SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-77049; File No. SR-CBOE-2016-005)

February 4, 2016

Self-Regulatory Organizations; Chicago Board Options Exchange, Incorporated; Notice of Filing of a Proposed Rule Change Relating to Professionals

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the "Act"), and Rule 19b-4 thereunder, notice is hereby given that on January 27, 2016, 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 amend Interpretation and Policy .01 to Rule 1.1(ggg) relating to Professionals. 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 I Definitions

Rule 1.1. Definitions
When used in these Rules, unless the context otherwise requires:

(a) Any term defined in the Bylaws and not otherwise defined in this Chapter shall have the meaning assigned to such term in the Bylaws.

(b) – (fff) No change.

Professional

(ggg) The term "Professional" means any person or entity that (i) is not a broker or dealer in securities, and (ii) places more than 390 orders in listed options per day on average during a calendar month for its own beneficial account(s). A Professional will be treated in the same manner as a broker or dealer in securities for purposes of Rules 6.2A, 6.2B, 6.8C, 6.9, 6.13A, 6.13B, 6.25, 6.45, 6.45A (except for Interpretation and Policy .02), 6.45B (except for Interpretation and Policy .02), 6.53C(c)(ii), 6.53C(d)(v), subparagraphs (b) and (c) under Interpretation and Policy .06 to Rule 6.53C, 6.74 (except Professional orders may be considered public customer orders subject to facilitation under paragraphs (b) and (d)), 6.74A, 6.74B, 8.13, 8.15B, 8.87, 24.19, 43.1, 44.4, 44.14. The Professional designation is not available in Hybrid 3.0 classes. All Professional orders shall be marked with the appropriate origin code as determined by the Exchange.

. . . Interpretations and Policies:

.01 [For purposes of this Rule 1.1(ggg), an order which is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple parts by a broker or dealer or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer in order to achieve a specific execution strategy including, for example, a basket trade, program trade, portfolio trade, basis trade, or benchmark hedge, constitutes a single order and shall be counted as one order.] <u>Except as noted below, each order of any order type counts as one order for Professional order counting purposes.</u>

<u>(a) Complex Orders:</u>

- <u>(1) A complex order comprised of four (4) legs or fewer counts as a single order;</u>

- <u>(2) A complex order comprised of five (5) legs or more counts as multiple orders with each option leg counting as its own separate order;</u>

<u>(b) “Parent”/“Child” Orders:</u>

- <u>(1) Same Side and Same Series: A “parent” order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple “child” orders on the same side (buy/sell) and series as the “parent” order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the “child” orders are routed across multiple exchanges.</u>

- <u>(2) Both Sides and/or Multiple Series: A “parent” order (including a strategy order) that is broken into multiple “child” orders on both sides (buy/sell) of a series and/or multiple series counts as multiple orders, with each “child” order counting as a new and separate order.</u>

(c) Cancel/Replace:

(1) Except as provided in paragraph (c)(2) below, any order that cancels and replaces an existing order counts as a separate order (or multiple new orders in the case of a complex order comprised of five (5) legs or more).

(2) Same Side and Same Series: An order that cancels and replaces any "child" order resulting from a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, does not count as a new order.

(3) Both Sides and/or Multiple Series: An order that cancels and replaces any "child" order resulting from a "parent" order (including a strategy order) that generates "child" orders on both sides (buy/sell) of a series and/or in multiple series counts as a new order.

(4) Pegged Orders: Notwithstanding the provisions of paragraph (c)(2) above, an order that cancels and replaces any "child" order resulting from a "parent" order being "pegged" to the BBO or NBBO or that cancels and replaces any "child" order pursuant to an algorithm that uses BBO or NBBO in the calculation of "child" orders and attempts to move with or follow the BBO or NBBO of a series counts as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO.

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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 Interpretation and Policy .01 to Rule 1.1(ggg) (Professional) relating to Professionals. Specifically, the Exchange proposes to delete current Interpretation and Policy .01 to Rule 1.1(ggg) and adopt new Interpretation and Policy .01 to Rule 1.1(ggg), setting forth amended standards for calculating average daily order submissions for Professional order counting purposes. The Exchange believes that the proposed rule change would provide additional clarity in the Rules and serve to promote the purposes for which the Exchange originally adopted Rule 1.1(ggg) relating to Professionals.

