represents that it has the systems capacity to permit the operation of these enhanced QRM Mechanism functions. The Exchange does note that, in a situation in which the QRM Mechanism is triggered, and quotes (and in the case of an Exchange-wide cancellation, orders) must be canceled for multiple classes related to the same underlying security or across multiple business clusters,⁶ it may take a brief period for such cancellation to occur (during which period orders may execute against such quotes and orders; this functionality will not

⁶ The Exchange's systems group various classes into different business clusters for systems purposes.

violate the Exchange's firm quote rules). The Exchange will use best efforts to cancel such quotes and orders as rapidly as possible.

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.⁷ Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)⁸ 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)⁹ 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 that investors and market participants will benefit from the proposed new functionality of the QRM Mechanism. Hybrid Market-Makers are vulnerable to the risk that, through an error in pricing or due to market events, they will receive multiple, automatic executions at disadvantageous or erroneous prices before they can adjust their quotes. Without adequate risk management tools such as the QRM, Hybrid Market-Makers

⁷ 15 U.S.C. 78f(b).

⁸ 15 U.S.C. 78f(b)(5).

⁹ Id.

could widen their quotes, quote less aggressively or limit their quote size. Such actions may undermine the quality of the markets available to customers and other market participants.

Accordingly, with the enhancements proposed by the Exchange to QRM, the use of the QRM Mechanism will encourage more aggressive and narrower quoting, thereby removing impediments to and perfecting the mechanism of a free and open market and a national market system, and, in general, more effectively protecting investors and the public interest. In addition, providing Market-Makers with more tools for managing risk will facilitate transactions in securities because, as noted above, the quotes of market makers will be more reliable and could help prevent erroneous orders and transactions. As a result, the new functionality for the QRM Mechanism has the potential to promote just and equitable principles of trade. Also, the proposed changes do not change to whom any aspects of the QRM Mechanism applies, as the proposed changes apply to all market participants to whom the QRM Mechanism previously applied.

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. Rather, the Exchange believes that the functions of the QRM mechanism help promote fair and orderly markets.

The Exchange does not believe that the proposed rule change will impose any burden on intramarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because the use of the QRM Mechanism including the new enhancements is voluntary. Further, the proposed changes do not change to whom any aspects of the QRM Mechanism applies, as the proposed changes apply to all market participants to whom the QRM Mechanism previously applied. Similarly, the Exchange does not believe that the proposed rule change will

impose any burden on intermarket competition that is not necessary or appropriate in furtherance of the purposes of the Act because, again, the use of the QRM Mechanism including the new enhancements is voluntary. Moreover, the proposed enhancements to the QRM Mechanism apply only to trading on CBOE. To the extent that the proposed changes may make CBOE a more attractive trading venue for market participants on other exchanges, such market participants may elect to become CBOE 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

The Exchange has filed the proposed rule change pursuant to Section 19(b)(3)(A) of the Act¹⁰ and Rule 19b-4(f)(6) thereunder.¹¹ 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, if consistent with the protection of investors and the public interest, the proposed rule change has become effective pursuant to Section 19(b)(3)(A) of the Act¹² and Rule 19b-4(f)(6) thereunder.¹³

At any time within 60 days of the filing of such proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such

¹⁰ 15 U.S.C. 78s(b)(3)(A).

¹¹ 17 CFR 240.19b-4(f)(6).

¹² 15 U.S.C. 78s(b)(3)(A).

¹³ 17 CFR 240.19b-4(f)(6). In addition, Rule 19b-4(f)(6) requires the Exchange to give the Commission written notice of the Exchange's 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.

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-2014-002 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-2014-002. 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, N.E., 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-2014-002 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.¹⁴

Kevin M. O'Neill
Deputy Secretary

¹⁴ 17 CFR 200.30-3(a)(12).