

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-70103; File No. SR-CBOE-2013-077)

August 2, 2013

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Exchange Order Handling

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 July 23, 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 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 modify its rules to address certain option order handling procedures on the Exchange in connection with the implementation of the market wide equity Plan to Address Extraordinary Market Volatility (the “Plan”). The text of the proposed rule change is available at the Exchange’s Office of the Secretary, on the Exchange’s website at <http://www.cboe.com/AboutCBOE/CBOELegalRegulatoryHome.aspx>, at the Commission’s Public Reference Room, and on the Commission’s website at <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

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

<sup>2</sup> 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 the Statutory Basis for, the Proposed Rule Change

1. Purpose

In an attempt to address extraordinary market volatility in NMS Stock, and, in particular, events like the severe volatility on May 6, 2010, the Exchange, in conjunction with the other national securities exchanges and the Financial Industry Regulatory Authority, Inc. (collectively, “Participants”) drafted the Plan pursuant to Rule 608 of Regulation NMS and under the Securities Exchange Act of 1934 (the “Act”).<sup>3</sup> The Plan is primarily designed to, among other things, address extraordinary market volatility in NMS stocks, protect investors, and promote fair and orderly markets. The Plan provides for market-wide limit up-limit down requirements that prevent trades in individual NMS Stocks from occurring outside of specified price bands, as defined in Section I(N) of the Plan. These requirements are coupled with trading pauses, as defined in Section I(Y) of the Plan, to accommodate more fundamental price moves (as opposed to erroneous trades or monetary gaps of liquidity).

The Plan was filed on April 5, 2011 by the Participants for publication and comment.<sup>4</sup> The Participants requested the Commission approve the Plan as a one-year pilot. On May 24, 2012, the Participants filed an amendment to the Plan which clarified, among other things, the calculation of the reference price, as defined in Section I(T) of the Plan, potential for order type

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<sup>3</sup> See Securities Exchange Act Release No. 64547 (May 25, 2011), 76 FR 31647 (June 1, 2011)(File No. 4-631).

<sup>4</sup> Id.

exemption, and the creation of an Advisory Committee.<sup>5</sup> On May 31, 2012, the Commission approved the Plan, as amended, on a one-year pilot basis.<sup>6</sup> The Plan was implemented on April 8, 2013.

Though the Plan was primarily designed for equity markets, the Exchange believed it would impact the options markets as well. Thus, the Exchange filed rule changes to amend the Exchange rules to ensure the option markets are not compromised as a result of the Plan's implementation.<sup>7</sup> The Exchange is proposing to further amend these rules to clarify how the "Hybrid Opening System" will operate on the Exchange in the event of a limit up-limit down state.

The current rule 6.2B.07, as recently amended, states that if an underlying security for an option class enters into a limit up-limit down state when the class moves to opening rotation, "all market orders in the system will be cancelled except market orders that are considered limit orders pursuant to Rule 6.13(b)(iv) and entered the previous trading day."<sup>8</sup> The Exchange is proposing to: (1) correct the incorrect reference to Exchange Rule 6.13(b)(iv), and (2) provide greater clarity on the effect of a limit up-limit down state on an underlying security after the opening rotation has begun.

First, the Exchange is proposing to clarify an incorrect reference in Rule 6.13(b)(iv). The orders described in the purpose section of the original rule filing are, "No-Bid Series" which are actually found in Exchange Rule 6.13(b)(vi) and not Exchange Rule 6.13(b)(iv). The Exchange is now proposing to amend Rule 6.2B.07 to reflect this correction. As stated in the original rule filing,

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<sup>5</sup> See Securities and Exchange Act Release No. 67091 (May 31, 2012), 77 FR 33498 (June 6, 2012) (File No. 4-631).

<sup>6</sup> See Securities and Exchange Act Release No. 67091 (May 31, 2012) 77 FR 33498 (June 6, 2012).

<sup>7</sup> See Securities and Exchange Act Release No. 34-69328 (April 5, 2013), 78 FR 21642 (April 11, 2013) (order approving SR-CBOE-2013-030).

<sup>8</sup> See Exchange Rule 6.2B.07.

the Exchange is proposing to allow such market orders to remain in the Exchange Book because these orders essentially act as limit orders at the minimum increment. Cancelling such orders could potentially cause such orders to lose their priority with respect to other market orders in the Exchange Book. In addition, limit orders are not cancelled while the underlying security is in a limit up-limit down state, so the Exchange believes allowing market orders that function as a limit orders to remain in the Exchange Book is consistent with the way limit order are generally handled.

Next, the Exchange is proposing to add further clarity to the recently amended rule to clarify that if a limit up-limit down state commences after the opening rotation process has begun for a class of options, the opening rotation will continue normally. More specifically, the Exchange is proposing to add language to state that market and limit orders will continue through the opening rotation as they would if there was not a limit up-limit down state. Once the opening rotation has begun for a class of options, due to how the Exchange System operates, the process will not be interrupted to modify the order handling mid-process.