Background

In general, "public customers" are granted certain marketplace advantages over other market participants, including Market-Makers, brokers and dealers of securities, and industry "Professionals" on most U.S. options exchanges. The U.S. options exchanges, including CBOE, have adopted materially similar definitions of the term "Professional,"[1] which commonly refers to persons or entities that are not a brokers or dealers in securities and who or which place more than 390 orders in listed options per day on average during a calendar month for their own beneficial

1 Some U.S. options exchanges refer to "Professionals" as "Professional Customers" or non-"Priority Customers." Compare BATS Exchange, Inc. ("BZX") Rule 16.1(a)(45) (Professional); BOX Options Exchange LLC ("BOX") Rule 100(a)(50) (Professional); CBOE Rule 1.1(ggg) (Professional); C2 Rule 1.1; BX Chapter I, Sec. 1(49) (Professional); NASDAQ OMX PHLX LLC ("PHLX") Rule 1000(b)(14) (Professional); Nasdaq Options Market ("NOM") Chapter I, Sec. 1(a)(48) (Professional); with ISE Rule 100(a)(37A) (Priority Customer); Gemini Rule 100(a)(37A) (Priority Customer); Miami International Securities Exchange LLC ("MIAX") Rule 100 (Priority Customer); NYSE MKT LLC ("NYSE MKT") Rule 900.2NY(18A) (Professional Customer); NYSE Arca, Inc. ("Arca") Rule 6.1A(4A) (Professional Customer).

account(s).[2] Various exchanges adopted similar Professional rules for many of the same reasons, including, but not limited to the desire to create more competitive marketplaces and attract retail order flow.[3] In addition, as several of the exchanges noted in their original Professional rule filings, their beliefs that disparate Professional rules and a lack of uniformity in the application of such rules across the options markets would not promote the best regulation and may, in fact, encourage regulatory arbitrage.[4]

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2 See, e.g., BZX Rule 16.1(a)(45); BOX Rule 100(a)(50); CBOE Rule 1.1(ggg); C2 Rule 1.1; BX Chapter I, Sec. 1(49); PHLX Rule 1000(b)(14); NOM Chapter I, Sec. 1(a)(48); see also ISE Rule 100(a)(37A) (Priority Customer); Gemini Rule 100(a)(37A) (Priority Customer); MIAX Rule 100 (Priority Customer); NYSE MKT Rule 900.2NY(18A) (Professional Customer); Arca Rule 6.1A(4A) (Professional Customer).

3 See, e.g., Securities Exchange Act Release No. 60931 (November 4, 2009), 74 FR 58355, 58356 (November 12, 2009) (Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders) (SR-CBOE 2009-078); Securities Exchange Act Release No. 59287 (January 23, 2009), 74 FR 5694, 5694 (January 30, 2009) (Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of the Proposed Rule Change, as Modified by Amendment Nos. 1 and 2 Thereto, Relating to Professional Account Holders) (SR-ISE-2006-026); Securities Exchange Act Release No. 61802 (March 30, 2010), 75 FR 17193, 17194 (April 5, 2010) (Notice of Filing of Amendment No. 2 and Order Granting Accelerated Approval of the Proposed Rule Change, as Modified by Amendment No. 2 Thereto, Relating to Professional Orders) (SR-PHLX-2010-005); Securities Exchange Act Release No. 61629 (March 2, 2010), 75 FR 10851, 10851 (March 9, 2010) (Notice of Filing of Proposed Rule Change Relating to the Designation of a "Professional Customer") (SR-NYSEMKT-2010-018).

4 See, e.g., Securities and Exchange Act Release No. 62724 (August 16, 2010), 75 FR 51509 (August 20, 2010) (Notice of Filing of a Proposed Rule Change by the NASDAQ Stock Market LLC To Adopt a Definition of Professional and Require That All Professional Orders Be Appropriately Marked) (SR-NASDAQ-2010-099); Securities and Exchange Act Release No. 65500 (October 6, 2011), 76 FR 63686 (October 13, 2011) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt a Definition of Professional and Require That All Professional Orders Be Appropriately Marked) (SR-BATS-2011-041); Securities Exchange Act Release No. 65036 (August 4, 2011), 76 FR 49517, 49518 (August 10, 2011) (Notice of Filing and Immediate Effectiveness of Proposed Rule Change To Adopt a Definition of "Professional" and Require That Professional Orders Be Appropriately Marked by BOX Options Participants) (SR-BX-2011-049); Securities Exchange Act Release No. 60931 (November 4, 2009), 74 FR 58355, 58357 (November 12, 2009) (Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders) (SR-CBOE 2009-078); see also Securities Exchange Act Release 73628

Similar to other U.S. options exchanges, the Exchange grants "public customers" certain marketplace advantages over other market participants pursuant to the Exchange's Fees Schedule[5] and the Rules.[6] In general, public customers receive allocation and execution priority above equally priced competing interests of Market-Makers, broker-dealers, and other market participants. In addition, customer orders are generally exempt from transaction fees and certain Exchange surcharges. Similar to other U.S. options exchanges, the Exchange affords these marketplace advantages to public customers based on various business- and regulatory-related objectives, including, for example, to attract retail order flow to the Exchange and to provide competitive pricing.

Prior to 2009, the Exchange designated all orders as either customer orders or non-customer orders based solely on whether or not the order was placed for the account of a registered securities broker or dealer. As non-broker-dealer investors gained more access to electronic trading platforms, analytics technology, and market data services previously available only to securities brokers and dealers, the distinction between public customers and non-customers became less effective in promoting the intended purposes of the Exchange's customer priority rules because certain customers were more similarly situated to broker-dealers. As the Exchange noted at the time, the Exchange no longer believed that the definitions of customer and non-customer properly distinguished between the kind of nonprofessional retail investors that the order priority rules and fee exemptions were intended to benefit and non-broker-dealer professional traders with access to

(November 18, 2014), 79 FR 69958, 69960 (November 24, 2014) (Notice of Filing and Immediate Effectiveness of a Proposed Rule Change Relating to Professional Orders) (SR-CBOE-2014-085).

5 See, e.g., Fees Schedule (Options Transaction Fees).

6 See, e.g., Rules 6.45A (Priority and Allocation of Equity Option Trades on the CBOE Hybrid System), 6.45B (Priority and Allocation of Trades in Index Options and Options on ETFs on the CBOE Hybrid System).

advanced market data information and sophisticated trading platforms that were not intended to benefit from those rules and exemptions.[7] Furthermore, the Exchange believed that distinguishing solely between registered broker-dealers and non-broker-dealers with respect to order priority and fee exemptions was inconsistent with principles of fair competition and inappropriate in the marketplace given professional traders' access to the same trading tools and market data services as broker-dealers while taking advantage of the same order priority and fee exemptions as retail investors. Accordingly, in 2009, the Exchange adopted a definition of "Professional" under Rule 1.1(ggg) to further distinguish different types of orders placed on the Exchange.[8]

Under Rule 1.1(ggg), a Professional is defined as a person or entity that is not a securities broker or dealer that places more than 390 listed options orders per day on average during a calendar month for its own beneficial account(s). As discussed above, in large part, the Exchange's Professional order rules were adopted to distinguish non-broker dealer individuals and entities that have access to information and technology that enable them to professionally trade listed options in a manner similar to brokers or dealers in securities from retail investors for order priority and/or transaction fees purposes. In general, Professionals are treated as brokers or dealers in securities under the Exchange's rules, including, but not limited to with respect to order priority and fees.[9]

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7 See Securities Exchange Act Release No. 60931 (November 4, 2009), 74 FR 58355, 58356 (November 12, 2009) (Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders) (SR-CBOE 2009-078).

8 Notably, the Exchange's Professional order rule was materially based upon a similar proposal by the International Securities Exchange, LLC ("ISE") as set forth in SR-ISE-2006-026. See id. at 58356, note 6.

9 See Rule 1.1(ggg). Notably, however, Professional orders are treated as public customer orders pursuant to certain rules, such as if the order is held by a broker and the broker crosses it with a facilitation order on the floor.

Rule 1.1(ggg) is substantially similar to the Professional order rules of other exchanges and was materially based upon the preexistent Professional order rules of other exchanges.[10]

After adopting Rule 1.1(ggg), the Exchange issued a Regulatory Circular, interpreting Rule 1.1(ggg).[11] In particular, with respect to the counting of single original orders that are then broken up into multiple orders to achieve a specific execution strategy, the Exchange interpreted Rule 1.1(ggg) to allow such orders to be counted as one single order for Professional order counting purposes.[12] Over time, however, the Exchange began to receive more and more questions as to what constitutes an "order" for Professional order counting purposes, including, but not limited to questions about how to count certain types of strategy orders and how to count "child" orders generated as part of specific "parent" execution strategies.

In November 2014, in response to these questions, the Exchange clarified its Professional order rule by adopting Interpretation and Policy .01 to Rule 1.1(ggg). Specifically, the Exchange codified its interpretation that, for Professional order counting purposes, "parent" orders that are placed on a single ticket and entered for the beneficial account(s) of a person or entity that is not a broker or dealer in securities and that are broken into multiple parts by a broker or dealer, or by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer that is housed with the customer in order to achieve a specific execution strategy, including, but not limited to basket trades, program trades, portfolio trades, basis trades, and benchmark hedges, should count as one single order for Professional order counting purposes. This interpretation was a clarification

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10 See Securities Exchange Act Release No. 60931 (November 4, 2009), 74 FR 58355, 58356 (November 12, 2009) (Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders) (SR-CBOE 2009-078); see, e.g., ISE Rule 100(a)(31A).