Market orders will continue to process even though they are normally returned during a limit up-limit down state,<sup>9</sup> limit orders will process normally,<sup>10</sup> and auctions will open and operate as they normally do.<sup>11</sup> Market orders, though normally returned during a limit up-limit down state

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<sup>9</sup> See Exchange Rule 6.53(a) which describes how market orders process.

<sup>10</sup> See Exchange Rule 6.53(b) which describes how limit orders process.

<sup>11</sup> See Exchange Rule 6.2B.03 which describes the HAL Opening Procedure on the Exchange. If a limit up-limit down state commences after the opening rotation has begun for a class of options, options to buy and sell will be paired to the extent possible. If another market is displaying a more favorable price, then the HAL opening procedure (“HALO”) will begin as described in Exchange Rule 6.2B.03. At the end of the HALO, consistent with Rule 6.2B.03, the Exchange will link any unmatched portion of the market order to an away trading venue. Any portion of a market order that is unfilled and returned to the Exchange will be cancelled. Thus, market orders will not be filled at an unreliable price because they will either be paired with other resting orders at the open or linked to an away trading venue displaying a more favorable price. The Exchange believes this is consistent with the treatment of market orders and ensures they will not be

to avoid executions at unfavorable or unreliable prices, do not face the same risks when they are part of the opening process. This is because preopening orders are matched with each other and with other interest during the opening rotation. Thus market orders will trade at the calculated opening price. Preopening limit orders will also be filled at the opening price and cannot be filled through their limit prices.

The Exchange believes this clarity is necessary to ensure Trading Permit Holders are fully aware of special order handling during limit up-limit down states. Though the rule currently specifies what happens to orders on the Exchange if the limit up-limit down state commences prior to the opening rotation beginning for a class of options, the Exchange believes it is necessary to additionally state what would happen if the opening rotation had already begun and the limit up-limit down state triggers during the time of that process. The Exchange believes that including pre-opening market order interest in the opening rotation will enhance the liquidity available during the rotation, and that the nature of the opening match process will protect market orders against anomalous opening prices that could otherwise be caused by market conditions associated with a limit-up limit-down state. This will also help to ensure the options markets remain just and equitable with the implementation of the Plan.

## 2. Statutory Basis

The Exchange believes the proposed rule change is consistent with the Securities Exchange Act of 1934 (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>12</sup> Specifically, the

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given an unreliable price despite the limit up-limit down state. Additionally, because limit orders have a limit price, these orders will also not fill at an unreliable price.

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

Exchange believes the proposed rule change is consistent with the Section 6(b)(5)<sup>13</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>14</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 changes will be in accordance with the Act as they are merely intended to ensure the options markets will continue to remain just and equitable with the implementation of the Plan which is intended to reduce the negative impacts of a sudden, unanticipated price movement in NMS stocks. The proposed rule changes would promote this intention in the options markets while protecting investors participating there. More specifically, the currently proposed changes will correct and clarify current Exchange rules promoting the interest of investors. Finally, creating a more orderly market will promote just and equitable principles of trade by allowing investors to feel more secure in their participation in the national market system after the implementation of the Plan. In addition, the Exchange is proposing to provide a more robust rule text by clarifying what occurs if a limit up-limit down states initiates after the beginning of the Exchange's opening rotation. The Exchange believes that not cancelling the pre-opening interest will ensure investors can execute more interest

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<sup>13</sup> 15 U.S.C. 78f(b)(5).

<sup>14</sup> Id.

despite the change in the market conditions after the opening process has begun. This will also help to ensure the options markets remain just and equitable with the implementation of the Plan.

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. Specifically, the Exchange believes the proposed changes will not impose any burden on intramarket competition because it applies to all TPHs equally. The Exchange does not believe the proposed changes will impose any burden on intermarket competition as the changes are merely being made to protect investors with the implementation of the Plan. In addition, the proposed changes will provide certainty of treatment and execution of options orders during periods of extraordinary market volatility.

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)(iii) of the Act<sup>15</sup> and Rule 19b-4(f)(6) thereunder.<sup>16</sup> 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 Act and Rule 19b-4(f)(6)(iii) thereunder.

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

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

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 action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act. If the Commission takes such action, the Commission shall institute proceedings under Section 19(b)(2)(B)<sup>17</sup> of the Act to determine whether the proposed rule change should be approved or 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-2013-077 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-2013-077. 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

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<sup>17</sup> 15 U.S.C. 78s(b)(2)(B).



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 Section, 100 F Street, NE, Washington, DC 20549-1090 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of the filing will also 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-2013-077 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>

Kevin M. O'Neill  
Deputy Secretary

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