11 See Regulatory Circular RG09-148 (Professional Orders).

12 See id. at Question 14.

in the Rules based on the Exchange's past interpretations of Rule 1.1(ggg) and similar interpretations set forth in a previously issued ISE/ISE Gemini, LLC ("Gemini") Joint Regulatory Information Circular.[13]

The Exchange's adoption of Interpretation and Policy .01 to Rule 1.1(ggg), however, has not clarified the Exchange's Professional rule completely. The advent of new multi-leg spread products and the proliferation of the use of complex orders and algorithmic execution strategies by both institutional and retail market participants continue to raise questions as to what constitutes an "order" for Professional order counting purposes. For example, do multi-leg spread orders (which on the Exchange may be up to 12 legs) or strategy orders such as volatility orders constitute a single order or multiple orders for Professional order counting purposes? The Exchange's Professional rule does not fully address these issues and there is no common interpretation across the U.S. options markets. In fact, CBOE is the only U.S. options exchange to have adopted any interpretation of how certain types of orders should be counted under its Professional rule. The Exchange believes that additional clarity is needed regarding the application of Rule 1.1(ggg). Accordingly, the Exchange is proposing to amend Interpretation and Policy .01 to Rule 1.1(ggg) to address how various new execution and order strategies should be treated under the Exchange's Professional rule.

Moreover, the Exchange believes that a new Interpretation and Policy would better serve to accomplish the Exchange's stated goals for its Professional rule. Under current Interpretation and Policy .01 to Rule 1.1(ggg) many market participants using sophisticated execution strategies and trading algorithms who would typically be considered professional traders are not identified under the Exchange's Professional rule. The Exchange believes that these types of market participants

13 See ISE Regulatory Information Circular 2014-007/Gemini Regulatory Information Circular 2014-011 (Priority Customer Orders and Professional Orders (FAQ)).

have access to technology and market information akin to broker-dealers. The Exchange also believes that a new Interpretation and Policy to Rule 1.1(ggg) is warranted to ensure that public customers are afforded the marketplace advantages that they are intended to be afforded over other types of market participants on the Exchange.

The Exchange notes that despite the adoption of materially similar Professional rules across the markets, exchanges' interpretations of their respective Professional rules vary. Although Professionals are similarly defined by exchanges as non-broker-dealer persons or entities that place more than 390 orders in listed options for their own beneficial account(s) per day on average during a calendar month, there is no consistent definition across the markets as to what constitutes an "order" for Professional order counting purposes. While several options exchanges, including CBOE, have attempted to clarify their interpretations of their Professional rules through regulatory and information notices and circulars,[14] many of the options exchanges have not issued any guidance regarding the application of their Professional rules. Furthermore, where exchanges have issued such interpretive guidance, those interpretations have not necessarily been consistent.[15] As a result, the Exchange believes that the rather than helping to promote the best regulation and discourage regulatory arbitrage, the Professional rules have become a basis of intermarket

[14] See Regulatory Circular RG09-148 (Professional Orders); ISE Regulatory Information Circular 2014-007/Gemini Regulatory Information Circular 2014-011 (Priority Customer Orders and Professional Orders (FAQ)); MIAX Regulatory Circular 2014-69 (Priority Customer and Professional Interest Order Summary); NYSE Joint Regulatory Bulletin, NYSE Acra RBO-15-03, NYSE Amex RBO-15-06) (Professional Customer Orders); BOX Regulatory Circular RC-2015-21 (Professional Orders).

[15] Compare NYSE Joint Regulatory Bulletin, NYSE Acra RBO-15-03, NYSE Amex RBO-15-06) (Professional Customer Orders) with Interpretation and Policy .01 to Rule 1.1(ggg); Regulatory Circular RG09-148 (Professional Orders); ISE Regulatory Information Circular 2014-007/Gemini Regulatory Information Circular 2014-011 (Priority Customer Orders and Professional Orders (FAQ)); and ISE Regulatory Information Circular 2009-179 (Priority Customer Orders and Professional Orders (FAQ)).

competition. As noted above, CBOE is the only U.S. options exchange that has adopted interpretive guidance regarding its Professional rule in its rules.

The Exchange believes that a new set of standards and a more detailed counting regime than the Exchange's current Professional order rules provide would allow the Exchange to better compete for order flow and help ensure deeper levels of liquidity on the Exchange. The Exchange also believes that the proposed rule change would help to remove impediments to and help perfect the mechanism of a free and open market and a national market system by increasing competition in the marketplace. Accordingly, the Exchange proposes to amend the Rules by deleting current Interpretation and Policy .01 to Rule 1.1(ggg) and, in its place, adopt a new Interpretation and Policy with respect to Professional order counting.

Proposal

The Exchange proposes to delete current Interpretation and Policy .01 to Rule 1.1(ggg) and replace it with a new Interpretation and Policy setting forth a more detailed counting regime for calculating average daily orders for Professional order counting purposes. Specifically, the Exchange's proposed Interpretation and Policy would make clear how to count complex orders, "parent/child" orders that are broken into multiple orders, and "cancel/replace" orders for Professional order counting purposes.

Under the Exchange's proposed Interpretation and Policy .01 to Rule 1.1(ggg), all orders would count as one single order for Professional counting purposes, unless otherwise specified under the Rules. Proposed Interpretation and Policy .01 to Rule 1.1(ggg) would provide that except as noted below, each order of any order type counts as one order for Professional order counting purposes. Paragraph (a) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would discuss complex orders. Under paragraph (a)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), a complex order comprised of four (4) legs or fewer would count as a single order. Conversely, paragraph (a)(2) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would provide that a complex order comprised of five (5) legs or more counts as multiple orders with each option leg counting as its own separate order. The Exchange believes the distinction between complex orders with up to four legs from those with five or more legs is appropriate in light of the purposes for which Rule 1.1(ggg) was adopted. In particular, the Exchange notes that multi-leg complex order strategies with five or more legs are more complex in nature and thus, more likely to be used by professional traders than traditional two, three, and four leg complex order strategies such as the strangle, straddle, butterfly, collar, and condor strategies, which are oftentimes used by retail investors. Thus, the types of complex orders traditionally placed by retail investors would continue to count as only one order while the more complex strategy orders that are typically used by professional traders would count as multiple orders for Professional order counting purposes.

Paragraph (b) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would provide details relating to the counting of "parent/child" orders. Under paragraph (b)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer, counts as one order even if the "child" orders are routed across multiple exchanges. Essentially, this paragraph would describe how orders placed for public customers, which are "worked" by a broker in order to receive best execution should be counted for Professional order counting purposes. Paragraph (b)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would permit larger "parent" orders (which may be simple orders or complex orders consisting of up to four legs), to be broken into multiple smaller orders on the same side (buy/sell) and in the same series (or complex orders consisting of up to four legs) in order to attempt to achieve best execution for the overall order.

For example, if a customer were to enter an order to buy 1,000 XYZ $5 January calls at a limit price of $1, which the customer's broker then broke into four separate orders to buy 250 XYZ $5 January calls at a limit price of $1 in order to achieve a better execution, the four "child" orders would still only count as one order for Professional order counting purposes (whether or not the four separate orders were sent to the same or different exchanges for execution).[16] Similarly, in the case of a complex order, if a customer were to enter an order to buy 1,000 XYZ $5 January(sell)/March(buy) calendar spreads (with a 1:1 ratio on the legs), at a net debit limit price of $0.20, which the customer's broker then broke into four separate orders to buy 250 XYZ $5 January/March calendar spreads (each with a 1:1 ratio on the legs), each at a net debit limit price of $0.20, the four "child" orders would still only count as one order for Professional order counting purposes (whether or not the four separate orders were sent to the same or different exchanges for execution).

Conversely, under paragraph (b)(2) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), a "parent" order (including a strategy order)[17] that is broken into multiple "child" orders

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16 Notably, however, if the customer herself were to enter the same four identical orders to buy 250 XYZ $5 January calls at a limit price of $1 prior to sending the orders, those orders would count as four separate orders for Professional order counting purposes because the orders would not have been broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, or by an algorithm housed at a broker or dealer or by an algorithm licensed from a broker or dealer, but which is housed with the customer.

17 For purposes of this proposed Interpretation and Policy, the term "strategy order" is intended to mean an execution strategy, trading instruction, or algorithm whereby multiple "child" orders on both sides of a series and/or multiple series are generated prior to being sent to any or multiple U.S. options exchange(s).

on both sides (buy/sell) of a series[18] and/or multiple series counts as multiple orders, with each "child" order counting as a new and separate order. Accordingly, under this provision, strategy orders, which are most often used by sophisticated traders best characterized as "Professionals," would count as multiple orders for each child order entered as part of the overall strategy. For example, if a customer were to enter a volatility order[19] or "vega" order[20] with her broker by which multiple "child" orders were then sent to the Exchange across multiple series in a particular option class, each order entered would count as a separate order for Professional order counting purposes. Likewise, if the customer instructed her broker to buy a variety of calls across various option classes

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18 The Exchange recognizes that with respect to customers and, in particular, the counting of customer orders for Professional purposes, paragraphs (b)(2) and (c)(3) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) contain language that is somewhat redundant and superfluous. Because non-professional customers may not simultaneously or nearly simultaneously enter multiple limit orders to buy and sell the same security (i.e. act as Market-Makers) (see Rule 6.8C), a "parent" customer order that is broken into multiple "child" orders on both sides (buy/sell) must necessarily be placed across multiple series. Accordingly, when considered in conjunction with the prohibitions in Rule 6.8C, the operation of paragraphs (b)(2) and (c)(3) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would be the same even if the proposed rule were only applied to "child" orders placed in multiple series. The Exchange, however, has determined to include references to "both sides (buy/sell) of a series" in the text of proposed Interpretation and Policy .01 to Rule 1.1(ggg) to reinforce the concepts underlying the Exchange's proposed Professional order counting structure.

19 A "volatility" or "volatility-type" order may be characterized as an order instruction or combination to buy/sell contracts at a specific implied volatility rather than at a specific price or premium. Because implied volatility is a key determinant of the premium on an option, some traders may wish to take positions in specific contract months in an effort to take advantage of perceived changes in implied volatility arising before, during, or after earnings or in a certain company when specific or broad market volatility is predicted to change. In certain cases, depending on where a customer's account is housed or the trading capabilities of the participant involved, an options trader may trade and position for movements in the price of the option based on implied volatility using a "volatility" or "volatility-type" order or trading instruction by setting a limit for the volatility level they are willing to pay or receive. In such cases, premiums may be calculated in percentage terms rather than premiums.

20 An option's vega is a measure of the impact of changes in the underlying volatility on the option price. Specifically, the vega of an option expresses the change in the price of the option for every 1% change in underlying volatility.

as part of a basket trade, each order entered by the broker in order to obtain the positions making up the basket would count as a separate order for Professional counting purposes.[21]

The Exchange believes that the distinctions between "parent" and "child" orders in paragraph (b) to proposed Rule 1.1(ggg) are appropriate. The Exchange notes that paragraph (b) to proposed Interpretation and Policy .01 to Rule 1.1(ggg) is not aimed at capturing orders that are being "worked" or broken into multiple orders to avoid showing large orders to the market in an effort to elude front-running and to achieve best execution as is typically done by brokers on behalf of retail clients. Rather, paragraph (b) to proposed Interpretation and Policy .01 to Rule 1.1(ggg) is aimed at identifying "child" orders of "parent" orders generated by algorithms that are typically used by sophisticated traders to continuously update their orders in concert with market updates in order to keep their overall trading strategies in balance. The Exchange believes that these types of "parent/child" orders typically used by sophisticated traders should count as multiple orders.

Paragraph (c) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), would discuss the counting of orders that are cancelled and replaced. Similar to the distinctions drawn in paragraph (b) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), paragraph (c) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would essentially separate orders that are cancelled and replaced as part of an overall strategy from those that are cancelled and replaced by a broker that is "working" the order to achieve best execution or attempting to time the market. Specifically, paragraph (c)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would provide that except as otherwise provided in the rule (and specifically as provided under paragraph (c)(2) to

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21 Notably, with respect to the types of "parent" orders (including strategy orders) described in paragraph (b)(2) to proposed Interpretation and Policy .01 to Rule 1.1(ggg), such orders would be received only as multiple "child" orders the U.S. options exchange receiving such orders. The "parent" order would be broken apart before being sent by the participant to the exchange(s) as multiple "child" orders. See supra at note 19.

proposed Interpretation and Policy .01 to Rule 1.1(ggg)), any order that cancels and replaces an existing order counts as a separate order (or multiple new orders in the case of a complex order comprised of five (5) legs or more). For example, if a trader were to enter a non-marketable limit order to buy an option contract at a certain net debit price, cancel the order in response to market movements, and then reenter the same order once it became marketable, those orders would count as two separate orders for Professional order counting purposes even though the terms of both orders were the same.

Paragraph (c)(2) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would specify the exception to paragraph (c)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) and would provide that an order that cancels and replaces any "child" order resulting from a "parent" order that is placed for the beneficial account(s) of a person or entity that is not a broker, or dealer in securities that is broken into multiple "child" orders on the same side (buy/sell) and series as the "parent" order by a broker or dealer, by an algorithm housed at a broker or dealer, or by an algorithm licensed from a broker or dealer, but which is housed with the customer, would not count as a new order. For example, if a customer were to enter an order with her broker to buy 10,000 XYZ $5 January calls at a limit price of $1, which the customer's broker then entered, but could not fill and then cancelled to avoid having to rest the order in the book as part of a strategy to obtain a better execution for the customer and then resubmitted the remainder of the order, which would be considered a "child" of the "parent" order, once it became marketable, such orders would only count as one order for Professional order counting purposes. Again, similar to paragraph (b) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), the Exchange notes that paragraph (c) to proposed Interpretation and Policy .01 to Rule 1.1(ggg) is not aimed at capturing orders that are being "worked" or being cancelled and replaced to avoid showing large orders to the market in an effort to elude front-running and to achieve best execution as is typically done by brokers on behalf of retail clients. Rather, paragraph (c) to proposed Interpretation and Policy .01 to Rule 1.1(ggg) is aimed at identifying "child" orders of "parent" orders generated by algorithms that are typically used by sophisticated traders to continuously update their orders in concert with market updates in order to keep their overall trading strategies in balance. The Exchange believes that paragraph (c)(2) to proposed Interpretation and Policy .01 to Rule 1.1(ggg) is consistent with these goals.

Accordingly, consistent with paragraph (c)(1) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), under paragraph (c)(3) of proposed Interpretation and Policy .01 to Rule 1.1(ggg), an order that cancels and replaces any "child" order resulting from a "parent" order (including a strategy order) that generates "child" orders on both sides (buy/sell) of a series and/or in multiple series would count as a new order. For example, if an investor were to seek to make a trade (or series of trades) to take a long vega position at a certain percentage limit on a basket of options, the investor may need to cancel and replace several of the "child" orders entered to achieve the overall execution strategy several times to account for updates in the prices of the underlyings. In such a case, each "child" order placed to keep the overall execution strategy in place would count as a new and separate order even if the particular "child" order were being used to replace a slightly different "child" order that was previously being used to keep the same overall execution strategy in place. The Exchange believes that the distinctions between cancel/replace orders in paragraph (c) to proposed Rule 1.1(ggg) are appropriate as such orders are typically generated by algorithms used by sophisticated traders to keep strategy orders continuously in line with updates in the markets. As such, the Exchange believes that in most cases, cancel/replace orders should count as multiple orders.

Finally, paragraph (c)(4) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would codify the Exchange's "pegged" order interpretation in the text of the Rules. Paragraph (c)(4) of proposed Interpretation and Policy .01 to Rule 1.1(ggg) would provide that notwithstanding the provisions of paragraph (c)(2) above, an order that cancels and replaces any "child" order resulting from a "parent" order being "pegged" to the Exchange's best bid or offer ("BBO") or national best bid or offer ("NBBO") or that cancels and replaces any "child" order pursuant to an algorithm that uses BBO or NBBO in the calculation of "child" orders and attempts to move with or follow the BBO or NBBO of a series would count as a new order each time the order cancels and replaces in order to attempt to move with or follow the BBO or NBBO. This interpretation is similar to the Exchange's current interpretation of its Professional order rules, but adds clarifying language to the Exchange's current interpretation and the Rules.[22] The Exchange believes that paragraph (c)(4) is appropriate to make clear that "pegged" strategy orders that are typically used by sophisticated traders should be counted as multiple orders even though such orders may cancel/replace orders in on the same side (buy/sell) of the market in a single series in order to achieve an overall order strategy.

Under current Rule 1.1(ggg), in order to properly represent orders entered on the Exchange according to the Professional order rules, Trading Permit Holders ("TPHs") are required to indicate whether public customer orders are "Professional" orders.[23] This requirement will remain the same. To comply with this requirement, TPHs are required to review their customers' activity on at least a quarterly basis to determine whether orders that are not for the account of a broker or dealer should

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[22] See CBOE Regulatory Circular RG09-148 (Professional Orders) at Question 12.

[23] See Securities Exchange Act Release No. 60931 (November 4, 2009), 74 FR 58355 (November 12, 2009) (Notice of Filing of Proposed Rule Change, as Modified by Amendment No. 1, Related to Professional Orders) (SR-CBOE 2009-078).

be represented as customer orders or Professional orders.[24] Orders for any customer that had an average of more than 390 orders per day during any month of a calendar quarter must be represented as Professional orders for the next calendar quarter. TPHs are required to conduct a quarterly review and make any appropriate changes to the way in which they are representing orders within five days after the end of each calendar quarter. While TPHs only will be required to review their accounts on a quarterly basis, if during a quarter the Exchange identifies a customer for which orders are being represented as public customer orders but that has averaged more than 390 orders per day during a month, the Exchange will notify the TPH and the TPH will be required to change the manner in which it is representing the customer's orders within five days. Because Rule 1.1(ggg) only requires that TPHs conduct a look-back to determine whether their customers are averaging more than 390 orders per day at the end of each calendar quarter, the Exchange proposes an effective date of April 1, 2016 for proposed Interpretation and Policy .01 to Rule 1.1(ggg) to ensure that all orders during the next quarterly review will be counted in the same manner and that proposed Interpretation and Policy .01 to Rule 1.1(ggg) will not be applied retroactively.

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.[25] Specifically, the Exchange believes the proposed rule change is consistent with the Section 6(b)(5)[26] 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,

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[24] See id.

[25] 15 U.S.C. 78f(b).

[26] 15 U.S.C. 78f(b)(5).

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)[27] 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 proposed Interpretation and Policy .01 to Rule 1.1(ggg) provides a more conservative order counting regime for Professional order counting purposes that would identify more traders as Professionals to which the Exchange's definition of Professional was designed to apply and create a better competitive balance for all participants on the Exchange, consistent with the Act. As the options markets have evolved to become more electronic and more competitive, the Exchange believes that the distinction between registered broker-dealers and professional traders who are currently treated as public customers has become increasingly blurred. More and more, the category of public customer today includes sophisticated algorithmic traders including former market makers and hedge funds that trade with a frequency resembling that of broker-dealers. The Exchange believes that it is reasonable under the Act to treat those customers who meet the high level of trading activity established in the proposal differently than customers who do not meet that threshold and are more typical retail investors to ensure that professional traders do not take advantage of priority and fee benefits intended for public customers.

The Exchange notes that it is not unfair to differentiate between different types of investors in order to achieve certain marketplace balances. The Rules currently differentiate

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27 Id.

between public customers, broker-dealers, Market-Makers, Designated Primary Market-Makers ("DPMs") and the like. These differentiations have been recognized to be consistent with the Act. The Exchange does not believe that the current rules of CBOE and other exchanges that accord priority to all public customers over broker-dealers are unfairly discriminatory. Nor does the Exchange believe that it is unfairly discriminatory to accord priority to only those customers who on average do not place more than one order per minute (390 per day) under the counting regime that the Exchange proposes. The Exchange believes that such differentiations drive competition in the marketplace and are within the business judgment of the Exchange. Accordingly, the Exchange also believes that its proposal is consistent with the requirement of Section 6(b)(8) of the Act that the rules of an exchange not impose an unnecessary or inappropriate burden upon competition in that it treats persons who should be deemed Professionals, but who may not be under current Interpretation and Policy .01 to Rule 1.1(ggg) in a manner so that they do not receive special priority benefits.

Furthermore, the Exchange believes that the proposed rule change will protect investors and the public interest by helping to assure that retail customers continue to receive the appropriate marketplace advantages in the CBOE marketplace as intended, while furthering competition among marketplace professionals by treating them in the same manner as other similarly situated market participants. The Exchange believes that it is consistent with Section 6(b)(5) of the Act not to afford market participants with similar access to information and technology as that of brokers and dealers of securities with marketplace advantages over such marketplace competitors. The Exchange also believes that the proposed Interpretation and Policy would help to remove burdens on competition and promote a more competitive marketplace by affording certain marketplace advantages only to those for whom they are intended. Finally, the Exchange believes that the proposed rule change sets forth a more detailed and clear regulatory regime with respect to calculating average daily order entry for Professional order counting purposes. The Exchange believes that this additional clarity and detail will eliminate confusion among market participants, which is in the interests of all investors and the general public.

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. As discussed above, the Exchange does not believe that the current rules of CBOE and other exchanges that accord priority to all public customers over broker-dealers are unfairly discriminatory. Nor does the Exchange believe that it is unfairly discriminatory to accord priority to only those customers who on average do not place more than one order per minute (390 per day) under the counting regime that the Exchange proposes. The Exchange believes that its proposal does not impose an undue burden on competition. The Exchange notes that one of the purposes of the Professional rules is to help ensure fairness in the marketplace and promote competition among all market participants. The Exchange believes that proposed Interpretation and Policy .01 to Rule 1.1(ggg) would help establish more competition among market participants and promote the purposes for which the Exchange's Professional rule was originally adopted. The Exchange does not believe that the Act requires it to provide the same incentives and discounts to all market participants equally, so as long as the exchange does not unfairly discriminate among participants with regard to access to exchange systems. The Exchange believes that here, that is clearly the case.

Rather than burden competition, the Exchange believes that the proposed rule change promotes competition by ensuring that retail investors continue to receive the appropriate marketplace advantages in the CBOE marketplace as intended, while furthering competition among marketplace professionals by treating them in the same manner under the Rules as other similarly situated market participants by ensuring that market participants with similar access to information and technology (i.e. Professionals and broker-dealers), receive similar treatment under the Rules while retail investors receive the benefits of order priority and fee waivers that are intended to apply to public customers.

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 written 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. Please include File No. SR-CBOE-2016-005 on the subject line.

Paper comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC 20549-1090.

All submissions should refer to File No. SR-CBOE-2016-005. 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 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 No. SR-CBOE-2016-005 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.[28]

Robert W. Errett
Deputy Secretary

[28] 17 CFR 200.30-3(a)(12).